Angelo King Institute
for Economic and Business Studies

Monitoring the Philippine Economy
Third Quarter Report for 2016

Project of Angelo King Institute

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Third quarter growth expanded 7.1 percent from 6.2 percent the previous year despite conservative market projections.

Economic performance: capital formation and manufacturing expansion spurred third quarter growth.

- **Philippine economic growth rises above market expectations.** Third quarter growth increased to 7.1 percent (year-on-year) from 6.2 percent in the previous year. Despite lower market projections, growth surpassed that of China (6.7 percent) and Vietnam (6.4 percent). This affirms the target of an annual growth rate between 6.0 to 7.0 percent this 2016.

- **Major components of aggregate demand**

    - **Private consumption remains the pillar of demand-side growth.** Household consumption grew by 7.3 percent with greater consumer confidence bolstered by low inflation, low interest rates, better labor market conditions, and growth in remittances, exceeding last year's 6.1 percent growth.

    - **Durable equipment, private and public investments remain robust.** Strong investments sustained economic growth, particularly in durable equipment. Private sector investments in construction rose to 16.5 percent compared to 5.2 percent in the same quarter last year. Moreover, public investment in infrastructure expanded by over 20 percent.

    - **Government expenditure slows down due to reduced maintenance spending**. The third quarter growth of government spending slowed to only 3.1 percent from the previous period's 15.7 percent. Causing the slowdown, as reported by the Philippine Statistics Authority, were delays in the approval of certain projects by the new administration. This might only be temporary, however, as the next period will see a boost in government spending with the approval of other projects.

[1] Report is based on latest available data as of December 30, 2016. For comments and questions, please email mitzie.conchada@dlsu.edu.ph

- **Imports exceeded exports while both grew steadily.** Exports of goods steadily rose to 8.8 percent while imports rose to 14.2 percent after 17 months of decline. Total merchandise trade grew by 9.8 percent in September 2016, pulled up by exports growth. Total trade grew to US$ 12.3 billion in September 2016 from US$11.8 billion in August 2016. The growth of exports was due to upticks in all commodity groups, except forest products. Despite the uptick in exports, the outlook is clouded by sluggish recovery in Europe and uncertainties in economic policies in the UK and US.

- **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 3).[2]

- **Services sector weakens.** Services growth eased to 6.9 percent in the third quarter compared to a year ago. Expansion in the retail trade, repair of motor vehicle, wholesale and retail subsectors remained strong at 6.5 percent though lower than the previous year's 8.4 percent. The slowdown in the communications subsector (1.2 percent), however, could be temporary as the two large tele-communication companies went into a buy-out deal with San Miguel Corporation over its control of specific frequencies. Public administration, though expanding by

