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Monitoring the Philippine Economy Year-End Report for 2016

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Monitoring the Philippine Economy Year-End Report for 2016

Growing at 6.9% in 2016, the Philippine economy realized robust full-year forecasts despite tapering external demand and extreme weather changes.

Economic performance: Domestic consumption and capital formation drove demand-side growth while services and industry sectors lead supply-side growth.

Philippine economic growth topped regional performance for 2016. In line with election-year market expectations, annual growth accelerated to 6.9% from 6.0% in 2015, surpassing China (6.7%) and Vietnam (6.2%). Despite global economic slowdown, Philippine growth has continuously improved since 2015, showing resilience to external shocks with the expansion of manufacturing. On the demand side, household consumption and investments flourished with modest inflation and strong imports. On the supply side, the industry sector led as the service sector slowed down. Meanwhile, the agriculture sector continues to contract with the onslaught of weather disruptions like typhoons Karen and Lawin.

Major components of aggregate demand

Private consumption steadily rises. Comprising almost 70% of GDP, household consumption grew by 6.9% from 6.3% in 2015 while the inflation rate stayed low at 1.8%. High consumer spending leads to an optimistic outlook for business activities, boosting prospects for higher incomes and more employment to further reduce the current unemployment rate below 5.2%. To support rising household consumption, steady remittances rose to 4.9%, reaching US$29.7 billion. Moreover, fiscal expenditure increases of 8.3% for social programs, for example, education, health, and conditional cash transfers, and salary hikes, bolstered consumption.

Investments expand and outpace consumption. Fixed capital formation posted a 24.5% growth, with construction growing at 15.2%, and durable equipment at 35.5%. For construction, public investment grew at 29.0% while private investment rose to 9.5%. Outlays for durable equipment, infrastructure, and inventories spurred such private investments.

Fiscal spending remains stable. Government consumption maintained its 8.2% growth in the previous year. There were visible and large disparities between quarterly periods of fiscal spending, resulting from reduced maintenance spending. However, fiscal spending is planned to increase in line with the medium-term

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[1] Report is based on latest available data as of March 15, 2017. For comments and questions, please email mitzie.conchada@dlsu.edu.ph

goals set forth by the Philippine Development Plan 2017-2022 and the administration.

Strong imports boost trade growth by end of 2016. Imports accelerated by 17.5% growth against the meager exports rise of 9.1%; however, export earnings—especially **from exports** to China and Taiwan—**reached a total of US$56.3 billion** in December due to major commodity growth. December imports payments, on the other hand, jumped to US$80.8 billion from expanding demand. In sum, full-year trade reached US$137.4 billion fueled by imports of capital, consumer and intermediate goods, and exports of agro-based mineral, petroleum, and manufactured products.

Major components of aggregate supply

In this report, we present results from an alternative to the "traditional" (TRAD) method of decomposing growth of GDP in constant prices into sector contributions. This alternative method is a "generalized" (GEN) growth decomposition that applies to GDP in constant prices (e.g., in the Philippines) and to GDP in chained prices (e.g., in Canada and the US). While TRAD recognizes only "quantity" growth as the source of a sector's contribution to GDP growth, GEN posits that a sector's contribution comes from "quantity" growth and from "real price" growth where this price is, by definition, the ratio of a sector's deflator to the overall GDP deflator. The GDP deflator as the common denominator of the above ratio makes real GDP the numeraire and, thus, this ratio is the relative price or exchange value of the GDP of a sector in "GDP units," that is, the "real price" of a sector's GDP. Therefore, a sector's positive "quantity" growth contribution will be diminished if accompanied by a negative "real price" growth of the same sector that may even result in a negative net contribution by the sector to GDP growth. On the other hand, a sector's positive "quantity" growth contribution will be enhanced if accompanied by a positive "real price" growth (see Table 3).[2]

Services sector grows sturdily. Services sector comprise over half of GDP and employment and displayed a 7.5% growth, higher than 6.9% from 2015. The sector thus contributed 4.8 percentage points to annual GDP growth from the supply side. Retail trade, BPOs, tourism, financial services, and real estate subsectors posted the strongest growth.

Industry sector sustains higher growth. The industry sector grew by 8.4%, higher than 6.4% in the previous year. Mining and quarrying suffered a negative 0.3% rate of growth, likely because of DENR suspension of mining firms. Manufacturing remarkably expanded to 7.0% from 5.7% in 2015 where strong domestic demand for petroleum products and transport equipment boosted output gains from robust manufacturing. In December, the Volume of Production Index increased to 23% from 5% in the same month of 2015. Construction rose to 12.6% where public construction grew by an astounding 29.0% from 19.0% in 2015. Finally, electricity, gas, and water supply rose to 9.6%.

