Philippines

Robust private consumption alongside recoveries in exports and investment drove a vigorous economic rebound in 2010, while inflation remained moderate and the external position strengthened. Yet progress remained slow in reducing poverty and generating jobs. The forecast is for solid economic growth this year and next, and sustained increases in investment now appear achievable—provided that the government pushes through with policy and governance reforms.

Economic performance

A strong recovery in 2010 lifted GDP by 7.3%, as private consumption accelerated and exports and investment rebounded from a slump in 2009 (Figure 3.28.1). Nearly 60% of total growth came from private consumption, which rose by 5.3%. Remittances from overseas workers remained a key support to consumption, growing by 8.2% to $18.8 billion (the increase in peso terms was 2.4%).

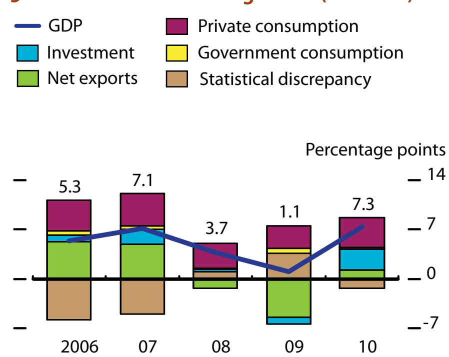
Investment contributed about 40% of total growth, the highest proportion in 10 years. Fixed capital outlays climbed by 17.1%, with equipment investment surging by 25.7%. Double-digit growth was recorded for investment in a broad range of equipment, including that for agriculture, construction, mining, metalworking, transport, and telecommunications. Fixed investment as a ratio to GDP edged up to 15.7%, the strongest rate in 6 years (Figure 3.28.2).

Recovery in exports and robust consumption underpinned this strong investment, with support from higher corporate earnings and low interest rates. Presidential and legislative elections in May 2010 went smoothly, and businesses generally were optimistic about the new government's commitment to improve the business climate. Surveys on business expectations showed steady gains in confidence throughout the year. Net exports, which had been a drag on GDP growth during the global recession, also made a positive contribution.

Government expenditure rose in the first half, before the new administration reined in some spending in the second half to curb the fiscal deficit.

On the production side, industry was the main contributor to growth (Figure 3.28.3), overtaking services. Manufacturing output increased by 12.3%, after shrinking in 2009. Export-oriented electrical machinery manufacturing shot up by nearly 33%, and industries such as food processing, petroleum products, and textiles recorded significant output gains. Construction activity rose by 10.5%, driven by strong demand for office space, particularly from the business process outsourcing subsector, and for housing. Low interest rates also stimulated construction.

3.28.1 Contributions to growth (demand)



Sources: Asian Development Outlook database; National Statistical Coordination Board. http://www.nscb.gov.ph (accessed 1 February 2011).

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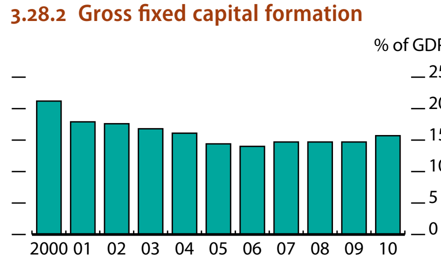
3.28.2 Gross fixed capital formation



Sources: Asian Development Outlook database; National Statistical Coordination Board. http://www.nscb.gov.ph (accessed 1 February 2011).

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

Services, still the biggest sector and generating about half GDP and employment, grew by 7.1% last year. Much of the growth came from retailing, which is bolstered by remittance inflows. Other high-growth components were business process outsourcing, finance, and real estate.

Dry weather caused by an El Niño weather pattern cut agricultural output, however, by 0.5%, a second consecutive year of weak performance (production was flat in 2009 mainly owing to severe tropical storms). Agriculture's share of GDP fell to just under 17%, although the sector still accounts for about a third of employment.

The strong economic rebound did not spark inflation (Figure 3.28.4): consumer prices rose by an average of 3.8%, within the 3.5%–5.5% target range set by Bangko Sentral ng Pilipinas, the central bank. Higher global oil prices pushed up transport costs (although an appreciating peso helped to damp imported price pressures) and electricity costs rose as the dry weather limited output from hydropower plants. Food price rises were relatively subdued, in part because rice imports countered local production shortfalls caused by the bad weather.