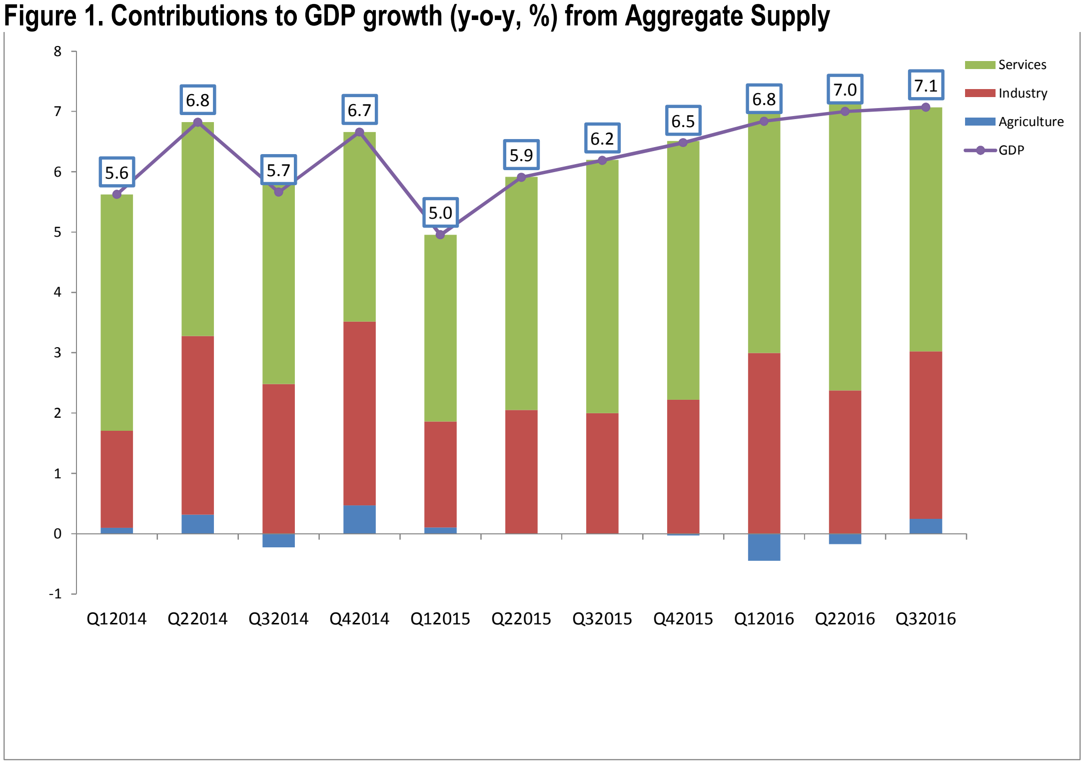
[2] The results in Table 3 are AKI-DLSU *Philippine Economic Monitor* calculations by applying the data in Table 1 to a "generalized" (GEN) exactly additive decomposition of GDP growth into *pure growth effect* (PGE) and *price change effect* (PCE) as an alternative to the "traditional" (TRAD) GDP growth 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, 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.

3.7 percent, slowed down compared to the previous quarters due to the waning effects of election spending.

- **Industry sector maintains upward trend.** Industry growth further improved to 8.6 percent in the third quarter. Manufacturing was the top contributor (with 6.9 percent growth) due to sustained increase in capital goods production. Construction also emerged stronger registering a 15.5 percent growth. On the other hand, growth in utilities was broadly steady. The manufacturing sector is expected to benefit from the strategic localization of industry roadmaps and robust domestic demand. It will also benefit from the projected rise of imports by both advanced economies and emerging markets and developing economies beginning 2017. Construction also will remain a major contributor to growth due to the strong commitment of the government to implement a massive infrastructure investment program.

- **Agriculture sector shows signs of recovery.** With the normalization of weather conditions and alleviation of El Nino, agriculture grew by 2.9 percent, breaking five consecutive quarters of decline. Agriculture and fisheries will likely continue to grow within the near term if the third quarter momentum of the crops, livestock and poultry subsectors is maintained. The expiry of the quantitative restrictions on rice by mid-2017 is an important opportunity to reduce the cost of rice, which eats up 20 percent of the budget of the poor. Moreover, transitioning to higher value crops and strengthening agro-industrial linkages could spur agriculture sector growth.

Figure 1. Contributions to GDP growth (y-o-y, %) from Aggregate Supply



Source: Author’s calculations based on data in Table 3 below.

Challenges facing the economy

- **Peso-dollar exchange rate depreciates[3].** The peso continued to depreciate against the dollar in the third quarter, probably induced by looming US Federal hike in interest rates and slowdown in China's economy. Based on Bangko Sentral ng Pilipinas' report, the peso weakened by 1.1 percent to average P47.06/US$1 from the previous quarter's average of P46.52/US$1 on a quarter-on-quarter basis. On a year-on-year basis, the peso likewise depreciated by 2.1 percent relative to the P46.05/US$1 average in the third quarter of 2015. These developments fuel concerns over further depreciation of the peso .

- **Sentiment in the global economy remains cautious.** With the upcoming elections 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.

