Philippines

Robust growth in the first half of 2014 was fueled by private consumption and investment coupled with a recovery in exports. Growth is seen quickening in 2015, though earlier forecasts for both this year and next are trimmed to take into account a slowdown in government spending and steady tightening of monetary policy. Inflation will be slightly above the earlier projections.

Updated assessment

Recovery in exports and sustained increases in private consumption and private investment generated 6.0% economic growth in the first half of 2014, moderating from a year earlier mainly because government spending has barely grown this year (Figure 3.8.1).

Private consumption contributed most of the increase in GDP, rising by 5.6% on higher remittances from overseas Filipinos and increased employment. Remittances rose by 6.2% to $12.7 billion, a sharp 14.5% gain in peso terms. Employment increased by 2.8% in the 12 months to July, or by 1.1 million new jobs, outpacing growth in the workforce over that period.

Government consumption spending, by contrast, braked hard to 0.9% from 11.1% a year earlier (Figure 3.8.2). The slowdown came off a high base in 2013, which was an election year, but also reflects cautious spending by government agencies amid concerns about the misuse of government funds. Since last November, the Supreme Court has declared unconstitutional the government's Priority Development Assistance Fund and some provisions of its Disbursement Acceleration Program.

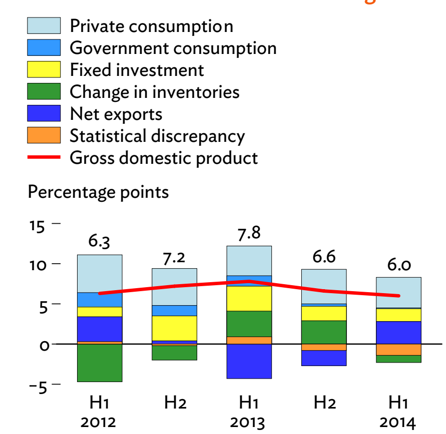
Growth in fixed investment was dragged down by a fall in government construction. Private construction grew, but at a more moderate pace than last year. Encouragingly, investment in equipment maintained double-digit expansion. Fixed investment overall grew by 7.6%, half the rate of a year earlier.

Exports of goods and services reversed a contraction in the first half of 2013 to rebound by 11.8% in volume terms, led by gains in electronics, including semiconductors. Exports benefited from a pickup in demand from major markets including the euro area, US, Japan, and the People's Republic of China. Imports of goods and services also recovered, but at a comparatively slower pace of 5.7%. This generated a significant contribution to GDP growth from net external demand.

From the production side, services and manufacturing were the major growth drivers. The service sector, accounting for over half of GDP, grew by 6.4%, slightly behind the year-earlier pace but still generating almost two-thirds of GDP growth. Key contributors were retail trading, finance and real estate services, business process outsourcing, and tourism.

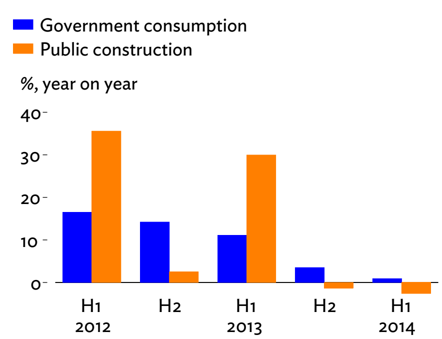
This chapter was written by Joven Balbosa and Teresa Mendoza of the Philippines Country Office, ADB, Manila.

3.8.1 Demand-side contributions to growth



Source: CEIC Data Company (accessed 15 September 2014).

3.8.2 Growth in real government spending



Source: CEIC Data Company (accessed 14 March 2014).

Industry expanded by 6.6%, having moderated from 10.9% growth a year earlier. Buoyant private consumption and rising external demand supported manufacturing, which grew by 8.8%. Gains were seen in food and drinks manufacturing, textiles, furniture, communications equipment, machinery, and chemicals. Construction slowed sharply, as noted above, but mining output rose.

Bad weather disrupted agriculture early in the year before a modest recovery in rice harvests lifted agricultural output by 2.2% in the first 6 months. Typhoon Rammasun hit important crop-growing areas in July this year, 9 months after Super Typhoon Haiyan devastated agriculture and infrastructure in parts of the Visayas in November 2013. Poor performances were recorded for fisheries, coconuts, livestock, and poultry.