Agriculture sector suffers further. Drought and typhoons sheared agricultural growth to negative 1.3%, lowering its 10.3% share of GDP in 2015 by over half a percent in 2016. The subsectors of forestry and fishing continue to underperform. As the National Economic and Development Authority recommended, the government must protect the agriculture sector with capacity building investments and appropriate labor policies for the impoverished farmers.

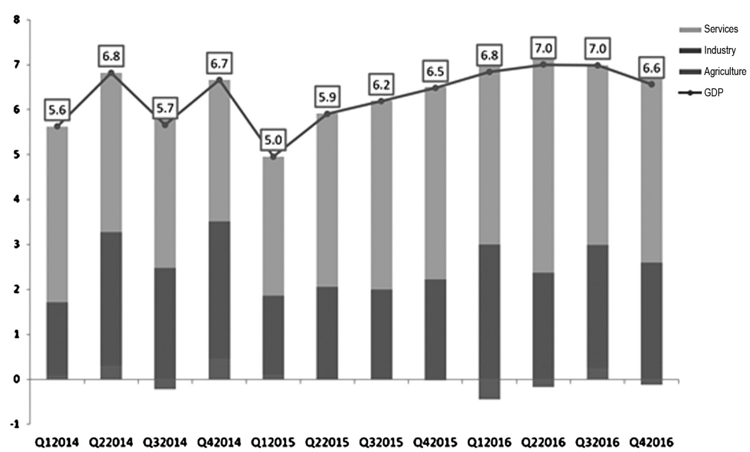

***Figure 1*. Contributions to GDP growth (y-o-y, %) from aggregate supply.**
Source: Author's calculations based on data in Table 2.

[2] The results in Table 3 are AKI-DLSU Philippine Economic Monitor calculations by applying the data in Table 1 to a "generalized" (GEN) exactly additive decomposition of GDP growth into pure growth effect (PGE) and price change effect (PCE) as an alternative to the "traditional" (TRAD) GDP growth decomposition. Analytically, PGE is the result of real GDP or "quantity" growth holding real price constant and PCE is the result of relative price or "real price" growth holding quantity constant. The GEN formulas for PGE and PCE and the TRAD formula are given, respectively, by equations (12), (13), and (17) in Dumagan (2016.). This alternative framework follows from the decomposition of "aggregate labor productivity" (ALP) growth in Dumagan (2013), where ALP is the ratio of GDP to total labor employment. Thus, by removing the labor variable, the decomposition of ALP growth in the latter paper yields the decomposition of GDP growth into PGE and PCE in the former paper which is implemented in Table 2.

Challenges facing the economy

Peso-dollar exchange rate average depreciates (Banko Sentral ng Pilipinas [(BSP], 2017b). Over monthly averages in 2016, the peso weakened by 4.2% to ₱47.49/US$ from the previous 2015 average of ₱45.50/US$1. The cause for such depreciation and volatility can be plausibly traced to local developments and global uncertainties as well as the US Fed rate hike in December 2016.

Sentiment in the global economy remains volatile, prompting caution. With election results in the US and the expected slowdown in China's growth, economies are wary that this would affect adversely exchange rates as well as prices of export products. With sluggish economic recovery going on in the euro area as well as in Japan, the Philippines prepares itself for the possible negative effects by strengthening its domestic economy.

Weather-related risk remains an obstacle to development plans. Over the current administration, the economy is expected to expand by 50% in real terms. This results in per capita income rising by over 40% and poverty dropping to 14%, lifting 6 million Filipinos above poverty. However, extreme weather changes like El Niño and sudden typhoons debilitate the agricultural sector, which is key to improving food security and lowering food costs especially for the poorest of the population. More investments to enhance the agriculture sector's resiliency to severe weather conditions are imperative.

Other economic news

BSP (2017a) maintains monetary policy settings. Modest inflation at 1.8% was higher than 1.4% in 2015 and lower than the BSP's target range of 2%–4%. Monetary policy remains static wherein the overnight reverse repurchase rate stayed at 3.0%. The decision comes due to transitory supply-side influence on domestic price movements instead of monetary policy influence. Meanwhile, the PSEi closed lower in 2016, down 1.6% from 2015.

Headline inflation rises but remains below target[4]. Year-on-year inflation averaged 1.8%.Food scarcity played a role due to weather disruptions in the supply chain while food inflation was unchanged at 2.6% and rice inflation turned negative. On the other end, non-food inflation rose to 0.9% from 0.5% in 2015. Additionally, domestic oil prices rose due to higher world prices.

