Philippines

Growth for the first half of this year was hampered by weaknesses in exports and government spending, though private consumption and private investment remained strong. A better overall performance is projected for July–December, but the GDP growth forecast for the full year is trimmed from April’s *Asian Development Outlook 2011*. Growth is still seen picking up in 2012. Inflation has quickened, in line with expectations, and will likely ease next year. Forecasts for current account surpluses are revised down.

Updated assessment

GDP growth slowed to 3.4% in the second quarter of 2011, putting the outcome for the first 6 months at 4.0%, below expectations. Consumer spending and private investment drove the moderate expansion in January–June, when net exports and lower government spending acted as drags.

Private consumption grew by 5.4% in the first 6 months and contributed half the overall GDP growth (Figure 3.8.1). Consumer spending was underpinned by a stronger labor market—employment grew by 4.0% in the 12 months to April 2011, mostly in services and agriculture.

Remittances from overseas Filipino workers—a large part spent on consumer goods and services—saw weaker growth because of political strife and economic slowdown in some host countries. The inflows rose by 6.3% to $9.6 billion in January–June, an increase of just 1% in nominal peso terms.

Fixed capital investment rose by 3.2%, subdued by weakness in public construction. However outlays for equipment, mainly by the private sector, rose by a strong 11.2%. Private construction continued to expand at double-digit rates, as it did in 2010. Investment overall contributed about half the overall GDP growth in the first 6 months.

The ratio of fixed investment to GDP—20.4% in the first half of 2011—approached its best level in a decade. (A rebasing and revision of the national accounts in May 2011 raised the investment-to-GDP ratio for recent years. They also lifted GDP growth for 2010, a year of economic recovery, to 7.6%, from 7.3%.)

Weakness in government spending reflected in part a high base set in 2010, when public expenditure rose, before national elections and after typhoons. A government campaign against corruption also had an impact on outlays, because public officials grew more cautious about making spending decisions. Government construction, for example, plunged by nearly half in the first 6 months, and overall public spending fell by 6.0%.

Services, the biggest sector, grew by 4.2% and contributed more than half the overall GDP increase from the production side (Figure 3.8.2). Its expansion was driven by real estate, business process

This chapter was written by Norio Usui and Teresa Mendoza of the Southeast Asia Department, ADB, Manila.
outsourcing, financial services, and transport and communications. Manufacturing output rose by 6.8%, with solid gains in industries such as food processing, chemicals, and communications equipment. Private construction picked up strongly by 20.5% and mining by 9.2%. Agriculture, which had contracted in the prior-year period owing to dry weather, rebounded by 5.6% in January–June.

Merchandise exports recorded weak growth of 4.3% in the first half, climbing to $24.8 billion according to customs data (Figure 3.8.3). The major export category—electronic products including semiconductors (about half the total)—fell by 12.1%, partly a result of supply chain disruptions caused by the March earthquake in Japan as well as weakness in global demand for semiconductors. This decline was outweighed by higher exports of agricultural commodities, mineral products, and garments.

Steeper prices and volumes of oil and raw material imports contributed to a 15.6% increase in merchandise imports to $30.5 billion. The cost of inputs for electronic products rose, even though their exports fell. Rice imports fell by nearly 83% owing to a better domestic harvest. Given that import growth outpaced exports by a wide margin, the trade deficit more than doubled from a year earlier, to $5.7 billion.

Trade in services generated a surplus of $1.0 billion in the first 3 months of 2011, nearly 30% higher than in the same period of the previous year. Business process outsourcing accounted for much of the increase. The rise in remittances also helped to sustain a current account surplus, amounting to $933 million (1.8% of GDP) in the first quarter of 2011 (the latest available data). Gross international reserves rose by nearly 14.0% to $71.0 billion in the 7 months to end-July 2011, equivalent to 10.6 months of imports of goods, services, and income.