With moderate inflation, the central bank kept policy interest rates in 2010 at the low levels it set during the global downturn—the overnight borrowing rate at 4.0% and the overnight lending rate at 6.0%. Pressures to raise rates to more normal levels as the economy rebounded were lessened by the appreciation of the exchange rate and the fact that real policy rates remained positive. The central bank did, however, withdraw some of the liquidity-enhancing measures that it took during the recession. Domestic liquidity rose by about 11%, a moderate increase given the strength of the economic recovery.

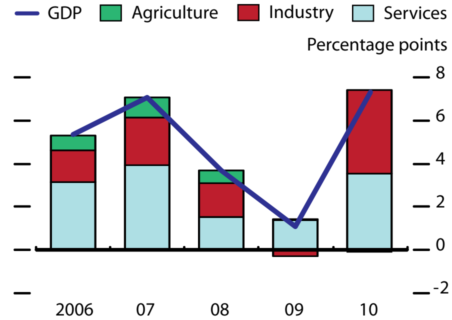
Merchandise exports shot up by 34.8% to $50.7 billion in 2010 (an increase of $13.1 billion over 2009), recovering from a 22% plunge in 2009 (Figure 3.28.5). Electronic products including semiconductors (three-fifths of total exports) surged by 40% as global demand bounced back. Shipments to the People's Republic of China and Southeast Asia nearly doubled from 2009, on healthy recovery there. The People's Republic of China accounted for 11.1% of total exports, well up from 7.6% in 2009, while Southeast Asia's share went up to 22.5% from about 15%. The share of exports going to the United States fell to 14.7% from 17.7%.

Imports rose by 31.5% or by $14.6 billion, reflecting strong demand for capital equipment, consumer goods, imported inputs for export-oriented manufacturing, and dearer oil. The deficit in merchandise trade widened by 17% to $10.4 billion, reflecting the higher growth in imports than exports.

The current account posted a surplus of $8.5 billion, equivalent to 4.5% of GDP, as a result of higher services receipts (mainly from business process outsourcing) and remittances. Coupled with the turnaround to net inflows in the capital and financial account in 2010, the overall balance-of-payments surplus rose to 7.6% of GDP.

Net portfolio investment amounted to $4.0 billion, driven by renewed global appetite for emerging markets. Partly on these inflows, stock prices soared by 38% and total stock market capitalization by 47% in 2010. The yield spread between United States and Philippine government bonds narrowed further (Figure 3.28.6). Still, net foreign direct investment remained low by regional standards, at $1.2 billion in 2010.

3.28.3 Contributions to growth (supply)



Sources: Asian Development Outlook database; National Statistical Coordination Board. http://www.nscb.gov.ph (accessed 1 February 2011).

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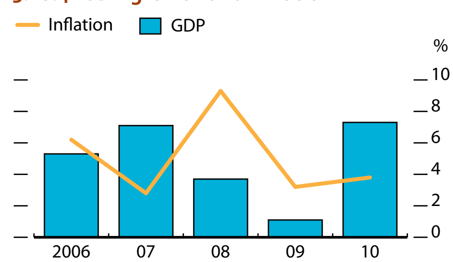
3.28.4 GDP growth and inflation



Sources: Asian Development Outlook database; National Statistical Coordination Board. http://www.nscb.gov.ph (accessed 1 February 2011); National Statistics Office. http://www.census.gov.ph (accessed 10 March 2011).

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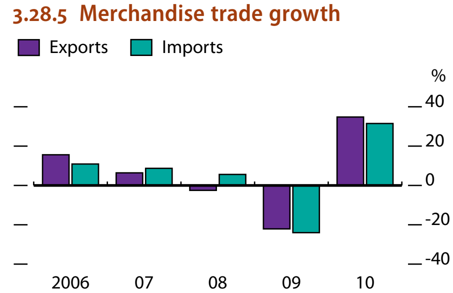
3.28.5 Merchandise trade growth



Sources: Bangko Sentral ng Pilipinas. http://www.bsp.gov.ph; CEIC Data Company (both accessed 26 March 2011).

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Robust external accounts supported a 41% increase in gross international reserves to $62.4 billion at end-2010, equivalent to more than 10 months of import cover. The strong current account and capital inflows also drove a 5% appreciation of the peso against the US dollar in 2010. To temper gains, the central bank approved higher ceilings on foreign exchange purchases such as those for outward investment and import payments, and it encouraged the public and private sectors to prepay foreign currency–denominated debt.

