Philippines

Robust private consumption and investment drove economic growth higher in 2013. Strong growth is expected to continue in the forecast period, though moderating from last year. Rehabilitation and reconstruction in areas hit by natural disasters may have a significant impact on the economy in late 2014 or 2015. Inflation is forecast to pick up this year but remain within the central bank’s target range. The challenge is to translate solid economic growth into poverty reduction by generating more and better jobs.

Economic performance

Despite natural disasters that devastated parts of the country in the fourth quarter of 2013, GDP grew by a solid 6.5% in that period, bringing full-year growth to 7.2% (Figure 3.28.1), well above the 4.7% average recorded from 2008 to 2012.

An earthquake of magnitude 7.2 on the Richter scale struck the Central Philippines in October, followed by Super Typhoon Haiyan in November, which left nearly 8,000 people dead or missing and destroyed buildings, infrastructure, and livelihoods in some parts of the Visayas.

Nevertheless, broad-based domestic demand drove economic growth through last year. Private consumption grew by 5.6% and contributed more than half of the increase in GDP. Consumer spending benefitted from growth in employment, largely in services and construction, as well as in remittances from overseas Filipinos, which rose by 8.6% to $25.4 billion, or by 9.4% in peso terms.

Fixed investment increased by 11.7%, accelerating from 2012 and adding significantly to GDP growth (Figure 3.28.2). Construction contributed about one-third of this growth. Encouragingly, investment in machinery and equipment rose by a robust 14.4%. The ratio of fixed investment to GDP improved by nearly 1 percentage point, to 20.2%.

Buoyant government spending was linked in part to legislative elections in May. The government raised spending on infrastructure and social services, including the national health insurance program and conditional cash transfers to poor families. Relief efforts following the natural disasters added to government spending. However, net exports of goods and services fell, acting as a drag on growth.

From the production side, the expansion last year was driven by services, manufacturing, and construction. Services, accounting for 57% of the economy, grew by 7.1% and contributed more than half of the increase in GDP. Strong growth was recorded in retailing, finance, real estate, and business services, which includes business process outsourcing (BPO). Manufacturing expanded by 10.5%, double the pace
of the previous year, as domestic demand strengthened and exports expanded for some industries including processed food, furniture, and chemical products. Construction sustained double-digit expansion, with increases in both the public and the private sector. Industry as a whole contributed more than 40% of GDP growth.

Bad weather contained growth in agriculture to just 1.1% in 2013. Rice production increased slightly, while harvests of maize, coconut, sugar, and banana declined.

Notwithstanding buoyant domestic demand, inflation eased for most of 2013, turning up late in the year when the natural disasters disrupted food supplies (Figure 3.28.3). Soft global commodity prices and a good domestic harvest early in the year helped to contain prices until then. For the year, inflation averaged 3.0%.

With inflation at modest rates, Bangko Sentral ng Pilipinas, the central bank, kept policy interest rates at record lows of 3.5% for the overnight borrowing rate and 5.5% for the overnight lending rate. Low interest rates, buoyant economic growth, strong remittances, and capital inflows fueled the rapid expansion of domestic liquidity, accelerating growth in broad money (M3) to 32.7% in December, the fastest rate since 2002. Actions by the central bank to encourage a shift of funds out of its special deposit accounts into lending for productive purposes added to liquidity. Lending to the private sector increased by 17.3%.

Faster growth in government revenue than in expenditure narrowed the fiscal deficit to 1.4% of GDP from 2.3% in 2012 (Figure 3.28.4). Revenue increased by 11.8%, getting a lift from higher taxes on alcohol and tobacco and from stronger tax enforcement. The ratio of tax collection to GDP improved to 13.3%. Expenditure, excluding interest payments, rose by 6.3%, with nearly one-third channeled to infrastructure.

Merchandise exports fell by 3.6% in US dollar terms last year, largely due to a slump in semiconductors, which comprise one-third of the total. Exports turned up slightly in the fourth quarter. Imports fell by 3.1% in US dollar terms, reflecting weak demand for electronic components for processing, while imports of consumer and capital goods rose.

