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Monitoring the Philippine Economy Second Quarter Report for 2014

Project of Angelo King Institute

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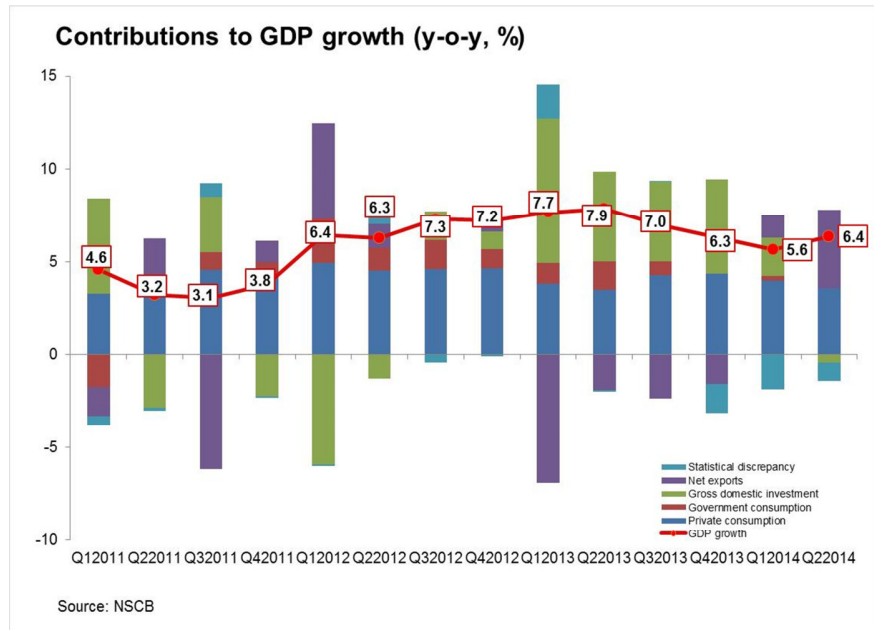
The Philippine economy regains its growth momentum in the second quarter despite higher prices of basic commodities, bringing growth in the first half to 6.0 percent.

Economic performance: improvements industry and services sector underpinned second quarter growth.

- **Domestic economy expands in the second quarter.** Growth of the domestic economy was recorded at 6.4 percent from 7.9 percent the previous year. The second quarter growth, however, was higher than the previous quarter and was driven by the services and industry with 6 percent and 7.8 percent year-on-year (y-o-y) growth respectively. The country's economic performance mirrored that of Malaysia who also recorded a 6.4 percent growth, the highest in East Asia.
- **Major components of aggregate demand**
 - **Higher household spending furthers aggregate consumption.** Private consumption grew 5.3 percent y-o-y in the second quarter, higher than last year's 5.1 percent growth. The National Statistical Coordination Board (NSCB) reported that consumption of alcoholic beverages and tobacco, which grew 11.4 percent y-o-y, had the highest contribution to growth. Other drivers of growth were: transport, which grew 11.9 percent; health, with 10.6 percent growth; and restaurant and hotels, with 10.4 percent growth.
 - **Domestic investment further slumps in second quarter.** Capital formation declined 2.3 percent y-o-y from last year's 33.6 percent growth due to lower investments in construction and durable equipment. Construction was sluggish at 5.1 percent y-o-y while durable equipment only recorded a 2.3 percent y-o-y growth due to a contraction in public construction projects. Moreover, capital formation for breeding stocks and orchard development declined 2 percent y-o-y.