Successful issuance of sovereign bonds eased concerns about financing the fiscal deficit. The government sold its first issue of peso-denominated global bonds in September 2010, and followed up with another large issue (equivalent to $1.25 billion of 25-year bonds priced to yield 6.25%) in January 2011. These issues, sold at a time of relatively low global interest rates, helped to reduce the government's foreign exchange risk and lengthen its debt profile. The government further raised $1.5 billion from the issuance of 15-year US dollar global bonds in March 2011. These issues were heavily oversubscribed.

Economic prospects

The outlook for this year and next assumes that the government follows through on its commitments to improve the fiscal position, governance, and the business environment, and that some of its planned public–private partnership projects start in the forecast period.

On fiscal policy, the government pulled back the deficit in 2010 to 3.7% of GDP from 3.9% in 2009. It trimmed noninterest expenditure in the second half by 0.4% year on year, after 15.8% growth in the first half (Figure 3.28.7). It also showed some progress in strengthening tax collection: tax revenue for the year rose by 11%, but was still short of target.

Fiscal policy will likely be less stimulative to the economy in 2011, given that the authorities aim to reduce the deficit to 3.2% of GDP (Figure 3.28.8). The budget approved in December 2010 restrains growth in public spending, but also puts greater emphasis on social services such as conditional cash transfers to the poor. It reduces infrastructure spending as the government looks to the private sector to play a greater role.

Five initial infrastructure projects (including construction of expressways and the privatization of light railway operations in Manila) are to be put out for bidding by midyear under public–private partnership arrangements.

The forecasts assume that monetary policy will be tightened gradually, continuing the first step made in March 2011 when the central bank raised the policy rates by 25 basis points to 4.25% for the overnight borrowing rate and to 6.25% for the overnight lending rate. They also assume that political uncertainties and natural disasters in countries that host many Filipino workers do not seriously hurt remittance inflows (about 16% comes from the Middle East and around 5% from Japan—Figure 3.28.9).

Sustained business optimism points to further growth in private investment. The outlook for business confidence for the second quarter of 2011 rose to the highest level since the survey started in 2001

3.28.6 Sovereign risk spreads

Source: Bloomberg (accessed 11 March 2011).

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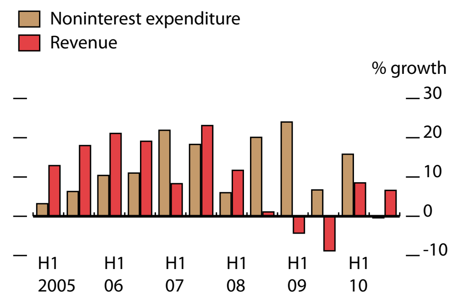
3.28.1 Selected economic indicators (%)

	2011	2012
GDP growth	5.0	5.3
Inflation	4.9	4.3
Current account balance (share of GDP)	4.1	3.9

Source: ADB estimates.

3.28.7 Fiscal indicators



Sources: CEIC Data Company; Bureau of the Treasury. http://www.treasury.gov.ph (both accessed 11 March 2011).

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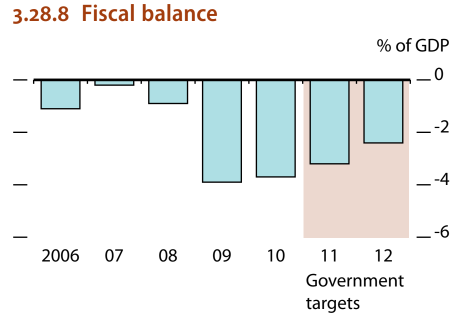
3.28.8 Fiscal balance



Sources: CEIC Data Company; Bureau of the Treasury. http://www.treasury.gov.ph (both accessed 11 March 2011).

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(Figure 3.28.10). Investment pledges reported by government agencies rose by 73% in 2010, mainly for manufacturing, utilities, and real estate. Capacity utilization in some manufacturing industries is at high levels, which is conducive to investment.

Upgrades by credit rating agencies support the investment environment. Standard & Poor's raised the Philippines' long-term foreign currency debt rating in November 2010 to BB, or two notches below investment grade, at par with Fitch's. Moody's, which rates the Philippines Ba3, in January 2011 lifted its outlook on the country's foreign- and local-currency bonds to positive, from stable, citing the stronger external position, well-managed inflation expectations, and improved prospects of economic reform.

