Angelo King Institute
for Economic and Business Studies

Monitoring the Philippine Economy
Fourth Quarter Report for 2018

Project of Angelo King Institute

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Fourth quarter 2018 growth performance slowed to 6.1 percent from 6.5 percent the previous year.

The Philippine economy registers decelerated growth amid policy uncertainties. Fourth quarter growth was recorded at 6.1 percent, which once again fell short of the government's growth expectations of 6.5 to 6.9 percent. Weak household consumption, slump in domestic investment, and dampened imports and exports significantly contributed to the economic slowdown. Slower service sector growth, downswing of manufacturing, and sluggish agriculture sector served as sources of deceleration to the Q4 2018 growth. Buoyant government spending and impressive growth in construction boosted economic performance. However, while inflation level eased this quarter, the carryover effect of the high inflation from the previous quarters notably contributed to the economic downgrade and pessimistic outlooks. The continued US-China trade tensions increase policy uncertainties, which remains as key challenges the government will have to address.

- **Major components of aggregate demand**

    - **Private consumption slightly recovered from the previous quarter.** Household Final Consumption Expenditure (HFCE) in the fourth quarter registered a growth of 5.4 percent year-on-year (y-o-y), which was significantly slower than 6.2 percent the previous year but slightly faster than 5.2 percent the previous quarter. According to the Philippine Statistics Authority (PSA)[2], all HFCE components except Education (18.7 percent from 5.9 percent, y-o-y) and Miscellaneous goods and services (7.6 percent from 7.2 percent, y-o-y) contributed to the slower HFCE growth. Food and Non-alcoholic Beverages, the component with the largest share of 42.8 percent in consumption, registered a decelerated growth (5.3 percent from 5.6 percent, y-o-y). Furthermore, Restaurants and hotels (6.2 percent from 12.5 percent, y-o-y), Furnishings, household equipment and routine household maintenance (5.7 percent from 10.4 percent, y-o-y), Housing, water, electricity, gas and other fuels (5.9 percent from 10.2 percent, y-o-y), Communication (2.6 percent from 5.5 percent, y-o-y), Health (3.8 percent from 5.0 percent, y-o-y), Transport (1.0 percent from 2.0 percent, y-o-y), Clothing and Footwear (-0.5 percent from 0.5 percent, y-o-y), Recreation and culture (4.3 percent from 4.9 percent, y-o-y), and Alcoholic beverages, Tobacco (-5.8 percent from -5.7 percent, y-o-y) all exhibited slowed down growth. Now on its sixth consecutive quarter, the alcoholic beverages and tobacco group has continuously been portraying negative growth rates, which may be an effect of the TRAIN Law. The overall slowdown in private consumption

[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

in Q4 2018 may be attributable to the pessimistic consumer outlook. The low confidence index was greatly influenced by the fact that there was no increase in income despite the hike in commodity prices.

- **Gross domestic capital formation registered lowest growth in four years.** Domestic investment decreased to 5.5 percent growth from 8.3 percent the previous year. The decline was the lowest since the 5.1 percent registered in 4Q 2014. Weakened investments in Durable Equipment caused the relatively large decrease in growth of the component (3.1 percent from 18.1 percent, y-o-y). According to PSA[3], fixed capital investments posted growth rates of 32.2, 19.3, 5.2, and 3.1 percent, respectively for Intellectual Property Products, Construction, Breeding Stocks and Orchard Development, and Durable Equipment.

- **Government spending remained buoyant with its double-digit growth.** Government final consumption expenditure displayed a growth of 11.9 percent. Although it was lower than its quarter-ago and year-ago growth of 14.3 and 12.2 percent, it was able to maintain its double-digit growth trend. According to BSP[4], the high government expenditure for Q4 2018 was due to the increased spending on personnel services. Also, higher maintenance and operating expenses for the continued implementation of government programs on social protection services such as the *Pantawid Pamilyang Pilipino Program* (4Ps) contributed substantially.

- **Both imports and exports dampened.** At the end of December, exports and imports were recorded at 4.72 billion USD (-12.3 percent growth y-o-y) and 8.47 billion USD (-9.4 percent growth y-o-y), respectively. Fourth quarter displayed a trade deficit of 3.75 billion USD, better than the 3.97 billion USD deficit in December 2017. The decrease in shipment of manufacturers, mineral and petroleum products influenced the negative growth in exports. Likewise, the plunge in purchases of all commodity groups negatively impacted imports. With the existing trade gap, the National Economic and Development Authority (NEDA)[5] expressed the view that the proposed amendments to the Foreign Investment, Retail Trade, and Public Services Acts must be pursued to mitigate threats from policy uncertainties.