¹ Report is based on latest available data as of August 29, 2014, 2014. For comments and questions, please email mitzie.conchada@dlsu.edu.ph

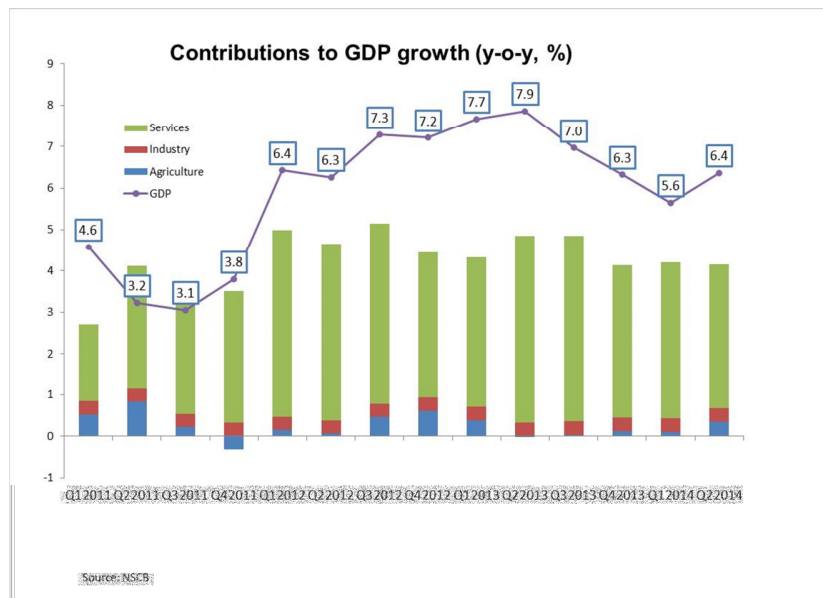
- Growth of government expenditure slows down.** Public spending on major government expenditures for personnel services and maintenance and other operating expenses continued to decelerate in the second quarter. Government expenditure expanded by a meager 0.02 percent compared to last year's 12.1 percent growth. The government's conservative spending pattern might be a concern for the economy's growth perspective.



- Philippine exports bounce back.** Exports in June increased 21.3 percent y-o-y, higher than last year's 4.1 growth. Total value of exports amounted to USD 5,444 million, bringing total value of exports for the second quarter to USD 15,472 million. Based on the report of the Philippine Statistical Authority – National Statistical Coordination Board (PSA-NSCB), growth in exports of goods in the second quarter was attributed to exports of electronic components such as medical/industrial instrumentation (139.5%), communication/radar (103%), and electronic data processing (76.7%). On the other hand, exports of principal agricultural products such as coconut oil, pineapple and sugar declined. This is due to the El Nino effect on farm output as well as the infestation of coconut scale insects in several provinces. However, total imports declined in June by 3.6 percent compared to last year's 4.2 negative growth. Lower imports of semiconductors and electronic data processing led to lower growth.

- **Major components of aggregate supply**

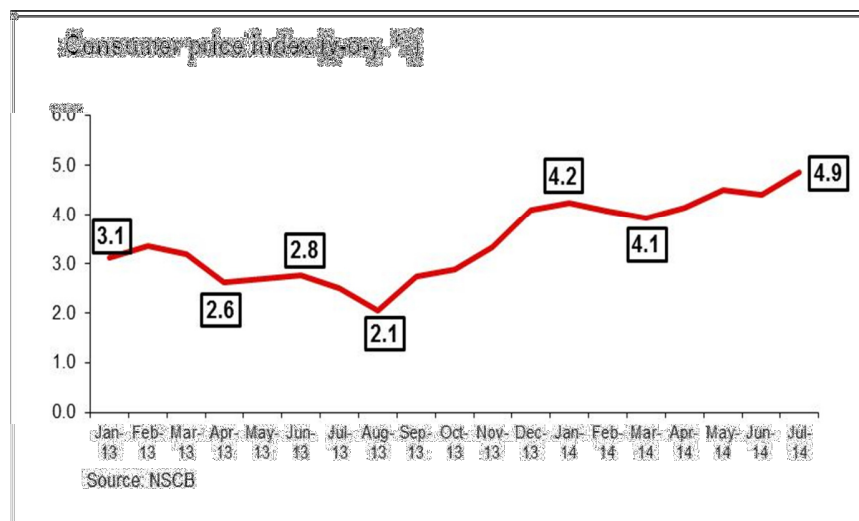
- **Services sector remains as the main driver of supply-side growth.** The services sector had the highest contribution to economic growth with 3.5 percent in the second quarter. The sector grew by 6.0 percent y-o-y, lower than last year's 7.8 percent growth on the improved performance of the subsector real estate, trade and transportation which grew by 8.9, 6.6 and 6.3 percent respectively.
- **Manufacturing leads the industry sector, displays renewed growth.** The industry sector contributed 2.5 percent to growth and grew 7.8 percent y-o-y in the second quarter. The laudable performance of the sector was attributed to the manufacturing subsector, particularly that of fabricated metal products, publishing and printing, and machinery and equipment which grew 48.6, 35.1, and 31.8 percent respectively. The improvement in the growth was caused by higher demand both locally and in the international market. On the other hand, construction decelerated to 1.4 percent due to lower public spending.



