Philippines

Slumping exports and a fall in government spending undercut the impact on economic growth of strong private consumption in 2011. This year, the authorities have stepped up public spending and relaxed monetary policy, laying the ground for an upturn in GDP growth that is projected to continue through 2013. Inflation is seen at moderate levels through the forecast period. Nevertheless, considerably stronger economic growth is needed to make substantial reductions in unemployment and poverty.

Economic performance

A sharp decline in exports of electronic products and weak government spending curtailed GDP growth to 3.7% in 2011. Most of the growth (Figure 3.28.1) came from a 6.1% increase in private consumption, which was again supported by remittances from overseas Filipino workers (up by 7.2% to $20.8 billion, or by 3.0% in peso terms) and by lower lending rates.

Fixed capital investment decelerated because of sluggish public construction and slower growth in private investment. As a share of GDP, fixed capital investment declined to 19.3% from a 7-year peak of 20.5% in 2010.

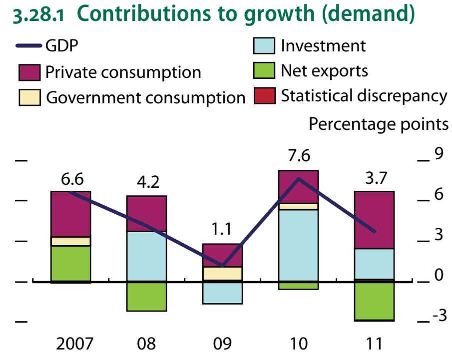
Government consumption and capital spending fell, reflecting a high base in 2010 (when expenditure had risen ahead of national elections) and the introduction of governance reforms in 2011 (which delayed spending by government agencies). As the economy softened, the government accelerated budget disbursements late in the year, mitigating the impact on the economy of a steep slide in exports.

Lower than planned government spending, coupled with some improvement in tax revenue, narrowed the fiscal deficit to 2.0% of GDP (Figure 3.28.2), well within the 3.0% deficit target. Expenditure rose by just 2.3% (nominal terms), with significant shortfalls in infrastructure outlays. The tax-to-GDP ratio rose slightly to 12.3%. One impact of these developments was to reduce national government debt to the equivalent of 50.9% of GDP, the lowest since 1998.

From the production aspect, services grew by 5.0% in 2011 and provided three-fourths of total GDP growth. Retail trade, business process outsourcing (BPO), and financial and real estate services were the main contributors. Industry grew by only 1.9% owing to weak public construction and subdued manufacturing, caused mainly by a slump in electronics exports. Some other manufacturing subsectors, such as food, chemicals, and furniture, drew support from the expanding domestic consumption. Private construction growth eased from the rapid pace in 2010. Agriculture, after 2 years of contraction due to bad weather, recovered by 2.6%.

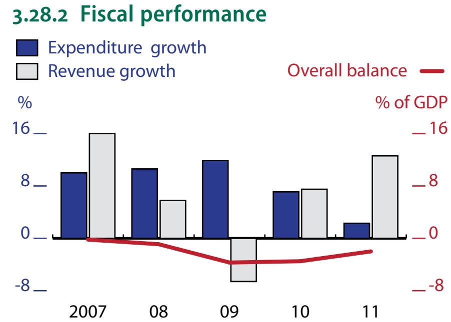
Employment improved by 3.2% in 2011, or about 1.2 million new

3.28.1 Contributions to growth (demand)



Sources: Asian Development Outlook database; National Statistical Coordination Board. http://www.nscb.gov.ph (accessed 1 March 2012).

3.28.2 Fiscal performance



Sources: CEIC Data Company; Bureau of the Treasury. http://www.treasury.gov.ph (both accessed 14 March 2012).

This chapter was written by Norio Usui and Teresa Mendoza of the Philippines Country Office, ADB, Manila. The policy challenge section is sourced from N. Usui. *Taking the Right Road to Inclusive Growth: Industrial Upgrading and Diversification in the Philippines.* Asian Development Bank, forthcoming.

jobs, although most were part time. The new jobs slightly exceeded the increase in the labor force. The unemployment rate eased to 7.0% from 7.4%, but the rate of underemployment rose to 19.3% while other labor market indicators remained weak: youth unemployment was high at 16.3% and employment in manufacturing was low at 8.3% of total employment. About 20% of the unemployed were college graduates, indicating a mismatch between their skills and the needs of the labor market.