On the supply side, services will benefit from growth in private consumption and investment. Manufacturing will get support from increased domestic and export demand, though its growth will decelerate after last year's strong bounce. Private construction is seen remaining healthy because of sustained demand for office space and housing. Agriculture is projected to recover from last year's contraction, but a La Niña weather pattern evident early in 2011 could bring heavier rainfall than usual for part of this year.

Taking into account these factors and the base effect of the strong recovery in 2010, GDP growth is projected at 5.0% in 2011, quickening to 5.3% in 2012 (Figure 3.28.11) on the assumption that good progress is made on starting some public–private projects.

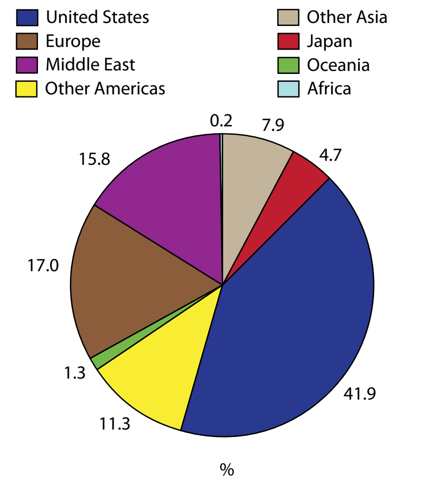
Inflation is forecast to rise to 4.9% in 2011 (it was 3.9% in the first 2 months). This projection reflects, besides higher prices for imported oil, hikes for utility charges and public transport fares. Higher global food prices will also put upward pressure on inflation, although this is cushioned by rice inventories and expectations of an improved harvest. On the basis of a deceleration in global commodity prices, inflation in 2012 is forecast to ease to 4.3% (Figure 3.28.12).

Growth in merchandise exports is seen pulling back from last year's levels to about 11% in the forecast period. Imports will likely grow slightly faster than that on the back of the projected growth in consumer demand and investment, as well as higher oil and commodity prices. The trade deficit is set to widen, but the services account will remain in surplus, largely because of growth in business process outsourcing. Remittances will remain a significant contributor to current account surpluses, which are forecast at about 4% of GDP during the forecast period (Figure 3.28.13).

In the context of still high national government debt (equivalent to 55.4% of GDP in 2010) the government has committed to reduce the budget deficit to 2.0% of GDP by 2013 and the debt to 47% of GDP by 2016. The focus on the revenue side of the budget is to raise the tax-to-GDP ratio from 12.8% in 2010 to 16%–18% over several years, through (at least for now) tighter tax administration and reforms to excise tax and investment incentives, rather than increases in tax rates.

For spending, the plan is to weed out programs that are no longer relevant or efficient and to strengthen the finances of government-controlled corporations. The government is also pushing for a fiscal responsibility law, under which proposals to grant fiscal incentives or

3.28.9 Remittances by region, 2010



Source: CEIC Data Company (accessed 11 March 2011).

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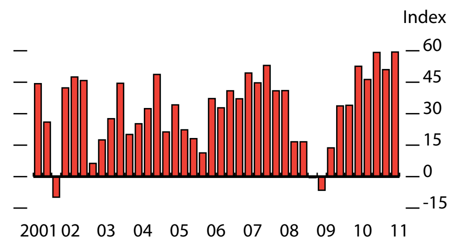
3.28.10 Business expectations index



Notes: Represents index for the next quarter. 2001 data is for June.

Source: CEIC Data Company (accessed 11 March 2011).

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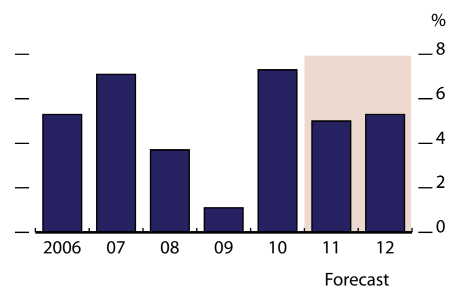
3.28.11 GDP growth



Sources: Asian Development Outlook database; National Statistical Coordination Board. http://www.nscb.gov.ph (accessed 11 March 2011).

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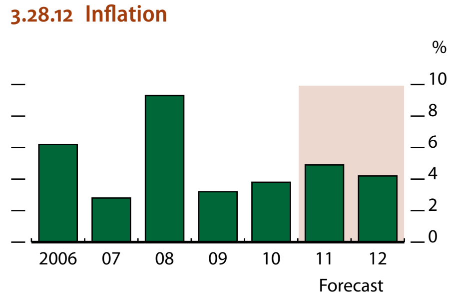
3.28.12 Inflation



Sources: Asian Development Outlook database; National Statistical Coordination Board. http://www.nscb.gov.ph (accessed 11 March 2011).