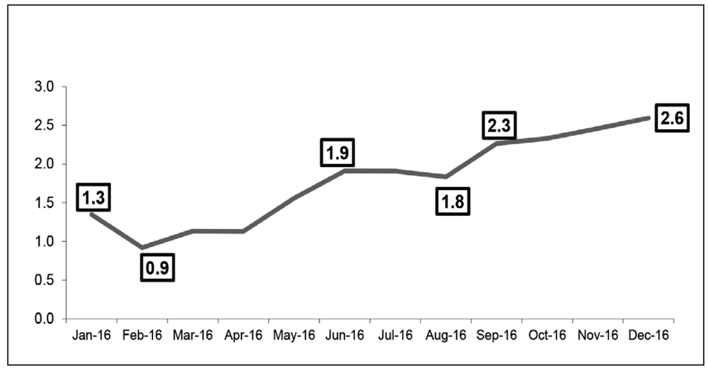

***Figure 2*. Consumer price index (y-o-y, %).**
Source: Graph prepared by author based on Philippine Statistics Authority data.

Remittances surged in November (Lopez, 2017) and December (Caraballo, 2017) 2016. Cash remittances in November surged at its fastest pace in over eight years while December posted a new high. This brought the 2016 tally above the BSP's target. In November, remittances reached US$2.2 billion, rising 18.5% from US$1.9 billion in 2015. In December, remittances reached US$2.6 billion, growing 3.6% from US$2.5 billion last year. The December remittances originated from land-based OFWs, particularly from Asia, the Americas, and the Middle East. This is expected to offset the decline recorded in Europe.

Philippine Development Plan 2017-2022 is close to completion (Pernia, 2017). The National Economic and Development Authority provides medium-term priorities of the Duterte administration based on the results of the nationwide survey *AmBisyonNatin 2040* as follows: infrastructure development, human capital investment, regional development, social protection and humanistic governance, a high-trust society, resilient communities, and a globally competitive knowledge economy.

Table 1
Philippine Economic Indicators

Philippines Economic Data												
Monthly Leading Indicators	**Jan-16**	**Feb-16**	**Mar-16**	**Apr-16**	**May-16**	**Jun-16**	**Jul-16**	**Aug-16**	**Sep-16**	**Oct-16**	**Nov-16**	**Dec-16**
Industrial Production (y-o-y, %)	35.8	11.6	8.2	10.8	8.2	10.8	13.4	15.3	11.8	10.5	15.1	23.0
Consumer Price Index (y-o-y, %)	1.3	0.9	1.1	1.1	1.6	1.9	1.9	1.8	2.3	2.3	2.5	2.6
Exports (y-o-y, %)	-3.9	-4.5	-15.1	-4.1	-3.8	-11.4	-13.0	-3.0	5.1	7.6	-7.5	6.3
Imports (y-o-y, %)	20.5	-5.6	11.7	29.8	39.3	15.4	-1.7	12.2	13.5	5.9	19.7	13.8
Trade Balance, US$ million	-2,638	-1,104	-1,747	-2,306	-2,021	-2,098	-2,058	-1,952	-1,890	-1,983	-2,566	-2,158
Total Reserves (less gold), US$ billion	73.65	74.06	75.21	75.58	75.26	76.95	77.00	77.53	77.83	76.98	74.05	73.43
Policy Rate	4	4	4	4	4	3	3	3	3	3	3	3
Fiscal Balance (million pesos)	-3,474	-34,626	-74,388	55,022	-17,656	-45,194	-50,667	32,607	-75,327	-2,345	-19,145	...
Quarterly/Annual Economic Indicators	**2011**	**2012**	**2013**	**2014**	**1Q2015**	**2Q2015**	**3Q2015**	**4Q2015**	**1Q2016**	**2Q2016**	**3Q2016**	**4Q2016**
Real GDP (y-o-y, %)	3.6	6.8	6.9	6.1	5.1	6.0	6.4	6.7	6.9	7.1	7.1	6.6
- Private Consumption	5.7	6.6	5.6	5.4	6.0	6.4	6.2	6.6	7.1	7.5	7.2	6.2
- Government Consumption	2.1	12.2	8.1	1.7	0.0	2.2	15.5	15.5	11.8	13.5	3.1	4.5
- Gross Capital Fixed Formation	2.0	-3.2	27.3	5.4	15.7	28.6	15.3	16.2	31.5	30.3	21.7	14.7
Current Account (% of GDP)	2.3	2.8	4.2	4.4	3.2	3.1	0.1	4.8	1.1	0.2	1	1.2
Financial Account (US$ million)	-5,610	-6,748	2,230	10,084	152	1,258	-291	1,404	955	-910	849	54
- Net Direct Investments, US$ million	-1,277	958	-90	789	358	-476	-11	7	-1,049	-969	-387	-1,829
- Net Portfolio Investments, US$ million	-4,390	-3,205	-1,001	2,460	-459	3,375	2,202	-361	1,446	880	-634	-309
Overall BOP position (US$, million)	11,400	9,236	5,085	-2,858	877	807	124	809	-210	843	1,014	-2,068
Unemployment rate	7.4	7.0	7.1	6.8	6.4	6.5	5.6	5.8	5.8	5.4	4.7	4.7
Others	**Jan-16**	**Feb-16**	**Mar-16**	**Apr-16**	**May-16**	**Jun-16**	**Jul-16**	**Aug-16**	**Sep-16**	**Oct-16**	**Nov-16**	**Dec-16**
Overseas Filipinos' Remittances (US$, million)	1,997	2,098	2,362	2,213	2,188	2,334	2,131	2,319	2,383	2,099	2,217	2,559
... = not available												

