Philippines

Consumption spending, both private and public, offset weakness in investment and net exports last year, enabling modest economic growth. Remittances from overseas workers and expansionary macroeconomic policies supported consumption. Growth is forecast to quicken this year, based on increases in private consumption and a rebound in both exports and investment. After elections in May 2010, one of the challenges for the new administration will be to strengthen the fiscal position and improve the investment climate.

Economic performance

In the face of the global recession, the economy grew by 0.9% in 2009, compared with average growth of 5.5% over the previous 5 years. (Gross national product, which includes remittances from nearly 9 million Filipinos working abroad, rose by 3.0%.) GDP maintained slight growth throughout 2009 on a year-on-year basis, picking up in the fourth quarter (Figure 3.28.1), as industrial output rebounded from a slump.

Buoyed by remittances from overseas workers, private consumption grew by 3.8% (compared with 4.7% in 2008) to remain the biggest contributor to GDP growth on the demand side. Remittances rose by 5.6% to $17.3 billion in 2009, with double-digit increases in November and December when workers sent additional amounts to their families who had been devastated by tropical storms.

Significantly higher government consumption spending (up by 8.5%) and a fiscal stimulus package helped support aggregate demand. The government provided cash transfers and emergency employment programs to vulnerable groups as the economy slowed. It also increased spending on infrastructure to compensate for a slump in private construction.

However, the impact of the global financial crisis and recession depressed investment, in fixed capital by 3.5% and in durable equipment by 11.4% (although the pace of contraction slowed in the second half). The ratio of fixed investment to GDP resumed its decline (Figure 3.28.2), after some improvement in 2007 and 2008. Total investment dragged down GDP growth, as did net exports.

On the supply side, services (accounting for 50% of GDP in 2009) expanded by 3.2% and was the only production sector to contribute to GDP growth (Figure 3.28.3). Retail trading, assisted by the growth in remittances, picked up during the year. So did communications, finance, and business process outsourcing. By contrast, industrial production fell by 2.0%, in its first contraction since 2001. Manufacturing, the biggest industry subsector, shrank by 5.1%, with weaker external demand for

This chapter was written by Teresa Mendoza of the Philippines Country Office, ADB, Manila.
electronic products and clothing a major factor. Public construction increased as the fiscal stimulus was launched, though private construction fell. Production from the fairly small mining industry rose by about 20% in 2009.

Agriculture, representing a declining share of GDP but still accounting for one-third of employment, suffered from severe tropical storms, which reduced rice output by nearly 14% in the fourth quarter from the year-earlier period. Overall, agricultural output was flat for the year.

Employment grew, mainly in services, but fell short of the 1.1 million increase in the labor force, so that the unemployment rate rose to 7.5% in 2009 (the rate of underemployment was 19.1%). Pressure on under- and unemployment was mitigated to some extent by the deployment of about 1.3 million workers overseas in the first 11 months of 2009, 12% higher than the prior-year period.

Lower international prices for oil and commodities, coupled with the soft domestic demand, pulled down consumer prices (Figure 3.28.4), so that inflation averaged 3.2% in 2009. It picked up to 4.4% in December, on the back of rising prices for oil and for food (owing to weather damage to agriculture).

The slump in global trade cut merchandise exports by just over 22% to $37.5 billion, the lowest value since 2003. Exports of electronic goods and clothing were particularly affected. Merchandise imports fell by about 24% to $46.4 billion, reflecting the weakness in exports (materials for manufactured exports are imported) and in investment, and lower prices for oil and commodities.

By November, though, trade grew on a year-on-year basis (Figure 3.28.5), from a low base in the prior-year month. In the last 2 months of 2009, the rebound in exports was driven by electronics; that in imports by capital goods, materials for manufactured exports, and higher oil prices. With the fall in the value of merchandise imports outpacing that of exports, the trade deficit shrank.

The current account recorded a large surplus of $8.6 billion (5.3% of GDP), benefiting from the narrower trade gap, growth in remittances, and an expansion of earnings from business process outsourcing. Portfolio investment recorded an inflow of $1.4 billion, a reversal from outflows of $3.8 billion in 2008. Net foreign direct investment remained low by subregional standards. The overall balance of payments recorded a substantial surplus, and the stronger external position contributed to a 2.4% appreciation of the peso against the United States dollar in 2009.