[3] http://psa.gov.ph/nap-press-release/sector/Capital%20Formation
[4] http://www.bsp.gov.ph/downloads/Publications/2018/LTP_4qtr2018.pdf
[5] http://www.neda.gov.ph/external-headwinds-dampen-trade-performance-in-december/

- **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]

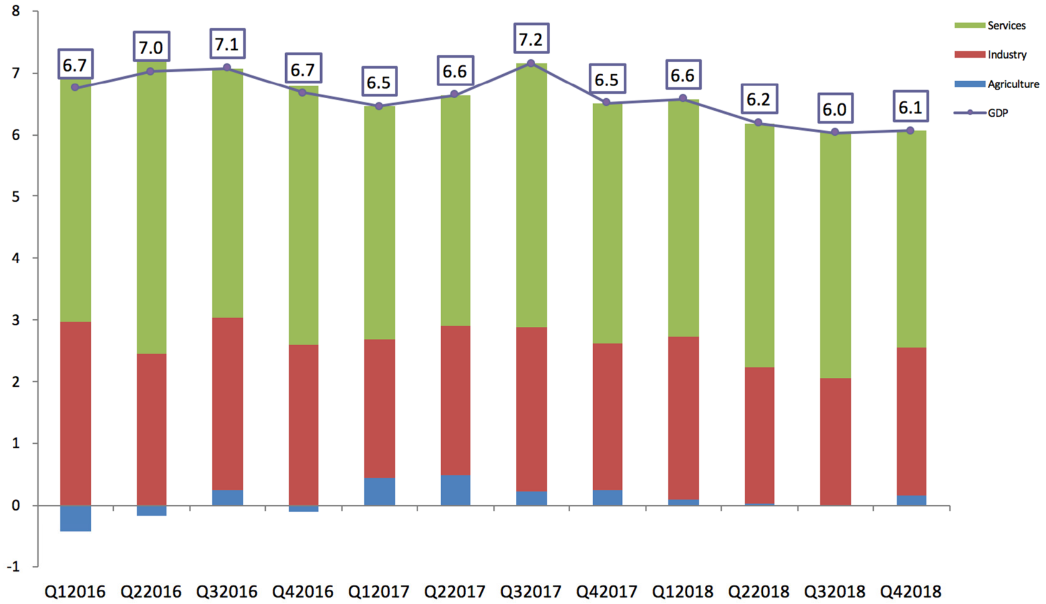
  - **Services sector experienced sluggish growth performance.** Services sector posted the highest contribution to growth, with 3.51 percentage points from positive quantity and real price growth (see Table 3). The sector maintained its share of 56.2 percent in GDP. However, growth decelerated to 6.3 percent, relative to the previous year's 6.9 percent growth. The registered growth for Q4 2018 was lowest since Q1 2015. The deceleration was caused by the lethargic performance of various sub-sectors, namely Transportation, Storage and Communication (2.7 percent from 5.4 percent), Financial Intermediation (6.0 percent from 6.9 percent), Real Estate, Renting and Business Activities (4.4 percent from 5.5 percent), and Public Administration and Defense (12.6 percent from 17.8 percent).

  - **Industry sector served as the key driver of Q4 2018 economic growth.** The industry sector registered a growth of 6.9 percent, faster than the 6.1 percent the previous quarter but slower than the 7.3 percent the previous year. The sector contributed 2.39 percentage points to GDP growth (see Table 3) while maintaining a 34.8 percent share in GDP. The expansion of the industry sector was due to the sustained growth in the construction (CNS) sub-sector since Q2 2018, with an average growth of 17.9 percent. Indeed, the national government's Build Build Build infrastructure agenda has notably contributed to the growth in CNS. CNS contributed 1.33 percentage points to GDP growth. On the other hand, manufacturing (MAN) sub-sector registered a decelerated growth of 3.2 percent, slower than the quarter-ago and year-ago growth rates of 3.3 percent and 7.9 percent, respectively, and contributed only 0.80 percentage points to GDP growth. [7]. The decline could be due to the persisting US-China trade tensions, which triggered global uncertainties and oil price increases.

