



Monitoring the Philippine Economy

Third Quarter 2011 Report

Project of Angelo King Institute

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The Philippine economy continued to exhibit sluggish growth amid slow recovery in advanced economies coupled with rising food and fuel prices.

1. Economic performance

- **Growth of the Philippine economy slows down further in the second quarter of 2011.** Despite improvements in government spending and agricultural sector, the economy grew only 3.4% year-on-year (y-o-y) growth (real GDP growth) in the second quarter – a lackluster figure compared to last year's booming 8.9% y-o-y growth. External factors such as the European debt crisis and the sluggish recovery of trading partners made it difficult for the economy to rebound. Supply-side growth was driven mainly by the agricultural sector (6.7% y-o-y) following the recovery from the El Niño effects last year. On the other hand, demand-side growth was attributed to consumer spending (5.4% y-o-y). The double-digit growth in fixed capital formation in the first quarter was not sustained in the second quarter, registering a growth of only 0.9% y-o-y due to a decline in construction spending.
- **Philippines' inflation decelerates in August.** After hitting the highest inflation rate in June (5.2% y-o-y) in over two years, inflationary pressures eased in August with 4.7% y-o-y. This is based on a new data series using 2006 prices of the National Statistics Office. Factors that contributed to August inflation were lower food prices as sugar and vegetable prices declined due to sufficient domestic supply coupled with lower oil prices in the international market.
- **External factors pull July trade balance further down.** By the end of July, trade balance worsened to USD-5.7 billion as reflected in a 1.7% y-o-y drop in exports while imports rose 6.9% y-o-y. The natural disasters that hit Japan in March, the sluggish recovery of the US economy, and the European debt crisis have put a toll on our exports. Based on 2000 constant prices, second quarter data reveal a 0.3% y-o-y drop in exports due to a decline in semiconductors and other electronic parts attributed to difficulties in procuring production inputs from Japan. Imports, on the other hand, grew only 4.1% y-o-y in the second quarter due to low demand for machinery, mechanical appliances, and electrical machinery.

- **Downbeat industrial production signals slowdown in June but rebounds in July.** As external conditions remain lackluster, industrial production in June dropped 1.2% y-o-y as compared to the previous month's 2.9% y-o-y growth. The top three sectors that contributed to the decline were machinery except electrical, wood and wood products, and transport equipment. Aside from external factors affecting industrial production, a contraction in construction in the domestic economy was seen as reflected in the drop in fixed capital formation in the second quarter to 0.9% y-o-y from the first quarter's 42.3% y-o-y growth. The month of July presented a more positive figure of 6.8% y-o-y growth which was led by furniture and fixtures, publishing and printing, and paper and paper products.
- **Sluggish domestic economy and weak investments affects unemployment rate.** Results from the latest Labor Force Survey indicate that unemployment rate improved slightly to 7.1% y-o-y in July compared to 7.2% y-o-y in April. The weak domestic growth and investments have been heavily influenced by Japan's post-earthquake contraction, debt concerns in the US and eurozone crisis. The political turmoil in the Middle East also caused Filipino overseas workers in the area to reconsider their employment contract.
- **Balance of payment surplus contracts on lower capital inflow.** First quarter BOP was recorded at PhP3.5 billion, 173.7% y-o-y increase compared to 2010 fourth quarter's 289.6% y-o-y growth. The overall balance of payments surplus though allowed the country to accumulate foreign exchange reserves. Total reserves (less gold) increased from USD61.4 billion to USD64.2 billion in July. A smaller current account surplus and financial account surplus contributed to the decline in the BOP surplus. Current account dropped to only 1.8% of GDP compared to 3.7% of GDP in the fourth quarter due to lower exports. Financial account also dropped from USD5.7 billion in the fourth quarter to only USD2.1 billion in the first quarter attributed to lesser direct investments and portfolio investments. Second quarter BOP surplus slowed down to PhP1.5 billion. Uncertainty in the global financial market due to the European debt crisis dampened investor's risk appetite.

2. Policy responses

- **BSP raises policy rates twice since June 2009 to oppose rising inflationary pressures.** The Philippines' Bangko Sentral ng Pilipinas started tightening its monetary policy last March 24, 2011 after raising its key policy rate by 25 basis points (from 4% to 4.25% per annum). This was followed by another increase by 25 basis points in May. The policy rate is now 4.5% per annum, which is still within BSP's inflation target of 4.0% with a tolerance interval of +1.0% for the year. BSP's implementation of a contractionary policy twice this year was done in response mainly to the volatility in global oil prices due to the

political unrest in the Middle East. On September 8, the Monetary Board decided to keep policy rates steady.

