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Angelo King Institute
for Economic and Business Studies

Monitoring the Philippine Economy Second Quarter Report for 2016

Project of Angelo King Institute

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Second quarter growth expanded 7.0 percent from 5.9 percent the previous year.

Economic performance: second quarter growth was led primarily by investments and domestic consumption on the demand side and services sector on the supply side.

- **Philippine economic growth sustains upward momentum.** Second quarter growth increased to 7.0 percent from 5.9 percent the previous year. Both the demand and supply sides posted positive growth. Private investment exhibited an impressive 27.6 percent growth from 21.4 percent last year. On the other hand, the services sector posted an 8.4 percent growth, an improvement from last year's 6.7 percent growth.
- **Major components of aggregate demand**
 - **Durable equipment and public construction boost domestic investment.** Second quarter private investment growth surged to 27.6 percent from 21.4 percent the previous year. The growth was primarily led by investments in public construction (27.9 percent) and durable equipment (42.8 percent). This was strengthened by the sector Intellectual Property Products' recovery, registering a 40.0 percent growth in the second quarter from negative 8.8 percent the previous year.
 - **Private consumption expands on higher food and non-food expenditures.** Household consumption outperformed its 6.4 percent growth the previous year to 7.3 percent this year. This was a result of low inflation and interest rates as well as vibrant labor market conditions. Aside from food items, transport, miscellaneous goods and services, and housing and utilities were considered top contributors with growth rates of 10.7 percent, 7.8 percent, and 6.0 percent respectively.
 - **Fiscal spending exhibits double-digit growth.** Government consumption surged to 13.5 percent from 2.4 percent the previous year mainly from the implementation of social programs as well as public projects namely the Inclusive Partnership for Agricultural Competitiveness, Metro Manila Flood Management, Metro Manila Bus Rapid Transit, and Ninoy Aquino International Airport PPP, among others.

¹ Report is based on latest available data as of September 18, 2016. For comments and questions, please email mitzie.conchada@dlsu.edu.ph

- **Trade balance contracts on depressed external demand.** In June, the PSA² reported export sales amounted to USD4.8 billion, a 11.4 percent decrease from the previous year due to weaker demand, especially for mineral products (-41.1%), machinery and transport equipment (-31.6%), other manufactures (-26.1%). Total exports from January to June for merchandise dropped 7.5 percent. On the other hand, import purchases registered a total of USD6.9 billion, mainly of semiconductors (52.8 percent), transport equipment (38.5 percent), and electronic data processing (43.3 percent). Trade balance by end of June registered a negative USD2.1 billion.

- **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 also 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,” i.e., 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 2).³

- **Services sector strengthens its position as top contributor to growth.** Services remained the main driver of supply-side growth and grew at 8.4 percent in the second quarter (Table 1). To the total GDP growth of 7.0 percent, services contributed 5.5 percentage points (Table 2) from 5.1 percentage points of quantity growth (PGE) and 0.4 percentage points of relative price change effects (PCE).

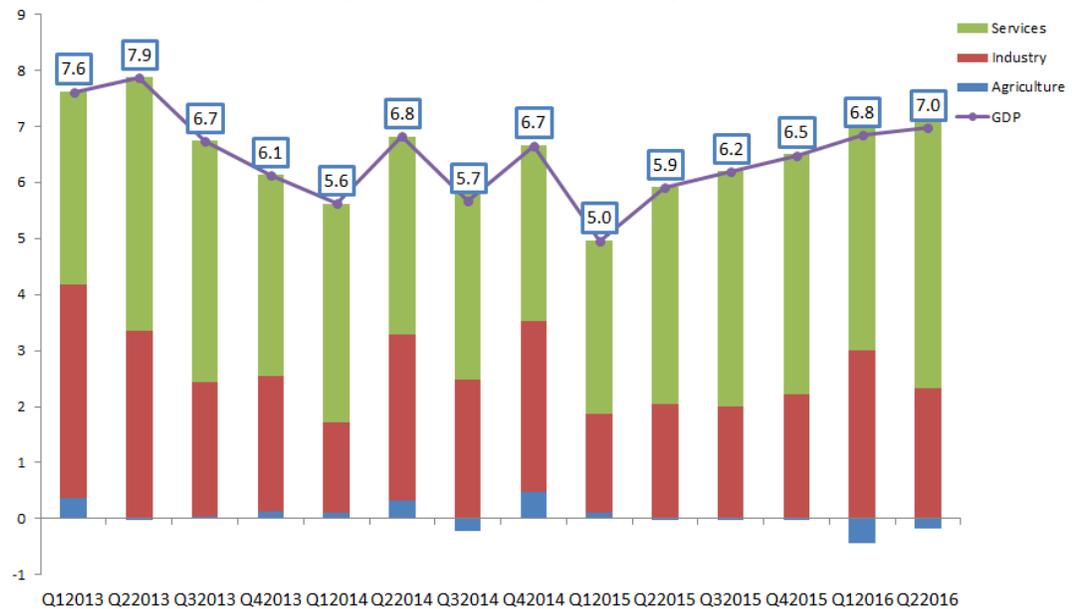
² <https://psa.gov.ph/content/merchandise-export-performance-june-2016>