[6] See the footnote to Table 3 for the source of the GDP growth contributions.
[7] http://www.bsp.gov.ph/downloads/Publications/2018/LTP_4qtr2018.pdf

- **Agriculture sector continued to be vulnerable to natural disasters.** The agriculture sector posted a growth of 1.7 percent, faster than the 0.2 percent the previous quarter but slower than the 2.4 percent the previous year. The sector contributed to GDP growth by 0.15 percentage points (see Table 3). The quarter reflected improved outputs in palay, corn, cassava, and fishing. Damages from several typhoons, inadequate irrigation, and insufficient rainfall are some of the factors that negatively affected agricultural activities during Q4 2018.

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 appreciates after two years[8].** The peso strengthened by 0.52 percent to average ₱53.26/US$1, on a quarter-on-quarter basis, from the previous average of ₱53.54/US$1. The Philippines has been experiencing a persistent depreciation of the peso against the US dollar. In fact, the last appreciation before this quarter was in 2Q 2016. The appreciation was mainly due to improvement in domestic inflation data and strong remittance inflow during Q4 2018. Meanwhile, on a year-on-year basis, the peso depreciated by 5.04 percent, from the previous year's ₱49.93/US$1 average. Nevertheless, consistent inflows of foreign exchange from remittances, foreign direct investments, and business process outsourcing receipts are expected to support the peso from further depreciation.

- **Unfavorable economic factors may serve as adversities to the Philippine economy[9].** External factors such as (a) forecasts of weaker global growth, (b) aggravated trade tensions, (c) tightening of global financial conditions, and (d) spillover effects emerging from geopolitical tensions serve as hindrances to the Philippine economy. In addition, internal factors such as the (a) delay in infrastructure projects given the foreseen 45-day ban on government expenditures before the May 2019 midterm elections, (b) heightened intensity and frequency of natural disasters, (c) lethargic agricultural output, and (d) security risks challenge domestic growth and development.

Other economic news

- **Stock market continues a declining trend in PSEi[10].** At the close of the fourth quarter, PSEi reported a quarter-on-quarter decline of 3.8 percent with an average index points of 7,247.09. The PSEi closed at its lowest for the year on November 13, with index points of 6,843.83, which was 24.4 percent lower than the highest recorded index points of 9,058.62 last January 29. The downturn was caused by less robust outlook for the Philippine economy and high domestic inflation, as well as ongoing trade tensions between US and China, rising US interest rates, sluggish global growth, and uncertainties over Brexit.

- **Inflation eases[11].** Fourth quarter inflation reported a further increased headline value of 5.9 percent, which was lower than the quarter-ago rate of 6.2 percent but higher than the year-ago rate of 3.0 percent. Despite the moderation, the recorded inflation rate still exceeds the national government's announced target rate of 2.0 percent to 4.0 percent. The ease in inflation was caused by the lowering of inflations in food and non-food. During the quarter, food inflation lowered to 7.7 percent from 8.2 percent, as well as non-food inflation, which lowered to 3.9 percent from 4.1 percent the previous quarter. On the other hand, inflation for non-alcoholic beverages registered a higher and double-digit inflation of 12.9 percent, reflecting the implementation of higher excise tax on sweetened beverages. Furthermore, inflation for alcoholic beverages and tobacco increased to 21.9 percent.

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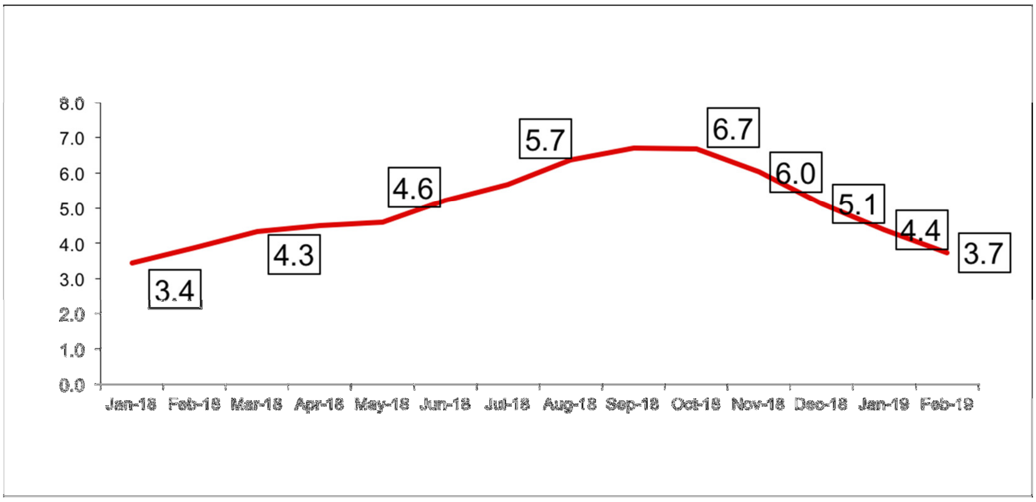
[8] http://www.bsp.gov.ph/downloads/Publications/2018/LTP_4qtr2018.pdf
[9] http://www.bsp.gov.ph/downloads/Publications/2018/LTP_4qtr2018.pdf
[10] http://www.bsp.gov.ph/downloads/Publications/2018/LTP_4qtr2018.pdf
[11] http://www.bsp.gov.ph/downloads/Publications/2018/IR4qtr_2018.pdf