Gross international reserves stood at $45.7 billion as of February 2010 (Figure 3.28.6), representing a high 9.3 months of import cover and 10.2 times short-term external debt (based on original maturity). Reserves were boosted by higher government borrowings on global financial markets to fund the fiscal stimulus.

That stimulus focused on extra spending for infrastructure and for social protection measures. Government expenditure, other than for interest payments on the large public debt, rose to 14.9% of GDP from 13.5% in 2008. Concurrently, tax revenue fell by 6.4%, eroded by weaker economic growth and provision of tax exemptions and reductions in 2009 (forgone revenue was estimated at about 0.6% of GDP). Poor investment sentiment stymied planned sales of government assets. In

---

**3.28.4 Monthly inflation**

![Monthly inflation graph](image1)

**Sources:** National Statistics Office, [http://www.census.gov.ph](http://www.census.gov.ph); CEIC Data Company (both accessed 10 March 2010).

**Click here for figure data**

**3.28.5 Merchandise trade growth**

![Merchandise trade growth graph](image2)

**Note:** Based on customs data.

**Sources:** National Statistics Office, [http://www.census.gov.ph](http://www.census.gov.ph); CEIC Data Company (both accessed 11 March 2010).

**Click here for figure data**
these circumstances, the fiscal deficit widened to 3.9% of GDP, from 0.9% of GDP in 2008 (Figure 3.28.7).

As the economy sagged and inflation waned, Bangko Sentral ng Pilipinas lowered its policy interest rates in steps by 200 basis points from December 2008 to July 2009, taking the overnight borrowing rate to 4.0%, the lowest in about two decades (Figure 3.28.8). The central bank also supported banking system liquidity and depositor confidence by, among other changes, reducing commercial bank reserve requirements and increasing the ceiling on deposit insurance.

Growth in bank lending slowed in the early part of the year, then picked up as economic conditions improved. Broad money (M3) growth decelerated to 8.3% year on year in December 2009, from nearly double that rate a year earlier.

**Economic prospects**

The outlook assumes that there is a smooth political transition in 2010 following presidential and legislative elections scheduled for May, and that the new government pursues credible economic and fiscal programs.

Fiscal policy will likely be less stimulative in 2010, given budget constraints and plans by the current administration to trim the fiscal deficit to 3.5% of GDP. Spending on social services is budgeted to rise (in nominal terms), but the amount set aside for infrastructure is lower than last year. There are risks on the revenue side. More tax exemptions were approved early in 2010, and additional tax breaks are proposed, even though the country’s low tax collection is a chronic constraint on the budget.

Monetary policy is expected to support the recovery while the authorities gradually unwind the liquidity-boosting measures put in place during the global financial crisis. The central bank increased the lending rate to banks under a rediscounting facility and reduced the size of its peso rediscounting window in the first quarter of 2010.

Private consumption will likely remain the main driver of growth in the next 2 years, underpinned by remittances (expected by the central bank to rise by about 6% in 2010), a firmer labor market, and stronger consumer confidence. Election-related spending will provide a boost through May. Exports will grow in line with the global recovery and, on a net basis, are expected to contribute modestly to GDP growth.

Investment is forecast to rebound from last year’s low levels now that the external and domestic outlooks have improved (businesses might be cautious until the May elections, though). Investment pledges reported by government agencies in the fourth quarter of 2009 nearly trebled from the prior-year period, and the index of business confidence rose to a 2-year high in the first quarter of 2010 (Figure 3.28.9). Property companies have laid out aggressive expansion plans to meet anticipated strong demand for office space, mainly from business process outsourcing firms, and for housing (stimulated by remittances and low interest rates).

Services will benefit from stronger growth in private consumption as well as election-related spending. Higher levels of external trade will continue, more specifically, to stimulate wholesale trade, storage, and transport. The association representing business process outsourcing
firms expects that growth in the industry’s revenue this year will exceed last year’s 19% gain. Rapid expansion has raised employment in outsourcing to about 450,000 from about 100,000 over the past 5 years, and some firms are extending into more value-added services fields.

Manufacturing is projected to recover gradually in tandem with the improvement in external demand, particularly for electronic products. Agriculture, still rebuilding after last year’s storms, was hit by an El Niño drought in the early months of 2010, which curtailed crop yields in some areas. The government planned rice imports of 2.4 million tons in 2010 (up from 1.8 million tons in 2009), but it might need to raise this target.