³ The results in Table 2 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, Jesus C. (2016), “Effects of Relative Prices on Contributions to the Level and Growth of Real GDP,” Working Paper Series No. 2016-036, Angelo King Institute for Economic and Business Studies, De La Salle University, Manila. This alternative framework follows from the decomposition of “aggregate labor productivity” (ALP) growth in Dumagan, Jesus C. (2013), “A Generalized Exactly Additive Decomposition of Aggregate Labor Productivity Growth,” *Review of Income and Wealth*, 59 (Issue 1): 157-168, 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.

Major contributors include trade and repair of motor vehicles (1.7 percentage points), real estate (1.3 percentage points), and other services (1.1 percentage points).

- Industry sector maintains upward trend.** The industry sector accelerated to 6.9 percent in the second quarter (Table 1) and contributed 1.5 percentage points to total GDP growth (Table 2). Manufacturing, which grew by 6.3 percent, remained the top contributing sector, contributing 0.8 percentage points to total GDP growth. The construction sector followed closely with a contribution of 0.7 percentage points.
- Agriculture sector growth remains weak.** The agricultural sector contracted 0.2 percent in the second quarter due mainly to the continuing effect of El Nino. To the total GDP growth, agriculture contributed a negative 0.02 percentage points (Table 2). According to the PSA, palay, mango, corn and other crops suffered the biggest decline while livestock, agricultural activities and services, sugarcane and poultry cushioned the industry's decline.

Contributions to GDP growth (y-o-y, %) from Aggregate Supply



Source: Author's calculations based on Philippine Statistics Authority data

Challenges facing the economy

- Peso-dollar exchange rate appreciates.** The average exchange rate at the end of June was Php 46.46⁴, an appreciation against the US dollar. On a quarterly outlook, the peso strengthened by 1.7 percent. On an annual comparison, however, the peso depreciated by 4.0 percent. The recovery of the peso during the review quarter was due to protracted uncertainty on the pace of interest rate hike

⁴ <http://www.bsp.gov.ph/statistics/keystat/day99.htm>

this year and concerns on the Brexit which drove fund flows to emerging markets, e.g. the Philippines.⁵

- **Stock market trending high⁶.** With lifting regional market stimulus hopes, the Philippine Stock Exchange index (PSEi) gained 12.12 points or 0.15 percent to close at 7,956.14, a fifth straight session growth to close the second quarter in June. Value e turnover for the day amounted to Php 8.21 billion with 121 advancers that edged out 73 decliners while 48 stocks were unchanged. The PSEi's rise was led by AGI and MPI, which both rose by over 2 percent. GTCAP and Megaworld both gained over 1 percent.

Other economic news

- **BSP maintains monetary policy settings; undertakes operational adjustments in monetary operations.** The Bangko Sentral ng Pilipinas (BSP) decided to maintain its key policy interest rate for the overnight reverse repurchase or RRP facility at 4.0 at the start of the second quarter but changed it to 3.0 in June. This is part of the shift to an Interest Rate Corridor (IRC) system in June. The IRC is a system for guiding short-term market rates towards the BSP policy interest rate which is the overnight reverse repurchase rate and consists of the following instruments: overnight lending facility, overnight deposit facility, overnight reverse repurchase rate facility, and term deposit action facility⁷. The interest rates for other monetary policy instruments and reserve requirement ratios were kept steady.
- **Inflation remains manageable in June.** Second quarter inflation ended at 1.9 percent slightly higher than the first quarter. This was due mainly to an upward trend in the prices of fuel, light and water as well as food and beverages. Despite the upward trend, inflation is expected to remain manageable and well within the target of the BSP.