- **Agriculture sector growth shows signs of recovery.** The agriculture, hunting, forestry, and fishing industry displayed a higher growth in the second quarter with 3.6 percent from a negative 0.2 percent last year. Despite the effects of El Nino and the infestation of coconut scale insects in several provinces, production of certain crops showed positive growth. Production of mangoes and corn increased 12.9 and 11.8 percent respectively. However, livestock and poultry grew only by less than 1 percent due to typhoon Glenda, pier congestion, and additional administrative costs associated with tax exemptions on feeds for livestock and poultry. It is expected that this slow growth in the aforementioned will continue in the next months.

Challenges facing the economy

- **Second quarter unemployment rate drops, but remains the highest in the region.** The recent Labor Force Survey (LFS) conducted in April revealed a lower unemployment rate compared to the previous year. Unemployment rate was recorded at 7 percent, lower than last year's 7.6 percent. Most of the unemployed were males and belonged to the age group 15 to 24 years old. Despite the impressive growth rate and stable prices, the country has the highest unemployment rate among the ASEAN countries. The decline in direct investments remains one of the factors that could affect unemployment.
- **Inflation continues its upward trend, prompts BSP to revise key policy rates.** Average headline inflation for July reached 4.6 percent, the highest since October 2011. Alcoholic beverages and tobacco, food and non-alcoholic beverages, and education had the highest consumer price index. Prices of basic commodities such as petroleum products and utilities have driven the prices of other leading commodities. On the other hand, OFW remittances remain to increase domestic consumption, driving demand for goods and services and forcing prices to eventually increase in utilities and basic commodities.



- **Sluggish government spending remains a concern.** Second quarter revealed a zero percent growth in government spending despite budget allocations for major infrastructures such as airports and roads as well as the reconstruction for typhoon Yolanda-stricken provinces. Factors that led to the flat government spending were the slowdown in disbursements in personal services and maintenance and other operating expenses as well as a decrease in construction of public works. Public spending in the third quarter is expected to pick-up with the start of various public-private partnership agreement programs and the preparations for the APEC Summit in 2015.

Policy response

- **BSP Monetary Board increases key policy rates to address increasing inflation rates.** The Bangko Sentral ng Pilipinas decided to increase the Overnight Borrowing rates to 3.75 percent from the 3.5 rate implemented since October 2012 in its July 31 meeting. This action is a response in order to mitigate the demand for currency in the economy. BSP may see that the rapid increase in inflation is a financial reallocation issue – wherein fuelling domestic demand for goods and services becomes favored to direct investments in infrastructure and capital formation. BSP's projection for August of 4.7 to 5.5 percent indicates that inflation may not fluctuate greatly in the beginning of the third quarter.