Higher global oil and food prices lifted average inflation to 4.8%, just within the central bank's 3–5% target range. A good harvest helped slow inflation from October (Figure 3.28.3). Earlier concerns over inflation prompted Bangko Sentral ng Pilipinas to lift its policy interest rates by 50 basis points in early 2011, to 4.5% for overnight borrowing and 6.5% for overnight lending. It also raised bank reserve requirements, by 2 percentage points to 21.0%. As inflation moderated, the central bank kept policy rates steady for the rest of the year. The pace of lending to the private sector almost doubled to 15.7%, and growth in total domestic credit rose sharply to nearly 15%.

A slump in exports widened the trade deficit in 2011, eroding the current account surplus (Figure 3.28.4). Merchandise exports fell by 6.9% to $47.2 billion, reflecting weak global demand coupled with supply chain disruptions in electronics caused by the March earthquake in Japan and floods in Thailand later in the year. Electronic products (mainly semiconductors), which make up about half of total exports, plunged by 23.4%, although the impact was cushioned by double-digit growth in shipments of clothing, chemicals, and agricultural commodities. Exports of minerals also posted strong gains, helped by high world mineral prices.

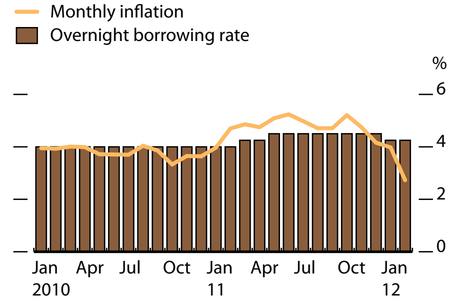
Imports rose by 1.6% to $62.7 billion, with substantial increases in oil (reflecting much higher oil prices), and in durable consumer goods and industrial machinery. By contrast, imports of electronics fell, in line with electronics exports, and imports of automobiles were disrupted by the flooding in Thailand that closed factories there.

Trade in services produced a larger surplus, mainly owing to income from BPO. Remittances also contributed to the current account surplus. Net inflows of portfolio investment rose by 26.6% to $5.5 billion and inflows of foreign direct investment (FDI) were broadly steady at $1.3 billion, producing a surplus in the capital and financial account (Figure 3.28.5).

Relatively low levels of FDI reflect deficiencies in the investment environment. The country's ranking in the World Economic Forum's *Global Competitiveness Report 2011–2012* rose by 10 places to 75 (of 142 countries), mainly due to the lower public deficit and debt, improved credit ratings, and moderate inflation. However, the Philippines scored low marks for infrastructure, quality of public institutions, and corruption, so that its overall competitiveness ranking lagged behind neighbors such as Indonesia (46) and Viet Nam (65).

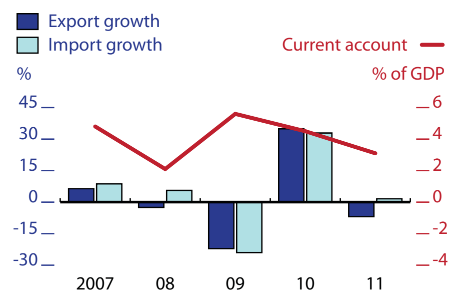
Gross international reserves increased by 21% to $75.3 billion, cover for 11.1 months of imports. Domestic financial markets strengthened, with stock prices up by 4% over the year and yields declining on government bonds. The peso ended 2011 little changed against the United States (US) dollar from a year earlier.

3.28.3 Inflation and policy interest rate



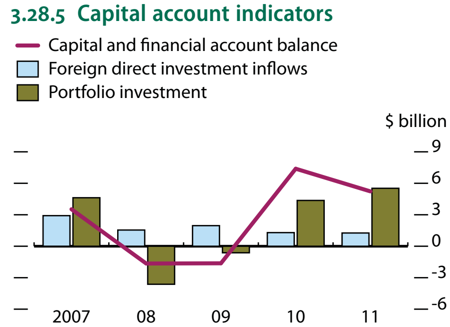
Source: CEIC Data Company (accessed 16 March 2012).

3.28.4 Merchandise trade growth and current account balance



Sources: Asian Development Outlook database; National Statistical Coordination Board. http://www.nscb.gov.ph (accessed 23 March 2012).