Source: Bangko Sentral ng Pilipinas (2017), Philippine Statistics Authority (2017), and Asian Development Bank (2017)

Table 2
Level of Philippine GDP, 2015– 2016

	Nominal GDP (million current pesos)		Real GDP (million constant 2000 pesos)	
	2015	2016	2015	2016
Agriculture and Forestry	1,173,088	1,212,818	591,269	587,555
Fishing	193,778	184,796	128,473	122,955
Mining and Quarrying	108,109	114,317	80,500	83,112
Manufacturing	2,669,222	2,844,927	1,760,989	1,884,320
Construction	904,510	1,049,671	456,932	519,697
Electricity Gas and Water Supply	434,181	455,538	246,990	271,218
Transport Communication and Storage	856,051	913,100	581,289	615,583
Trade and Repair of Motor Vehicles Motorcycles Personal	2,412,096	2,643,389	1,270,526	1,362,635
Financial Intermediation	1,063,668	1,164,718	546,714	588,169
Real Estate Renting & Bus. Actvt	1,698,079	1,898,897	854,747	930,555
Public Administration & Defense: Compulsory Social Security	512,992	575,693	297,449	318,900
Other Services	1,296,268	1,422,855	784,297	841,704
Sum = GDP	13,322,041	14,480,720	7,600,175	8,126,403

Source: Philippine Statistical Authority, 2017

Table 3
Industry Contributions to Philippine GDP Growth, 2016

	TRAD GDP Growth (percent)	PGE (percent)	PCE (percent)	GEN GDP Growth (percent)
		(1)	(2)	(1)+(2)
GDP Growth	**6.92**	**6.98**	**0.03**	**6.92**
Industry Growth Contribution				
Agriculture	**-0.12**	**-0.12**	**0.18**	**0.06**
Agriculture and Forestry	-0.05	-0.06	0.21	0.15
Fishing	-0.07	-0.06	-0.03	-0.09
Industry	**2.80**	**2.68**	**-0.61**	**2.07**
Mining and Quarrying	0.03	0.03	0.01	0.03
Manufacturing	1.62	1.40	-0.43	0.97
Construction	0.83	0.93	0.03	0.96
Electricity Gas and Water Supply	0.32	0.32	-0.22	0.10
Services	**4.24**	**4.42**	**0.38**	**4.80**
Transport Communication and Storage	0.45	0.38	-0.06	0.32
Trade & Repair of Motor Veh., Cycles, Personal, & House. Goods	1.21	1.31	0.10	1.41
Financial Intermediation	0.55	0.61	0.01	0.62
Real Estate Renting & Bus. Actvt	1.00	1.13	0.14	1.27
Public Administration & Defense: Compulsory Social Security	0.28	0.28	0.12	0.40
Other Services	0.76	0.71	0.06	0.78

Source: DLSU-AKI Philippine Economic Monitor calculations by applying the data in Table 2 to a "generalized" (GEN) exactly addtive decomposition of GDP growth into pure growth effect (PGE) and price change effect (PCE) as an alternative to the "traditional" (TRAD) GDP growth decomposition. The GEN formulas for PGE and PCE and the TRAD formula are given, respectively, by equations (12), (13), and (17) in Dumagan (2016). Analytically, PGE is the result of real GDP or "quantity" growth holding real price constant and PCE is the result of relative price or "real price" growth holding quantity constant. This alternative framework follows from the decomposition of "aggregate labor productivity" (ALP) growth in Dumagan (2013), where ALP is the ratio of GDP to total labor employment. Thus, by removing the labor variable, the decomposition of ALP growth in the latter paper yields the decomposition of GDP growth into PGE and PCE which is implemented in this Table 3.

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