A narrower trade deficit, coupled with higher inflows from remittances, BPO, and tourism, raised the current account surplus by 35.6% to $9.4 billion, equivalent to 3.5% of GDP (Figure 3.28.5). Net inflows of foreign direct investment rose to $3.9 billion, improving from an average of $2.0 billion over recent years but still low by the standards of other major Southeast Asian countries. Portfolio investment inflows fell. Gross international reserves were little changed at $83.2 billion, providing a high 11.5 months of import cover.

Along with other Southeast Asian currencies, the peso weakened when the US reported it would reduce its monetary stimulus. It depreciated by 7.6% against the US dollar over 2013.

**Economic prospects**

Relatively high rates of economic growth are projected over the forecast period, though easing from the fast pace in 2013. GDP growth is forecast at 6.4% in 2014 and 6.7% in 2015 (Figure 3.28.6).
Signs are positive for continued growth in investment. Improved business confidence and rising inflows of foreign direct investment will support private investment. Confidence has been reinforced by the achievement last year of investment grade sovereign credit ratings and improvements in several global competitiveness indices. For example, the Philippines’ ranking in the World Bank’s Doing Business survey jumped by 30 places to 108th of 189 economies in 2013.

Other positive indicators for investment are sustained expansion in credit to businesses, increased investment in machinery and equipment, and a buoyant stock market, backed up by rising corporate earnings.

Private consumption will continue to benefit from remittance inflows and positive consumer sentiment, though higher inflation and interest rates will likely dampen the pace of growth in consumer spending. Remittances rose by 6.8% in January, easing after the year-end holiday season (Figure 3.28.7).

The pace of increase in government spending is also expected to ease from 2013. That trend started late last year when government spending slowed after the elections and government agencies appeared to become more cautious about disbursing funds in response to a public outcry over allegations of misuse of some government funds. This issue has continued into 2014. The government targets a budget deficit of 2.0% of GDP in 2014.

Reconstruction and rehabilitation in areas hit by the natural disasters may not have a significant impact on the economy until late in 2014 and 2015. The direct and timely transfer of national government resources to local governments and affected communities has been hindered by highly centralized national government systems. Also, regional and local administrations have limited capacity to implement reconstruction and rehabilitation programs. These matters are being addressed, which could accelerate work in the affected areas.

The damaged regions contributed 17% of GDP in 2010–2012, with Eastern Visayas, the worst hit, accounting for 2.5% of GDP.

From the production side, manufacturing is expected to perform well during the forecast period, underpinned by robust domestic demand and an improvement in exports as demand picks up in the US and the euro area. Manufacturing production indices continued to expand through January with gains in chemicals, furniture and fixtures, rubber and plastic products, and transport equipment. Sustained growth in credit to manufacturers, rising by 12.7% year on year in January, and high manufacturing capacity utilization bode well for investment in manufacturing (Figure 3.28.8).

Construction is forecast to remain buoyant, though the rapid growth in building approvals seen in recent years started to cool in 2013. Private investment focuses on offices, shopping malls, and housing, where demand is strong. The government raised its infrastructure budget in 2014 to the equivalent of 3.0% of GDP for projects such as constructing national roads and bridges, rail systems, and ports to provide better access to the provinces.

Growth in services will be driven by consumption spending and the expansion of BPO and tourism. Tourist arrivals rose by 10.0% to 4.7 million in 2013 with revenue up by 15.1% to an estimated $4.4 billion.
The government aims to attract 6.8 million tourists in 2014 and 10.0 million by 2016, and it has liberalized aviation policy and removed two taxes on international airlines to spur growth.

BPO revenue rose by an estimated 16% to $15.5 billion in 2013, and the number of full-time employees in the industry reached 900,000.

Inflation in the first 2 months of 2014 quickened to 4.2% as bad weather drove up food prices. It is forecast to average 4.3% in 2014, increasing from 2013 on the impact of last year's natural calamities on food supplies, rising domestic demand, and expected increases in utility tariffs (Figure 3.28.9). Peso depreciation from last year will push up import prices. In 2015, inflation is seen abating to 4.0%, assuming softer global commodity prices.

There is, however, a risk that inflation expectations could build if M3 liquidity continues to surge; it accelerated by 38.6% in January 2014 (Figure 3.28.10). The central bank increased the bank reserve requirement effective April 2014 to guard against the risks from strong liquidity growth and rapid credit expansion.