Consumer price index (y-o-y, %)



Source: Graph prepared by author based on Philippine Statistics Authority data.

⁵ <http://www.bsp.gov.ph/downloads/Publications/FAQs/exchange.pdf>
⁶ <http://business.inquirer.net/211869/psei-closes-at-2016-high>
⁷ <http://www.bsp.gov.ph/publications/media.asp?id=4063>

- **Remittances growth accelerates in June.** Cash remittances in June rose 4.8 percent over the same month last year and reached USD2.3 million. Total remittances at the end of the second quarter reached USD13.2 million, mainly coming from land-based workers.
- **Philippines will likely weather Brexit effects but cannot be complacent.** The move by the United Kingdom to leave the European Union via referendum has plunged the world into uncharted waters. While Brexit will have no direct effect on Philippine debt structure, the national government debt may be indirectly affected due to loan denominations from the US dollar, Japanese Yen, and Euro. Lastly, remittances may be inversely and indirectly affected.
- **National Economic and Development Authority prepares for Philippine Development Plan 2017-2022⁸.** In the view of the new administration, the aim is to build (1) a high trust society, (2) a smart and innovative society, (3) a healthy society with life expectancy at birth of at least 80 years, (4) a prosperous, predominantly middle-class society where no one is poor, and (5) a people-centered vision that leads to people-centered policies. Such plans are expected to complement existing macroeconomic policies and fundamentals.

⁸ <http://www.pagba.com/wp-content/uploads/2016/07/Crafting-the-First-Medium-Term-Filipino-Development-Plan-2017-2022.pdf>



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Philippines Economic Data												
Monthly Leading Indicators	Jul-15	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-16
Industrial Production (y-o-y, %)	-0.2	2.2	3.1	1.6	4.2	4.7	35.8	11.6	8.0	10.9	6.8	10.3
Consumer Price Index (y-o-y, %)	0.8	0.6	0.4	0.4	1.1	1.5	1.3	0.9	1.1	1.1	1.6	1.9
Exports (y-o-y, %)	-1.8	-6.3	-15.5	-10.8	-1.1	-3.0	-3.9	-4.5	-14.2	-2.8	-3.8	-11.4
Imports (y-o-y, %)	23.0	5.7	8.2	16.9	11.4	-16.7	30.8	1.2	23.9	39.2	53.4	15.8
Trade Balance, US\$ million	-1,519	-1,048	-1,316	-1,944	-977	604	-2,638	-1,104	-1,747	-2,306	-2,021	-2,099
Total Reserves (less gold), US\$ billion	73	73	74	74	73	74	74	74	75	76	75	77
Policy Rate	4	4	4	4	4	4	4	4	4	4	4	3
Fiscal Balance (million pesos)	-32,198	15,040	-22,140	-27,022	6,029	30,400	-3,474	-34,626
Quarterly/Annual Economic Indicators	2012	2013	1Q2014	2Q2014	3Q2014	4Q2014	1Q2015	2Q2015	3Q2015	4Q2015	1Q2016	2Q2016
Real GDP (y-o-y, %)	6.8	6.9	5.6	6.8	5.7	6.7	5.0	5.9	6.2	6.5	6.8	7.0
- Private Consumption	6.6	5.6	6.3	5.7	4.9	5.3	6.1	6.4	6.1	6.5	7.0	7.3
- Government Consumption	12.2	8.1	3.4	1.5	-1.1	11.0	0.2	2.4	15.7	15.8	11.8	13.5
- Gross Capital Fixed Formation	-3.2	27.3	8.6	7.7	-0.2	5.7	12.5	21.4	14.5	13.3	26.6	27.6
Current Account (% of GDP)	2.8	4.2	2.3	4.4	4.8	5.9	3.2	3.1	0.1	4.8	1	0.1
Financial Account (US\$ million)	-6,748	2,230	4,098	696	810	4,480	152	1,258	-291	1,404	1,064	-1,224
- Net Direct Investments, US\$ million	958	-90	-487	-543	842	977	358	-476	-11	7	-1,119	-1,030
- Net Portfolio Investments, US\$ million	-3,205	-1,001	2,811	-649	-903	1,202	-459	3,375	2,202	-361	1,457	640
Overall BOP position (US\$, million)	9,236	5,085	-4,475	330	712	574	877	807	124	809	-210	843
Unemployment rate	7.0	7.1	7.5	7	6.7	6	6.4	6.5	5.6	5.8	5.8	5.4
Others	Jul-15	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-16
Overseas Filipinos' Remittances (US\$, million)	2253	1994	2234	2164	1871	2470	1997	2098	2362	2213	2188	2334
... = not available												