3.28.5 Capital account indicators



Sources: Asian Development Outlook database; National Statistical Coordination Board. http://www.nscb.gov.ph (accessed 23 March 2012).

Economic prospects

Forecasts for 2012 and 2013 assume that the government will raise spending, follow through on its commitment to improve the business environment, and carry out some of the planned public–private partnerships, which include airports, highways, and water supply operations (they were delayed in 2011).

GDP growth is forecast to recover to 4.8% in 2012 (Figure 3.28.6), underpinned by strong private consumption and a pickup in public and private investment. Household consumption will benefit from inflows of remittances, lower average inflation, and positive consumer sentiment. Remittances in US dollars will increase by about 5% in 2012, the central bank projects.

Business sentiment is positive, too, according to a survey by the central bank in the first quarter of 2012 (Figure 3.28.7). Respondents cited increasing orders, new contracts and projects, and higher government spending. Investment commitments approved by state agencies rose by 37.6% in 2011. Bank credit has been on an upward trend and the stock market index reached a record high in March 2012, spurred by expectations of better corporate earnings.

Sovereign rating upgrades support the investment outlook. Moody's raised the country's foreign and local currency long-term bond ratings in 2011 from Ba3 to Ba2 (two notches below investment grade), while Fitch lifted the long-term foreign currency rating from BB to BB plus (one notch below investment grade). Standard & Poor's late last year raised the rating outlook to positive from stable (its long-term foreign currency rating is two notches below investment grade).

Fiscal policy is set to be more expansionary in 2012. Budget allocations for social services and infrastructure are up sharply from 2011 (Figure 3.28.8) and the budget deficit target is widened to 2.6% of GDP from last year's actual deficit of 2.0%. The pickup in budget spending that started late last year continued into January 2012, and in that month the government released to its agencies a large portion of the 2012 infrastructure budget, signifying early project implementation.

Monetary policy has been relaxed to support growth. Early in 2012, the central bank cut policy rates by 50 basis points to the low levels set during the 2009 global recession—4.0% for overnight borrowing and 6.0% for overnight lending. It also reduced bank reserve requirements by 3 percentage points, though this was primarily to offset the impact of other changes in the reserve requirements.

The drag on economic growth exerted by weakness in net exports is expected to diminish in 2012. Modest growth is seen for merchandise exports (about 5%), on a pickup in economic growth in the US and Japan (which together take about a third of exports) and solid growth in Southeast Asia (about a sixth). Weakness in Europe and moderating growth in the People's Republic of China (each absorbing about one-eighth of exports) will temper export growth.

Reversing an 8-month slide, exports in January 2012 rose by 3.0% year on year (21% month on month). Electronics exports picked up, and the outlook for semiconductor sales to the US showed improving signs.

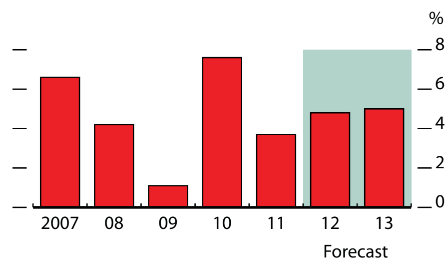
Merchandise imports will likely rise faster than exports, given robust consumer demand and the expected lift in investment. The current

3.28.1 Selected economic indicators (%)

	2012	2013
GDP growth	4.8	5.0
Inflation	3.7	4.1
Current account balance (share of GDP)	2.1	2.3

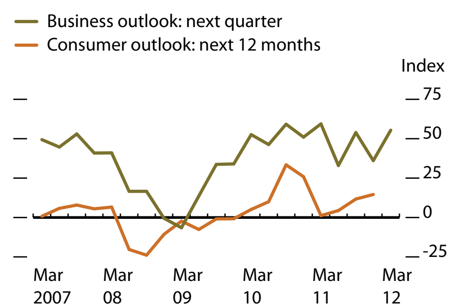
Source: ADB estimates.

3.28.6 GDP growth



Sources: Asian Development Outlook database; National Statistical Coordination Board. http://www.nscb.gov.ph (accessed 1 March 2012).

3.28.7 Confidence indexes



Notes: The consumer (or business) outlook index is computed as the percentage of households (or firms) answering affirmatively less the percentage of households (or firms) answering negatively for a given indicator. A positive index shows a favorable view.