3. Other economic news

- **Poverty incidence in the Philippines rises while income inequality and subsistence incidence declines.** Poverty incidence in poor families improved from 21.1% in 2006 to 20.6% in 2009, but poverty incidence in the poor population increased from 26.4% to 26.5%. The proportion of families whose income is below the food threshold fell by 0.8 percentage points for poor families and by 0.9 percentage points for poor population. There is a reduction in the food poor population, despite the rise in food prices during 2008. The country's Gini coefficient continues to decline from 0.4605 in 2003 to 0.4580 in 2006 to 0.4484 in 2009, showing an improvement in terms of income inequality. This is mainly due to the faster rate of increase in the average per capita income relative to change in price of all goods and the growing share of the bottom 70% of the population in terms of income (NSCB, 2011). Furthermore, there was a 3 percentage point decline in the country's poverty gap, and a 0.2 percentage point decline in the severity of poverty in the country. On a regional level, Zamboanga del Norte, Agusan del Sur, Surigao del Norte, and Maguindanao continue to have a the highest number of poverty incidence have the highest poverty incidence in the country. This may be attributable to their political environment.
- **Philippine stock market falls amid bleak recovery in the US economy and the European debt crisis.** The PSEi dropped to 4,366.45 at the close of the third week (with a 23.67% increase y-o-y) of August. This can be attributed to the sharp decline in the services sector which only grew by 1.38% (y-o-y). With the exception of the mining sector which experienced more than 200% rise on the index (y-o-y) and a continuously increasing index, other sectors such as the holdings sector, commercial sector, and financial sector remain on a relatively steady movement over the past month.
- **Overseas Filipino workers' remittances drop slightly in July.** Despite difficult conditions abroad, overseas Filipino remittances grew 6.1% y-o-y in July because of the continuous demand for Filipino manpower. Total remittances for the month amounted to USD1.72 billion, slightly lower compared to June's USD1.74 billion. This brings total remittances for the seven-month period to USD11.35 billion.

4. Future challenges

- **Political unrest in the Middle East and North Africa adds pressure on overseas employment and remittances.** Recent developments regarding political turmoil in other countries have affected our overseas Filipino workers (OFWs), with some of them being displaced and sent back to the country. In addition to that, the decision by Saudi Arabia in June to impose a moratorium on work permits issued for Filipinos may affect remittances coming from the Middle East. The government is now challenged with providing safety nets such as livelihood programs and trainings for displaced OFWs.
- **Price movements peak due to external and internal factors.** External factors such as higher global prices for commodities particularly oil coupled with internal factors driven by devastation of the agricultural sector from the recent typhoon Pedring, looming increase in LRT/MRT fare, toll fee and the recently announced proposal to increase excise duties on alcohol and tobacco may result in an acceleration in consumer price inflation by end of the year. Wage pressures are likely to resurface but may be offset by the country's labor surplus.
- **President Aquino plans to establish public-private partnership to improve the country's infrastructure.** In the government's effort to improve infrastructure, public-private partnership projects are in the pipeline. Private investors, however, remain cautious in committing due to the stipulation of the constitution on foreign ownership of public utilities which the Supreme Court stressed in June.



Philippines Economic Data

Monthly Leading Indicators	Nov-10	Dec-10	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11	Jul-11	Aug-11
Industrial Production (y-o-y, %)	17.0	15.6	14.3	11.1	10.2	2.1	2.9	1.2	6.8	...
Consumer Price Index (y-o-y, %)	3.0	3.0	4.1	4.7	4.8	4.7	5.1	5.2	5.1	4.7
Broad Money (y-o-y, %)	7.3	10.7	9.9	10.1	10.6	7.5	8.6	...	...	...
Exports (y-o-y, %)	11.7	26.8	11.8	8.3	4.1	19.7	-3.1	-9.4	-1.7	...
Imports (y-o-y, %)	36.3	26.7	24.7	20.1	21.6	23.8	2.8	6.6	6.9	...
Trade Balance, US\$ billion	-797.6	-728.9	-1312.3	-823.3	-1169.7	-1195.0	-780.1	-375.9	-570.0	...
Total Reserves (less gold), US\$ billion	53.7	55.4	57.0	56.9	58.9	60.9	61.3	61.4	64.2	...
Policy Rate	4	4	4	4	4.25	4.25	4.5	4.5	4.5	4.5
Quarterly/Annual Economic Indicators	2007	2008	2009	2010	1Q2010	2Q2010	3Q2010	4Q2010	1Q2011	2Q2011
Real GDP (y-o-y, %)	6.6	4.2	1.1	7.6	8.4	8.9	7.3	6.1	4.6	3.4
- Private Consumption	4.6	3.7	2.3	3.4	4.0	1.9	2.4	4.9	5.3	5.4
- Government Consumption	6.9	0.3	10.9	4.0	21.4	7.4	-6.5	-6.6	-17.2	4.5
- Gross Capital Fixed Formation	-0.5	23.4	-8.7	31.6	31.9	38.0	34.5	25.7	42.3	0.9
Current Account (% of GDP)	4.8	2.1	5.6	4.2	2.7	3.6	6.9	3.7	1.8	...
Financial Account (US\$ million)	3503	-1702	-1731	7850	18	-424	2545	5711	2105	...
- Net Direct Investments, US\$ million	-620	1285	1604	1226	314	18	281	613	432	...
- Net Portfolio Investments, US\$ million	4623	-3627	-625	4018	-193	-1205	1710	3706	1546	...
Overall BOP position (US\$, million)	8557	89	6421	14403	1276	2008	3256	7863	3493	1523
Fiscal Balance (million pesos)	-12441	-68117	-298532	...	...	...	...	...	...	...
Unemployment rate	7.8	7.4	7.7	7.3	7.3	8	6.9	7.1	7.2	7.1
Others	Oct-10	Nov-10	Dec-10	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11	Jul-11
Overseas Filipinos' Remittances (US\$, million)	1673.7	1612.7	1694.1	1476.9	1500.9	1616.5	1615.9	1688.2	1737.3	1715.3

... = not available

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