Net portfolio investment inflows remained relatively high, totaling $2.7 billion in the first 7 months of 2011. These inflows underpinned solid demand for peso-denominated government securities and helped to push the stock market to record levels in August.

Robust external accounts and the capital inflows supported an appreciation of about 3% in the peso against the US dollar in the 8 months through end-August 2011. Higher food and oil prices fueled inflation (Figure 3.8.4), which averaged 4.8% in the first 8 months of 2011 on a new 2006-based consumer price index. Bad weather disrupted supplies of fruit, vegetables, and fish but a good rice harvest helped to damp food price inflation from April. An appreciating peso countered some of the pressure from imported inflation.

To lean against rising inflation and inflation expectations, Bangko Sentral ng Pilipinas, the central bank, bumped up its policy interest rates twice in the first 6 months by a cumulative 50 basis points to 4.5% for the overnight borrowing rate and 6.5% for the overnight lending rate. These were its first increases since it cut the rates by 200 basis points during the global recession.

The central bank also raised bank reserve requirements in two steps in the first 8 months (to 21.0%) and used its special deposit accounts (deposits placed with the central bank by banks and certain other financial institutions) to manage domestic liquidity. But broad money

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<tr>
<th>3.8.1 Selected economic indicators (%)</th>
<th>2011</th>
<th>2012</th>
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<tbody>
<tr>
<td>GDP growth</td>
<td>5.0</td>
<td>5.3</td>
</tr>
<tr>
<td>Inflation</td>
<td>4.9</td>
<td>4.3</td>
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<tr>
<td>Current acct. bal. (share of GDP)</td>
<td>4.1</td>
<td>2.1</td>
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Source: ADB estimates.
(M3) growth still accelerated through the first half, to 11.4% in June year on year, and the pace of bank lending picked up to 18.8% in that month.

Government spending fell short of target by nearly 17% in the first half. Tax revenue also missed its target, although collections increased somewhat owing to better tax administration. The fiscal deficit narrowed to P17.2 billion, well below both the budgeted figure and the prior-year deficit of P967.2 billion. Excluding interest payments, the primary budget balance was in surplus compared with a deficit a year earlier (Figure 3.8.5). Interest payments on the large public debt, which require about a fifth of budget spending, fell by 8.3%.

Prospects

The Philippine Development Plan 2011–2016, approved by the government in March 2011, focuses on investment and employment; outlays on infrastructure supported by public–private partnerships; a drive against corruption; and better access to social services. The plan’s goals include average GDP growth of 7%–8%, generation of 1 million new jobs each year, and a reduction in poverty incidence to 16.6% by 2015 (from 26.5% in 2009).

The Update’s forecasts assume that the government follows through on this plan and on reforms of the past year (Box 3.8.1). They also assume that some of the planned public–private infrastructure projects, which include expressways and airports, get under way in the forecast period.

Government spending is expected to pick up in the second half of 2011 from the low pace in the first, giving some lift to the economy. Nevertheless, the full-year budget deficit is likely to be narrower than the target of 3.2% of GDP. For 2012, the government proposes to sharply raise spending on social programs and infrastructure, but also to rein in the fiscal deficit to 2.6% of GDP (the medium-term deficit target is 2.0% of GDP in 2013).

Private investment is expected to remain robust, based on positive business sentiment, high manufacturing capacity utilization (above 80%), and solid domestic demand. Signs pointing to robust investment in the months ahead include a 21% increase in investment commitments in the first half of 2011 and near 21% rise in bank lending to businesses. Upgrades in the Philippines’ sovereign credit ratings support the investment environment. Moody’s raised the country’s foreign and local currency long-term bond ratings from Ba3 to Baa2 (two notches below investment grade) in June 2011 and Fitch raised the long-term foreign currency rating from BB to BB plus (one notch below investment grade). The ratings agencies cited progress on fiscal consolidation, macroeconomic stability, and a strong external position.