Despite the modest recovery in rice production, these storms and supply bottlenecks contibuted to food price inflation of 8.7% year on year in August 2014 and overall inflation of 4.9% (Figure 3.8.3). A Manila city ordinance restricting cargo trucks with the aim of easing traffic congestion disrupted port and cargo deliveries, adding to pressure on prices. In the first 8 months of 2014, inflation averaged 4.4%.

With inflationary pressures gaining momentum, Bangko Sentral ng Pilipinas, the central bank, raised policy interest rates by 50 basis points between July and September this year, to 4.0% for the overnight borrowing rate and 6.0% for the overnight lending rate. The policy rates had been at record lows for almost 2 years.

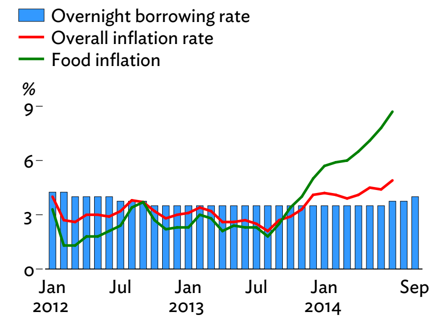
Liquidity growth remained high, though decelerating. The pace of increase in broad money (M3) eased to 18.3% year on year in July from 38.0% in January (Figure 3.8.4). To drain excess liquidity, the central bank raised the reserve requirement for banks twice and increased the interest rate on its special deposit account in June and again in September. Nevertheless, credit to the private sector expanded by 20.1% in July, accelerating from 16.5% at the end of last year.

Subdued government spending and higher revenue nearly halved the budget deficit to P55.7 billion in the first 7 months. Expenditure, excluding interest, rose by 8.0%, though this undershot the target. Tax revenue rose by 11.5%, helped by stronger enforcement. The fiscal deficit shrank to 0.9% of GDP in the first half, well under the full-year target of 2.0% of GDP and narrower than last year's actual deficit of 1.3%.

In the trade accounts, merchandise exports rose by 6.6% in US dollar terms in the first quarter, while imports rose by 4.1%. The trade deficit narrowed to $4.1 billion; coupled with higher inflows of remittances, earnings from business process outsourcing, and income from tourism, this raised the current account surplus by 13.2% to $2.0 billion in the first quarter, equal to 3.1% of GDP (Figure 3.8.5). However, net outflows in the capital and financial accounts, mainly of portfolio investment, put the balance of payments in deficit by $4.5 billion.

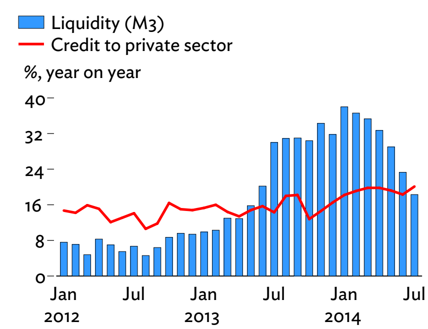
Gross international reserves at $80.8 billion in August 2014 provided 11 months of cover for imports of goods and services and income payments. The peso appreciated by 1.0% against the US dollar from the end of 2013 to mid-September this year.

3.8.3 Inflation and policy rates



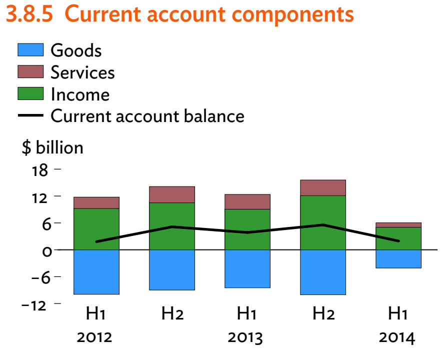
Source: CEIC Data Company (accessed 15 September 2014).

3.8.4 Domestic liquidity



Sources CEIC Data Company (accessed 15 September 2014).

3.8.5 Current account components



Source: CEIC Data Company (accessed 15 September 2014).