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



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

- **Consumer outlook remains pessimistic for the quarter and year ahead[12].** Overall confidence index (CI) remained at a pessimistic territory, further plunging to -22.5 percent from -7.1 percent the previous quarter. The recorded CI for Q4 2018 posted the most drastic decline of 15.4 percentage points since the nationwide survey started in Q1 2007. The negative outlook was due to (a) increase in commodity prices, (b) low salary/income, (c) higher household expenses, (d) surge in unemployment rate, and (e) no increase in income. Similar to the previous quarter, consumer confidence across all income groups weakened for Q4 2018. With leaden prospects, it is expected that CI would continue to be pessimistic for the next quarter.

- **Business outlook further declines, registering lowest level since Q1 2010[13].** Overall confidence index (CI) weakened to 27.2 percent from 30.1 percent the previous quarter, the lowest level since Q1 2010. The pessimistic sentiment was due to (a) increased inflation caused by rising raw material costs and global oil prices, (b) weakening peso, (c) increased interest rates, (d) decline in volume of sales and orders, and (e) lack of supply of raw materials. With increasing number of pessimists, business sentiment is expected to be less optimistic for the quarter and year ahead.

- **BSP tightens and maintains monetary policy to face market uncertainties[14].** For Q4 2018, BSP raised the key policy rate once during the fourth quarter on November 15, by 25 bps to 4.75 percent. Then, given signs of subsiding price pressures, the BSP decided to keep its monetary policy settings intact for December.

[12] http://www.bsp.gov.ph/downloads/Publications/2018/CES_4qtr2018.pdf
[13] http://www.bsp.gov.ph/downloads/Publications/2018/BES_4qtr2018.pdf
[14] http://www.bsp.gov.ph/downloads/Publications/2018/LTP4qtr_2018.pdf

Table 1. Philippine Economic Indicators

Monthly Leading Indicators	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18
Industrial Production (y-o-y, %)	-6.1	11.0	15.5	11.4	21.2	13.3	10.1	10.3	3.5	1.0	2.3	1.9	-11.3
Consumer Price Index (y-o-y, %)	2.9	3.4	3.9	4.3	4.5	4.6	5.2	5.7	6.4	6.7	6.7	6.0	5.1
Exports (y-o-y, %)	8.7	-4.0	-5.5	-6.8	-4.9	-1.8	2.8	0.3	3.4	0.8	5.5	-0.3	-12.3
Imports (y-o-y, %)	31.6	7.7	13.7	0.3	23.1	12.6	24.2	31.6	11.0	26.1	21.4	6.8	-9.4
Trade Balance, US$ million	-3,972	-3,163	-2,890	-2,532	-3,480	-3,690	-3,188	-3,546	-3,494	-3,723	-4,081	-3,901	-3,752
Total Reserves (less gold), US$ billion	73.2	72.7	72.1	72.1	71.4	71.0	69.6	68.9	70.3	67.4	66.9	67.9	71.0
Policy Rate	3	3	3	3	3	3.25	3.5	3.5	4	4.5	4.5	4.75	4.75
Fiscal Balance (million pesos)	-107,148	10,191	-61,734	-110,693	46,315	-32,873	-54,288	-86,383	-2,587	-96,247	-59,865	-39,118	-81,042
Quarterly/Annual Economic Indicators	**2015**	**1Q2016**	**2Q2016**	**3Q2016**	**4Q2016**	**1Q2017**	**2Q2017**	**3Q2017**	**4Q2017**	**1Q2018**	**2Q2018**	**3Q2018**	**4Q2018**
Real GDP (y-o-y, %)	6.1	6.7	7.0	7.1	6.7	6.5	6.6	7.2	6.5	6.6	6.2	6.0	6.1
- Private Consumption	6.3	7.2	7.5	7.3	6.7	5.9	6.0	5.4	6.2	5.7	5.9	5.2	5.4
- Government Consumption	7.6	12.4	14.0	3.6	5.0	0.1	7.6	8.3	12.2	13.6	11.9	14.3	11.9
- Gross Capital Fixed Formation	18.4	31.4	30.6	22.4	16.6	11.4	7.6	10.3	8.3	12.4	21.5	18.2	5.5
Current Account (% of GDP)	2.9	0.9	0.1	1.3	1.2	-1.2	-0.1	0.7	-3.8	-0.4	-4.2	-2.1	-2.6
Financial Account (US$ million)	2,523	995	-1,039	308	54	328	-945	442	-2,033	-816	-1,627	-1,621	-3,768
- Net Direct Investments, US$ million	-122	-1,119	-1,030	-498	-1,829	-1,480	-1,868	-2,117	-2,646	-1,025	-2,672	-1,360	-797
- Net Portfolio Investments, US$ million	4,757	1,573	787	-843	-309	3,258	-129	875	-114	1,612	1,021	-500	-1,275
Overall BOP position (US$, million)	2,616	-210	843	1,014	-2,068	-994	289	-662	505	-1,227	-2,030	-1,879	2,830
Unemployment rate	5.8	5.8	5.4	4.7	4.7	6.6	5.6	5.7	5	5.3	5.4	5.1	5.1
Others	**Dec-17**	**Jan-18**	**Feb-18**	**Mar-18**	**Apr-18**	**May-18**	**Jun-18**	**Jul-18**	**Aug-18**	**Sep-18**	**Oct-18**	**Nov-18**	**Dec-18**
Overseas Filipinos' Remittances (US$, million)	2,741	2,379	2,267	2,360	2,347	2,469	2,357	2,401	2,476	2,237	2,474	2,326	2,849