Other economic news

- **Tax Revenues as a share of GDP increases; a signal that fiscal reforms are working.** Recent data reveal that tax revenues increased in the first quarter of this year to 12.4 percent from 12 percent last year. This is attributed to the government's interest to improve tax collection through fiscal reforms. More reforms are expected in the near future to further improve the fiscal standing of the country.
- **Fears of 'hot money' outflow imminent as US stock market outlook improves.** Domestic trading in the Philippine Stock Exchange may decrease due to the US bullish run. The Dow Jones Industrial Average of the United States continues to soar upwards, ending at 16,826.60 at the end of the quarter. NASDAQ stocks as well continued to rise, barely dropping at the 4,000 mark this quarter. Although the Philippine market is improving as well (with the PSEi beyond the 6,500 mark), at the Asia Market, the Hong Kong stock exchange, has had an erratic 2nd quarter run, ending at the 23,000 mark at the end of the quarter; Nikkei, though having a June run ending at 15,162.10, has had quite an unstable market on the first two months of the quarter; SSE Composite with a run at the beginning of the quarter that ended early April, but continued to slump until the end of June, finishing at 2048.33; the US market is relatively more stable.
- **OFW remittances steadily increase in the second quarter.** Cash inflow in the economy, mostly from remittances abroad, continued to bolster the increase in domestic demand. As of June, total cash remittances reached USD 11.42 billion. Second quarter alone registered a total of USD 5.9 billion, higher than last year's USD 5.6 billion figure.
- **Maritime dispute with China continues to increase risk of economic sanctions.** The territorial dispute in China, though not highlighted by the media, remains to be an issue at hand. Although from an economic perspective, the ongoing territorial dispute has not impacted trade between China and the Philippines, the second largest importer of Filipino goods may pressure the Philippine economy by implementing formal or informal sanctions that may be used in order to pressure territorial negotiations.



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Philippines Economic Data										
Monthly Leading Indicators	Oct-13	Nov-13	Dec-13	Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14	Jul-14
Industrial Production (y-o-y, %)	21.1	18.8	22.8	4.8	6.8	1.2	12.1	13.4	13.3	...
Consumer Price Index (y-o-y, %)	2.9	3.3	4.1	4.2	4.1	3.9	4.1	4.5	4.4	4.9
Broad Money (y-o-y, %)	32.5	36.5
Exports (y-o-y, %)	14.0	18.9	15.8	9.2	24.4	20.7	0.8	6.9	21.3	...
Imports (y-o-y, %)	-8.6	0.5	-0.1	26.0	0.3	9.6	3.3	-9.6	-3.6	...
Trade Balance, US\$ million	201.57	-941.53	-694.90	-1,575.80	-66.40	-198.19	-765.01	718.20	728.89	...
Total Reserves (less gold), US\$ billion	75.45	75.82	75.69	71.63	72.21	71.64	71.83	72.45	72.45	72.63
Policy Rate	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.75
Fiscal Balance (million pesos)	-11,237	1,000	-52,598	-34,218	-9,718	-40,186	80,852	11,782	-62,486	...
Quarterly/Annual Economic Indicators	2009	2010	2011	2012	1Q2013	2Q2013	3Q2013	4Q2013	1Q2014	2Q2014
Real GDP (y-o-y, %)	1.1	7.6	3.6	6.8	7.7	7.9	7.0	6.3	5.6	6.4
- Private Consumption	2.3	3.4	5.7	6.6	6.7	6.5	6.5	6.5	6.5	6.5
- Government Consumption	10.9	4.0	2.1	12.2	15.9	13.6	14.5	14.2	14.5	14.2
- Gross Capital Fixed Formation	-8.7	31.6	2.0	-3.2	-5.6	-0.3	1.5	-0.1	-1.1	0.0
Current Account (% of GDP)	5.6	4.5	2.3	0.7	5.0	3.8	5.0	5.0	3.1	...
Financial Account (US\$ million)	-1731	7290	-5610	-4821	-655	835	1183	1585	3058	...
- Net Direct Investments, US\$ million	1604	682	-1277	-898	-1336	502	-589	168	-722	...
- Net Portfolio Investments, US\$ million	-625	4365	-4390	-1248	-1697	-255	217	948	2013	...
Overall BOP position (US\$, million)	6421	14308	11400	1243	1536	1041	1247	1260	-4475	...
Unemployment rate	7.7	7.3	7.4	7	7.1	7.5	7.3	6.5	7.5	7
Others	Sep-13	Oct-13	Nov-13	Dec-13	Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14
Overseas Filipinos' Remittances (US\$, million)	1,953	2,079	2,080	2,173	1,799	1,796	1,883	1,914	1,980	2,050
... = not available										

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