Sources: Bangko Sentral ng Pilipinas. 2012. *Consumer Expectations Survey Fourth Quarter 2011*. December; 2012. *Business Expectations Survey First Quarter 2012*. February. http://www.bsp.gov.ph account surplus is forecast at 2.1% of GDP, after taking into account increases in remittances and income from BPO.

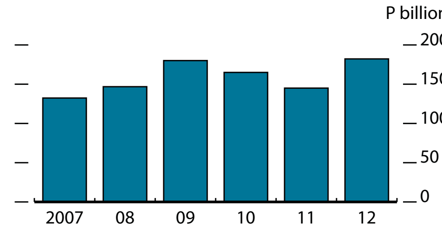
Services will remain the main contributor to growth on the supply side. BPO export revenue rose by an estimated 22% to $11 billion in 2011, and this industry continues to expand. Construction will benefit from the anticipated ramping up of infrastructure projects.

In 2013, GDP growth is projected to quicken to about 5% on expectations of a more favorable external environment and gathering momentum in infrastructure investment.

Inflation is forecast to be lower in 2012 than last year (Figure 3.28.9), assuming global food and oil prices on average change little this year relative to 2011. The peso is expected to be broadly stable against the US dollar.

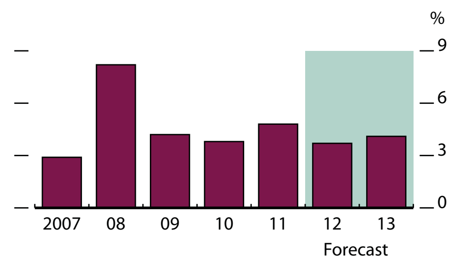
The government aims to rein in the 2013 budget deficit to 2.0% of GDP, which is likely to require a sizable increase in revenue. Thus, in addition to efforts on tax administration, the authorities are seeking higher tax revenue from alcohol and tobacco products and an overhaul of incentives to attract direct investment. Revenue increases are also needed if the country is to achieve key Millennium Development Goals. The Philippines is making slow progress on the goals related to poverty, primary education, and maternal and child health.

3.28.8 Government infrastructure outlays



Source: Department of Budget and Management. Various years. *Budget of Expenditures and Sources of Financing*. http://www.dbm.gov.ph

3.28.9 Inflation



Sources: Asian Development Outlook database; National Statistics Office. http://www.census.gov.ph (accessed 15 March 2012).

Policy challenge—securing inclusive growth

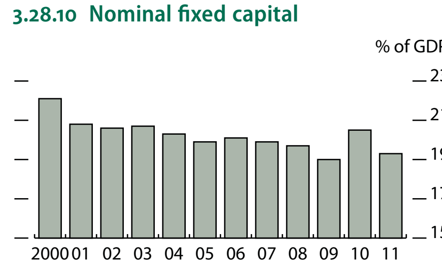
Economic growth in 2000–2011 averaged 4.7%, well above 2.9% in the 1990s and 1.7% in the 1980s. The pickup in growth was driven mainly by private consumption, backed by remittance inflows, and on the production side by services. Inflation has generally been moderate at an average of 5.1% in 2000–2011, and the external position has strengthened. Despite this better performance, however, structural weaknesses have frustrated the achievement of inclusive growth.

Weak link between growth and development. Unemployment and underemployment stayed high in 2011. Many workers are in low-productivity jobs and real average wages have declined. With a Gini coefficient of 45, income inequality is also high. The incidence of poverty fell from 33.1% in 1991 to 24.9% in 2003, but then turned up to 26.4% in 2006 and stayed around that rate in 2009. About 9.5 million Filipinos, or nearly 10% of the population, work abroad because of a lack of good jobs at home.

Rising growth and declining investment. Although growth quickened in 2000–2011, fixed investment as a share of GDP declined to 19% in the most recent years (it was 19.3% in 2011, for example), from slightly above 20% in 2000 (Figure 3.38.10). In Indonesia, by contrast, the investment rate has climbed from about 19% to 32% over the same period.

Limited diversification of exports. Merchandise exports are highly concentrated in electronics (60% of total exports in 2010), particularly semiconductors (about 77% of total electronics exports). This structure makes the economy vulnerable to downturns in global electronics demand and to disrupted electronics production chains, as happened in 2011. Philippine merchandise exports fell in the second half of 2011, while exports generally increased in other Southeast Asian countries.