Prospects

Slightly stronger growth is projected through the rest of this year and in 2015 on expectations that post-typhoon reconstruction accelerates, government fiscal disbursement improves, and exports benefit from brighter prospects in the major industrial economies. However, unexpectedly low government spending coupled with higher inflation and associated monetary tightening prompt revised forecasts trimmed to 6.2% for this year and 6.4% for 2015 (Figure 3.8.6).

Consumer spending, supported by large remittance inflows and accounting for two-thirds of GDP, will continue to fuel economic growth, though there are signs that higher inflation is starting to bite. The rate of increase in consumer spending eased to 5.3% in the second quarter from about 6% in the preceding 3 quarters.

Indicators of private investment are favorable, and surveys by Bangko Sentral ng Pilipinas find that business sentiment is generally positive. Foreign direct investment, though low by regional standards, jumped by 77% in the first half of 2014 to $3.6 billion (Figure 3.8.7). It almost doubled in 2013 to $3.8 billion from an average of about $2 billion in 2008–2012. Standard & Poor's and Japan-based Rating & Investment this year raised their long-term credit ratings on the Philippines by a notch from the minimum investment grade BBB– to BBB. Fitch and Moody's upgraded the Philippines in 2013 to investment grade.

Private construction, while moderating from the rapid pace of recent years, is projected to expand through the forecast period. The issuance of building permits rose by 11.2% year on year in the second quarter as both residential and nonresidential approvals increased.

Growth in private investment will mitigate weak government spending. Outlays on public infrastructure undershot the target in the first 7 months of this year. Government expenditure excluding interest remained weak in July, declining by 16.7% year on year. The outlook assumes that steps taken by the authorities to address administrative bottlenecks will accelerate fiscal disbursement from late in 2014.

Fiscal policy is expected to be more supportive of economic growth in 2015. The government's proposed 2015 budget increases spending by 15.1% over the budget for 2014, with increases for social services, infrastructure, and investment in agriculture, tourism, and manufacturing. Social programs include the expansion of health insurance and conditional cash transfers for poor families. The 2015 budget proposes a deficit of 2.0% of GDP, which would exceed this year's expected deficit outcome.

Reconstruction in areas hit by severe typhoons is expected to speed up by the end of this year. In July 2014, the government approved post-typhoon rehabilitation plans for the provinces of Cebu, Iloilo, Leyte, Eastern Samar, and Western Samar and for the city of Tacloban, covering most of the cities and municipalities hit by Typhoon Haiyan. A master plan for recovery and rehabilitation from that typhoon was submitted to the President in August 2014. It involves outlays of about $4 billion for infrastructure, resettlement, social services, and restoring livelihoods.

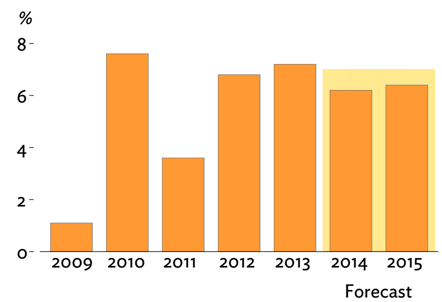
This Update nudges up forecasts for inflation owing to the higher outturn in the first 8 months of this year, expected dry weather from El Niño that could hurt food production late this year, and pending

3.6.1 Selected economic indicators (%)

	2014		2015	
	ADO 2014	*Update*	*ADO 2014*	*Update*
GDP growth	6.4	6.2	6.7	6.4
Inflation	4.3	4.4	4.0	4.1
Current acct. bal. (share of GDP)	3.4	3.4	3.2	3.2

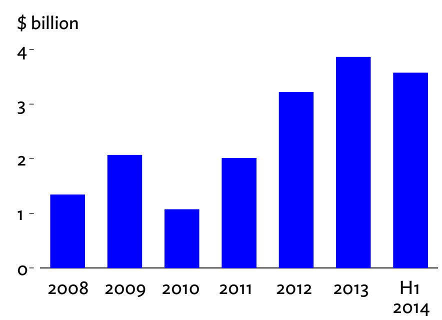
Source: ADB estimates.

3.8.6 GDP growth



Source: Asian Development Outlook database.

3.8.7 Foreign direct investment inflows



Source: CEIC Data Company (accessed 15 September 2014).

petitions for increases in utility charges. The government has increased rice imports to ease prices of the staple and is improving irrigation facilities to counter drought. Inflation is now forecast to average 4.4% in 2014, the highest in 3 years, and 4.1% in 2015, as some of the temporary factors pushing up prices this year abate (Figure 3.8.8).