... = not available

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

Table 2. Level of Philippine GDP, 2017Q4 – 2018Q4

	Nominal GDP (million current pesos)		Real GDP (million constant 2000 pesos)	
	2017Q4	**2018Q4**	**2017Q4**	**2018Q4**
Agriculture and Forestry	413,645	427,136	180,131	182,999
Fishing	52,233	57,392	38,487	39,236
Mining and Quarrying	31,900	35,327	17,791	19,574
Manufacturing	1,002,782	1,080,405	579,552	598,370
Construction	289,476	371,521	146,090	177,228
Electricity Gas and Water Supply	114,290	129,702	66,799	71,189
Transport Communication and Storage	249,452	263,984	172,694	177,329
Trade and Repair of Motor Vehicles Motorcycles Personal	830,041	922,296	415,516	440,223
Financial Intermediation	326,637	366,812	157,917	167,396
Real Estate Renting & Bus. Actvt	545,615	587,182	255,167	266,485
Public Administration & Defense: Compulsory Social Security	202,250	241,141	92,605	104,258
Other Services	412,678	465,222	221,786	242,232
Sum = GDP	**4,470,998**	**4,948,123**	**2,344,536**	**2,486,518**

Source: Philippine Statistics Authority

Table 3. Industry Contributions to Philippine GDP Growth, 2017Q4 – 2018Q4

	TRAD	GEAD		GEAD
	GDP Growth			GDP Growth
	PGE*	PGE*	PCE*	PGE* + PCE*
	(percent)	(percent)	(percent)	(percent)
		(1)	(2)	(1)+(2)
GDP Growth	**6.06**	**6.06**	**0.00**	**6.06**
Industry Growth Contribution				
Agriculture	**0.15**	**0.15**	**1.57**	**1.73**
Agriculture and Forestry	0.12	0.12	2.01	2.13
Fishing	0.03	0.03	-0.43	-0.40
Industry	**2.39**	**2.39**	**-2.83**	**-0.44**
Mining and Quarrying	0.08	0.08	-0.08	0.00
Manufacturing	0.80	0.80	-1.74	-0.93
Construction	1.33	1.33	-0.69	0.64
Electricity Gas and Water Supply	0.19	0.19	-0.33	-0.14
Services	**3.51**	**3.51**	**1.26**	**4.77**
Transport Communication and Storage	0.20	0.20	-1.65	-1.45
Trade and Repair of Motor Vehicles Motorcycles Personal	1.05	1.05	0.91	1.97
Financial Intermediation	0.40	0.40	0.61	1.01
Real Estate Renting & Bus. Actvt	0.48	0.48	1.58	2.06
Public Administration & Defense: Compulsory Social Security	0.50	0.50	0.35	0.85
Other Services	0.87	0.87	-0.54	0.33

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.