The drought has also reduced hydropower output. Electricity supplies for the largest island of Luzon, which accounts for about two-thirds of GDP, were interrupted in the first quarter when a lack of rain for hydropower coincided with maintenance shutdowns and technical problems of other plants. Mindanao, the second-largest island, has been worse hit because hydropower accounts for about 55% of its electricity supplies.

On drawing these strings together, GDP is forecast to increase by 3.8% in 2010 (Figure 3.28.10), still below potential and under the 5.5% recorded in 2004–2008.

Growth is seen accelerating to 4.6% in 2011, when a stronger global recovery is expected to give impetus to exports and remittances. The forecast is subject to more uncertainty than usual, since the new administration’s economic and fiscal policies will have an important bearing on the momentum of growth.

Inflation is forecast to rise to 4.7% this year, owing to the impact of the drought, which is putting some upward pressure on food prices, and higher prices for imported oil and commodities. Electricity charges look set to increase as producers seek to cover rising costs, and suppliers turn to more expensive oil-based power generation to compensate for shortfalls in hydropower. Inflation averaged 4.2% in the first 2 months of 2010.

External trade will be considerably stronger this year. Merchandise exports surged by nearly 43% and imports by 30% in January 2010 (both from low bases in the prior-year month). For the full year, growth of imports will likely outpace exports, widening the trade deficit. Taking into account higher remittances and business process outsourcing income, the current account is expected to record a surplus, although it will moderate from 2009 to around 3.3% of GDP in 2010–2011.

In the context of improved global financial market conditions, the government raised $2.6 billion from bond issues overseas in the first 2 months of 2010, securing about half its external borrowing target for 2010. The authorities also plan to issue bonds targeted at overseas Filipino workers. Borrowing costs for external debt have broadly declined to levels of before the financial crisis. Moody’s upgraded its sovereign credit rating for the Philippines in July 2009, from B1 to Ba3, citing the resilience of the financial system and of the external payments position during the global recession.

Risks to the forecasts come from the impact on agriculture and food prices of a more severe El Niño, and the impact on trade and growth
from slower than projected recovery in the global economy. Significant fiscal slippage could unsettle financial markets and raise the country’s risk premium. It will be important that the new government commit to a medium-term plan to strengthen the fiscal position.

**Development challenges**

Although the economy maintained some growth during the global recession, the slowdown in 2009, coming just after the surge in food and fuel prices in 2008, has made the attainment of the Millennium Development Goals more challenging. One-third of the population was poor even before the last 2 difficult years.

Over a long period, the Philippines has invested less in social sectors and infrastructure than most of its neighbors, in large part a result of the tight fiscal situation, high levels of public debt, and a business climate that hampers private investment. Gross domestic investment fell to the equivalent of 14.0% of GDP in 2009, the lowest rate on record.

Fiscal resources are severely constrained by weak revenue generation. Tax revenue as a share of GDP, also lower than among most of its neighbors, declined to 12.8% in 2009 (Figure 3.28.11). That decline reflected not only the temporary effect of lower tax collections during the economic slowdown, but also a long-term erosion of the tax base due mainly to tax exemptions. National government debt rose to 57.3% of GDP in 2009 (Figure 3.28.12), and interest payments on the debt absorb about 20% of total budget outlays, crowding out development expenditures.

Reversing the structural erosion of taxes and reducing government debt to release budget funds for development expenditure will require renewed efforts at tax reform by the new administration. That could include rationalization of fiscal and investment incentives (they cause large losses of tax revenue), and indexation of excise taxes to inflation. Enhancing tax administration is equally important, including cracking down on tax evaders and enforcing anticorruption programs in tax and customs agencies.

Higher private investment, too, could play a more significant role in upgrading infrastructure and, more generally, the productive capacity of the economy. Saving is not the main constraint (Figure 3.28.13), since national saving has steadily risen, bolstered by remittances. Rather, sluggish private investment reflects infrastructure deficiencies, particularly in power and transport, and weaknesses in governance and the policy climate. According to the World Economic Forum, the global competitiveness ranking of the Philippines in 2009/10 fell to 87 (out of 133 countries) from 71 (out of 134) in 2008/09, putting it below India, Indonesia, and Viet Nam, among others. The report cited corruption, inefficient bureaucracy, policy instability, and inadequate infrastructure as the main reasons for the low ranking.