Monetary policy is expected to tighten further as inflation is near the upper end of the central bank's 2014 target range of 3.0%–5.0%. In raising its policy rates, the central bank said the favorable outlook for domestic demand allows scope for measured adjustments in policy rates without hurting growth. Special deposit accounts and overnight borrowing still had rates below inflation after being raised by 50 basis points between June and September.

The rebound in merchandise exports and higher remittances will underpin current account surpluses (Figure 3.8.9). Merchandise exports posted double-digit growth in June and July. Shipments of semiconductors, comprising 26.0% of total exports, rose by 12.0% in July. Imports are projected to rise more rapidly in 2015 as reconstruction picks up. Forecasts for current account surpluses are maintained at 3.4% of GDP in 2014 and 3.2% in 2015.

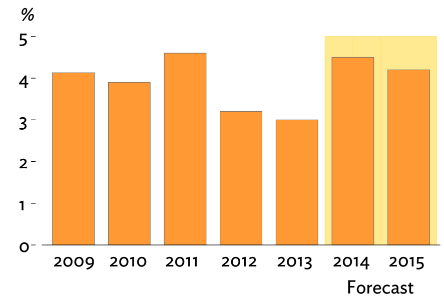
Volatility in global capital flows is a risk to the outlook, though better economic fundamentals have improved the economy's resilience. The current account has been in surplus since 2003 and the ratio of external debt to GDP declined to 21.5% in 2013. Most of the debt is medium to long term. Fiscal and debt consolidation has provided more flexibility to respond to downturns. Government debt as a share of GDP has declined since 2008 to equal 49.2% in 2013 (Figure 3.8.10). Banks' nonperforming loans are in the low single digits, and capital adequacy ratios are above regulatory and international standards.

The most pressing national challenges are to improve infrastructure, attract more investment to generate better jobs, and further reduce poverty, which at 24.9% in the first half of last year was down 3.0 percentage points from the same period in 2012.

Despite strong GDP growth averaging 6.3% since 2010, job generation is insufficient. Underemployment remains high at 18.3% of those employed because new jobs are largely part time or informal. A stronger manufacturing sector as well as further expansion of tourism and other service industries would create more and better-paid employment. Manufacturing currently provides only 8.3% of all jobs.

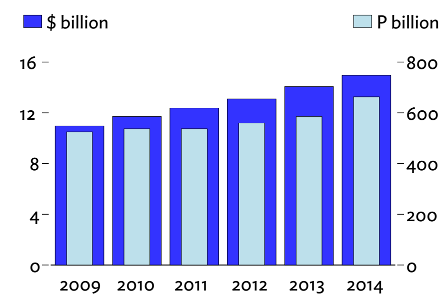
Fixed investment has increased in recent years and was 20.9% of GDP in the first half of 2014, but this still trails peer economies in Asia. Accelerating infrastructure development, especially in the regions, would support job creation and poverty reduction. Recent policy changes to stimulate investment include liberalizing aviation policy, opening further to foreign banks, and implementing road maps for manufacturing sector development. The government plans policy to strengthen competition, enhance the regulatory framework for public–private partnership, liberalize domestic coastal shipping, and approve the Bangsamoro Basic Law, which should boost investment in Mindanao. Such initiatives can make the country more competitive and help it prepare for subregional economic integration.

3.8.8 Inflation



Source: *Asian Development Outlook* database.

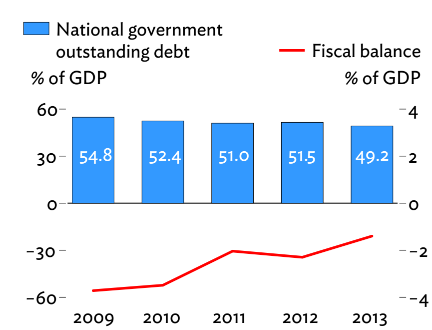
3.8.9 Personal remittances



Note: Data refer to Jan–July of each year.

Source: CEIC Data Company (accessed 15 September 2014).

3.8.10 Fiscal indicators



Source: *Asian Development Outlook* database.