3.28.10 Nominal fixed capital



Sources: Asian Development Outlook database; National Statistical Coordination Board. http://www.nscb.gov.ph (accessed 1 March 2012).

The root cause—industry has stagnated. The main growth engine of high-performing Asian economies has been dynamic structural transformation: output shifts from low-productivity goods into high-productivity ones, particularly manufactures; labor moves from agriculture to industry; and exports become more diversified. Industry in these economies has maintained productivity gains by upgrading technology and manufactured products. This transformation sustains growth and generates better-paying jobs to reduce poverty.

But in the Philippines, industry's share of GDP declined from 39% in 1980 to 32% in 2011. Manufacturing accounted for just 22.4% of GDP and 8.3% of employment that year. Growth has instead relied on services (Figure 3.28.11), a trend accelerated by rapid expansion of BPO services over the past 7 years (Figure 3.28.12).

Weak growth in industry has suppressed economy-wide labor productivity, which rose by only 10% over the past 30 years (Figure 3.28.13). Labor productivity in services has been less than half that of industry over this period. This implies that, although services has made the greatest contribution to economic growth and job creation, it is not necessarily associated with a rise in high-productivity employment on aggregate.

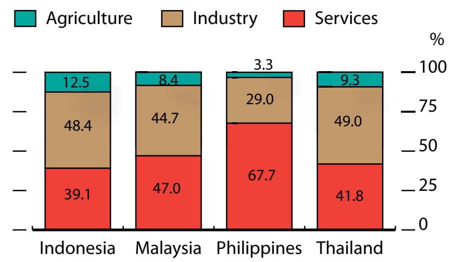
The BPO industry employs only about 1% of the labor force and it hires relatively skilled workers. Given the large, and increasing, number of underutilized workers with moderate skills, it is unlikely that BPO alone can drive inclusive growth.

Underlying reasons for the industrial stagnation can be traced to the 1980s, when global manufacturers relocated production to East and Southeast Asia. They sidestepped the Philippines largely because of domestic political instability. Later success at attracting electronics, mainly assembly work, in the 1990s raised the promise of a deepening of industrial capabilities. However, the electronics industry has not upgraded and diversified its products and its presence has not spurred significant development in fields such as machinery, chemicals, and metals processing, owing to the underprovision of infrastructure (particularly transport networks and electricity supply) and an unfriendly business environment (poor governance, weak contract enforcement and property rights, and cumbersome business regulations).

Policy actions. A first step is to resolve pervasive constraints by accelerating development of the physical, institutional, and social infrastructure; instituting good governance; and improving the business environment.

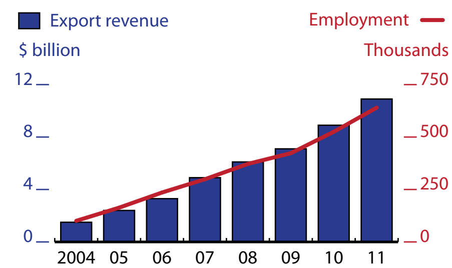
Specifically for industry, the government could consider support for diversification and value addition. Decisions on restructuring, innovation, and product mixes are matters for the private sector. Still, the government can play a strategic and coordinating role in creating incentives for industrial development and providing targeted support for selected products, with benchmarks for success and sunset clauses for phasing out support. Such measures would involve close government–private sector cooperation to identify promising products and to diagnose and address impediments to their development.

3.28.11 Sector contribution to GDP growth, 1980–2010



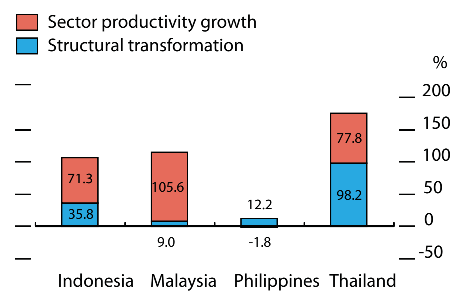
Source: Author's calculations.

3.28.12 Business process outsourcing



Sources: Business Processing Association of the Philippines. 2012. *BPAP 2011 and 2012*. March. http://www.bpap.org; Senate Economic Planning Office. 2010. BPO Industry at a glance. June. http://www.senate.gov.ph

3.28.13 Labor productivity growth, 1980–2009



Source: Author's calculations.