Source: Bangko Sentral ng Pilipinas, 2016a; Philippine Statistics Authority, 2016; Asian Development Bank, 2016.

Table 1. Level of Philippine GDP, 2015Q2 – 2016Q2

	Nominal GDP		Real GDP	
	(million current pesos)		(million constant 2000 pesos)	
	2015Q2	2016Q2	2015Q2	2016Q2
Agriculture and Forestry	261,719	268,955	138,012	136,152
Fishing	45,496	42,395	28,879	27,176
Mining and Quarrying	29,347	26,334	27,706	25,029
Manufacturing	589,112	625,268	434,160	461,713
Construction	257,021	285,488	127,003	140,962
Electricity Gas and Water Supply	133,769	139,409	63,316	69,505
Transport Communication and Storage	230,315	247,261	153,595	164,363
Trade and Repair of Motor Vehicles Motorcycles Personal	584,661	651,710	307,620	335,146
Financial Intermediation	281,385	304,468	144,619	154,107
Real Estate Renting & Bus. Actvt	430,572	482,688	224,220	245,237
Public Administration & Defense: Compulsory Social Security	136,410	152,364	82,685	87,978
Other Services	337,801	379,333	211,414	231,253
Sum = GDP	3,317,608	3,605,672	1,943,228	2,078,621

Source: Philippine Statistical Authority, 2016

Table 2. Industry Contributions to Philippine GDP Growth, 2015Q2 - 2016Q2				
	TRAD	PGE	PCE	GEN
	GDP Growth			GDP Growth
	(percent)	(percent)	(percent)	(percent)
		(1)	(2)	(1)+(2)
GDP Growth	6.97	7.16	-0.19	6.97
Industry Growth Contribution				
Agriculture	-0.18	-0.19	0.16	-0.02
Agriculture and Forestry	-0.10	-0.11	0.20	0.09
Fishing	-0.09	-0.08	-0.03	-0.11
Industry	2.32	2.29	-0.77	1.51
Mining and Quarrying	-0.14	-0.09	-0.02	-0.10
Manufacturing	1.42	1.13	-0.33	0.79
Construction	0.72	0.85	-0.13	0.72
Electricity Gas and Water Supply	0.32	0.39	-0.29	0.10
Services	4.83	5.06	0.42	5.48
Transport Communication and Storage	0.55	0.49	-0.09	0.39
Trade and Repair of Motor Vehicles Motorcycles Personal	1.42	1.58	0.13	1.71
Financial Intermediation	0.49	0.56	-0.01	0.55
Real Estate Renting & Bus. Actvt	1.08	1.22	0.12	1.34
Public Administration & Defense: Compulsory Social Security	0.27	0.26	0.15	0.41
Other Services	1.02	0.96	0.12	1.07

Source: DLSU-AKI 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. The GEN formulas for PGE and PCE and the TRAD formula are given, respectively, by equations (12), (13), and (17) in Dumagan, Jesus C. (2016), "Effects of Relative Prices on Contributions to the Level and Growth of Real GDP," Working Paper Series No. 2016-036, Angelo King Institute for Economic and Business Studies, De La Salle University, Manila. 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, Jesus C. (2013), "A Generalized Exactly Additive Decomposition of Aggregate Labor Productivity Growth," Review of Income and Wealth, 59 (Issue 1): 157-168, 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 2.