Despite these improvements, net foreign direct investment stayed low in the first 5 months of 2011 (less than $1 billion). The country also garners low scores on global rankings of the investment environment. Launch of public–private partnership projects has been delayed, with those slated for bidding in the first half of this year still being evaluated.

Consumer spending will be sustained by growth in employment and incomes and by easing inflation in 2012. As for remittances, increased

3.8.1 Key policy and administration changes in the past year

National budget. Earlier submission of the budget has enabled Congress to review and approve the annual fiscal program before year-end. The introduction of zero-based budgeting requires spending projects to be justified from a zero base (not incrementally). Key information on spending must be published on government websites to improve transparency.

Social programs. The government has expanded a conditional cash transfer program for poor families in return for their children’s regular school attendance and medical checkups and introduced mandatory, free immunization for children up to 5 years of age. Government-paid health insurance has been provided to more poor families and electricity subsidies for the poor extended to 2021.

Government owned and controlled companies. Their performance and viability will be reviewed regularly to determine if any should be abolished, merged, or privatized. A new law prescribes limits on compensation of their executives and directors.

Public–private partnerships. The government is drawing up new regulations to encourage private investment in infrastructure, and has set up a center to assist government agencies to form such partnerships.

Business regulations. Permit and license systems have been streamlined and a new registry system will be established to enable businesses to be set up more easily.

Competition policy. The Department of Justice has been directed to enforce competition policies and investigate cases of monopolies, cartels, and restraints to trade. More foreign airlines will be allowed to fly to airports outside Manila.
Asian Development Outlook 2011 Update

The deployment of Filipino workers to Asian countries and Canada is helping to offset some declines in the Middle East and North Africa.

A central bank survey of businesses in the third quarter showed positive sentiment (Figure 3.8.6), which suggests a hiring upturn. Further, the disruptions to manufacturing and trade from the Japanese earthquake will continue to fade in the second half.

Domestic demand will drive economic growth in the forecast period, with net exports acting as a drag. GDP is now forecast to rise by 4.7% this year (Figure 3.8.7), lowered a touch from Asian Development Outlook 2011 because of the weaker than expected first-half outcome and the deteriorating outlook for major industrial economies.

Next year, the economy is seen growing by 5.1%, gathering momentum from the expected pickup in domestic investment and the projected improvement in external demand.

Inflation is likely to stay around 5% for the rest of 2011 and average 4.9% for the whole year. Electricity prices might rise further because power companies have petitioned the government for increases in tariffs. In 2012, inflation is projected to ease to 4.3% (Figure 3.8.8), assuming that global oil and food prices soften as expected.

While 2011 year-average inflation is close to the high end of the central bank’s target of 3%–5%, the monetary authorities will likely be cautious about raising policy rates given the uncertain global economic outlook and weaker than expected domestic economic growth. They would probably consider raising bank-reserve requirements and taking other steps to manage liquidity if capital inflows continued to build.

Forecasts for current account surpluses are revised down to 2.5% of GDP in 2011 and 2.1% in 2012. Projected growth in exports in 2011 has been trimmed and that for imports raised, partly because of higher costs of oil. Receipts from business process outsourcing are expected to register solid growth this year. Despite a likely export recovery in 2012, imports will remain strong in line with the pickup in domestic demand.

The expansion of investment seen over the past 2 years is a positive indicator for employment generation. Although in the 12 months through April 2011 the unemployment rate fell to 7.2% from 8.0%, youth unemployment remained high at 16.6% and the underemployment rate rose to 19.4% from 17.8%. The ranks of unpaid family workers also grew, constituting about 12% of the workforce, mostly in agriculture. Manufacturing jobs account for only 8% (Figure 3.8.9) of total employment, down from 9.3% in 2004–2007. Sustainable gains in employment will depend on further increases in investment, underpinned by policy reforms.

The international economic outlook poses risks for the forecasts. Weaker than expected economic growth in industrial countries would hurt prospects for investment, remittances, and exports. Investor sentiment would be undermined if no progress is seen on the government’s reforms efforts, including public–private partnerships.