As inflation is projected to be within the central bank's target range of 3%–5% in 2014 and 2%–4% in 2015, monetary stance could remain accommodative to economic growth, though policy rates will probably be nudged up from record lows.

In light of the uptrends in consumption and investment, imports of goods and services are likely to rise relatively strongly, outpacing export growth. This is reinforced by the import intensity of electronics, the main export products. Consequently, declining net exports are expected to restrain economic growth.

Current account surpluses are projected to ease as a ratio to GDP during the forecast period. Merchandise exports picked up in late 2013 and, though they decelerated in January 2014, still grew by 9.3% (Figure 3.28.11). For 2014 as a whole, merchandise exports are expected to increase by 8.2% in US dollar terms, but imports are likely to rise by 9.4%.

A risk to the outlook comes from the possible impact on investment of national elections scheduled for May 2016. Investors could become increasingly cautious until the new government clarifies policy directions. Steady progress on reform will be important to sustaining market confidence.

A trend of improved fundamentals over several years has strengthened the economy’s resilience to shocks. The current account has been in surplus since 2003. Total external debt as a share of GDP has been on a downtrend since 2003, to 21.5%. Fiscal and debt consolidation give the government greater flexibility to respond to downturns. Public debt has fallen steadily since 2008 to reach in December 2013 the equivalent of 49.2% of GDP, and the government has sourced its financing largely from domestic sources. Finally, the banking system’s capital adequacy ratio is well above 10%, and nonperforming loans remain low at about 3% of all loans.

Policy challenge—generating more and better jobs

While economic expansion has exceeded 6% in the past 2 years, it has not generated enough jobs to reduce poverty (Figure 3.28.12).
The unemployment rate rose to 7.5% in January 2014 from 7.1% in January 2013, and the rate of underemployment remained elevated at 19.5%. The youth unemployment rate stood at 17.3%, up from 16.8% a year earlier and more than double the unemployment rate for the workforce as a whole. Improving the quality of jobs also remains a challenge, as nearly 40% of the workforce is in the informal sector or in vulnerable employment (Figure 3.28.13).

Reflecting the lack of good jobs, the poverty rate was 25.2% in 2012, only a small improvement on 26.3% in 2009. Persistent poverty has hindered progress toward achieving Millennium Development Goals relating to maternal health and primary education.

In an update to its development plan for 2010–2016, the government has heightened the emphasis on employment generation and poverty reduction. Its goals are to cut the unemployment rate to 6.5%–6.7% and underemployment to 17.0% by 2016, and to reduce poverty to 18.0%–20.0% by that year.

The government’s strategy is to raise public investment on infrastructure, agriculture, education, and health, while improving the investment climate and expanding manufacturing. Public–private partnership is a key strategy to raising investments and enhancing competitiveness. Poor infrastructure is a nagging constraint on investment. The Philippines ranks behind most major Southeast Asian countries in terms of infrastructure.

Although manufacturing grew at a brisk pace last year, it accounts for a small share of GDP and employment compared with other major economies in the subregion. A stronger manufacturing industry would generate more and better jobs, and manufacturing linked to agriculture would enable the poor in rural areas to rise out of poverty. Manufacturing sector roadmaps are being prepared by the private sector and the government to identify constraints on growth in manufacturing and decide what type of support would address them.

The government is also improving its approach to poverty reduction by adjusting interventions in accordance with local socioeconomic conditions. Provinces are categorized in terms of resource endowments, sector growth, and employment opportunities to ensure that government policies are well targeted. The strategy takes into consideration which areas are prone to disasters and how to make them more resilient. The poverty rate in the Eastern Visayas was a very high 45.2% even before the region was battered by Typhoon Haiyan.

Progress achieved in the Bangsamoro agreement, a roadmap for a political settlement between the government and the Moro Islamic Liberation Front (MILF), should unleash development on the large southern island of Mindanao, where poverty is worse than in the central Visayas or on the large northern island of Luzon. The government and the MILF signed the Comprehensive Agreement on the Bangsamoro in March 2014, which includes agreements such as those on revenue and wealth sharing, power sharing, and transitional arrangements. The government aims to have the Bangsamoro basic law approved by 2016.