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permanent increases in national government expenditure would require supporting revenue-raising measures or offsetting spending cuts.

Risks to the growth and inflation forecasts on the downside are global economic growth that is weaker than expected, interruptions to remittance inflows, and higher than forecast increases in global oil and food prices. There is a risk that the disruption to supply chains after the Japanese earthquake could dent manufacturing production and exports in 2011. Electronics and semiconductors, major export industries in the Philippines, depend heavily on components from Japan. Lack of progress in the public–private partnership program or in efforts to improve governance and public finances would likely undermine business confidence. A severe La Niña could delay agriculture's recovery.

Development challenges

Lackluster growth in employment is a chronic problem. Despite strong economic growth last year, the unemployment rate fell only slightly to 7.3% (Figure 3.28.14). Young people aged 15–24 account for about half the unemployed. The underemployment rate also remained high at about 20%. The proportion of workers classified as vulnerable—unpaid family members and the self-employed, most of whom are in the informal sector—has declined since 2006, but remains high at nearly 42%. Moreover, the lack of jobs drives large numbers of Filipinos to work abroad.

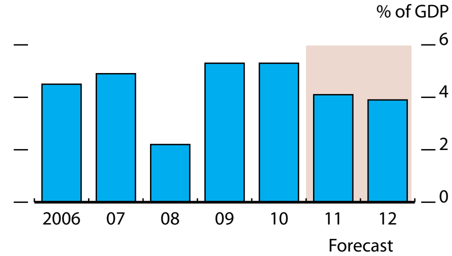
Weak employment generation and low productivity equate with slow reductions in poverty. The number of people living in poverty increased by 3.3 million to 23.1 million in the 6 years to 2009, when the incidence of poverty rose to 26.5% from 24.9%. Progress has been slower than hoped for on the Millennium Development Goals relating to poverty, maternal health, and primary education.

Much remains to be done to improve the business environment so that private investment and employment grow consistently. According to the World Economic Forum, the global competitiveness ranking of the Philippines in 2010/11 was 85 (out of 139 countries), compared with Malaysia (26), Thailand (38), Indonesia (44), and Viet Nam (59). Investors cited concerns such as poor infrastructure and policy instability.

The World Bank's *Doing Business 2011* report also showed the Philippines below these countries, ranked 148 out of 183, and slipping from the previous year's 146. Transparency International's 2010 Corruption Perceptions Index had the Philippines scoring just 2.4 out of 10 (Figure 3.28.15), where zero represents highly corrupt.

Against this backdrop, one key policy challenge is for the government to sustain the higher level of investor confidence built up last year by pushing ahead with policy and governance reforms. Another is to raise state revenue so as to fund the social development and infrastructure programs required to reduce poverty and underpin a stronger private sector.

3.28.13 Current account



Sources: Asian Development Outlook database; National Statistical Coordination Board. http://www.nscb.gov.ph (accessed 26 March 2011).

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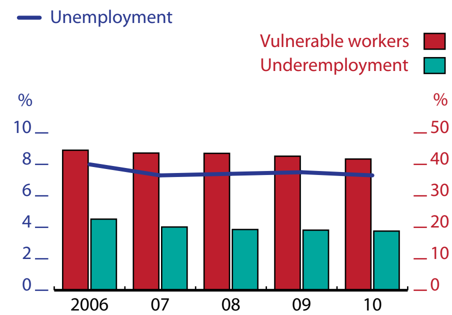
3.28.14 Labor indicators



Sources: CEIC Data Company (accessed 11 March 2011).

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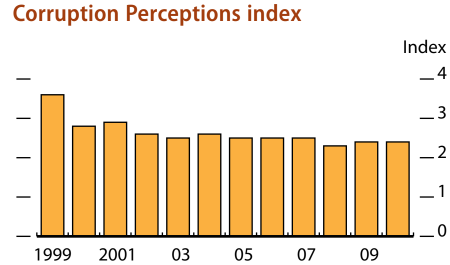
3.28.15 Transparency International's Corruption Perceptions index



Note: The index focuses on corruption in the public sector. It ranges from 0 to 10, with 0 the most corrupt.

Source: Transparency International. http://www.transparency.org/policy_research/surveys_indices

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