Other economic news

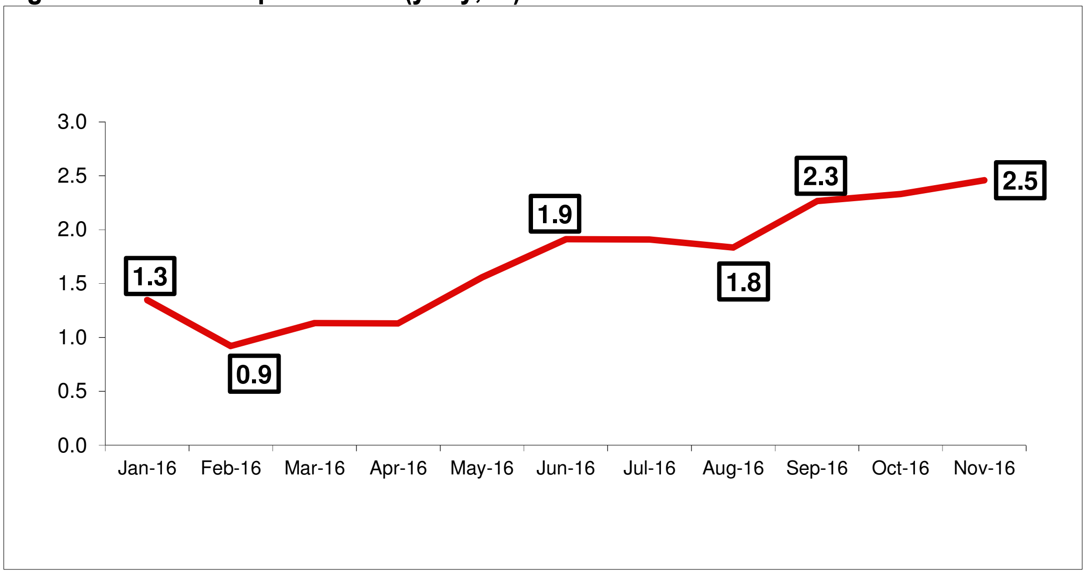
- **The BSP keeps its monetary policy settings[4].** Last September, the BSP decided to maintain its key policy interest rate (3.0) and the rest of the interest rates for other monetary policy instruments. The decision was based on the assessment of the country's sound economic fundamentals and manageable inflation environment.

- **Stock market trending strongly[5].** As of November 17, the stock market recovered after experiencing a slump at the end of the third quarter. The Philippine Stock Exchange index (PSEi) closed at 7,050.12. The stock market climbed back to the 7,000 mark following the upgrading of growth forecasts for the Philippines. The climb in the PSEi was led by URC while conglomerate Ayala Corp. rose by 3.77 percent. SM Prime, ALI and PLDT all advanced by over 2 percent while Metrobank, Jollibee, MPI, BPI and ICTSI all gained over 1 percent. SMIC and AEV also contributed modest gains.

- **Headline inflation accelerates but remains manageable.** Third quarter inflation increased to 2.0 percent from last year's 0.59 percent. Average inflation at the end of the third quarter was recorded at 1.6 percent, way below BSP's target range of 3.0 percent ± 1.0 percentage point for 2016-2018. Prices picked up in September (2.3 percent) on higher prices of selected food and petroleum products. Overall, changes in prices remain manageable and year-end inflation rate is seen to be lower than the target.

[3] http://www.bsp.gov.ph/downloads/Publications/FAQs/exchange.pdf
[4] http://www.bsp.gov.ph/publications/media.asp?id=4205
[5] http://business.inquirer.net/219697/philippine-stock-market-third-quarter-2016-gdp

Figure 2. Consumer price index (y-o-y, %)



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

- **Remittances soften in September 2016[6].** Total cash remittances by end of September reached USD 20 billion, registering only a 4.8 percent growth compared to 6 percent the previous year. On the other hand, personal remittances reached USD 22.1 billion, 4.7 percent lower than the previous year's 5.8 percent growth. Though their present levels are relatively low, remittances are expected to pick-up by the end of the year.

[6] http://www.philstar.com/business/2016/09/12/1622719/ofw-households-saved-more-invested-less-q3

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Table 1. Philippine Economic Indicators

Philippines Economic Data												
Monthly Leading Indicators	**Oct-15**	**Nov-15**	**Dec-15**	**Jan-16**	**Feb-16**	**Mar-16**	**Apr-16**	**May-16**	**Jun-16**	**Jul-16**	**Aug-16**	**Sep-16**
Industrial Production (y-o-y, %)	1.6	4.2	4.7	35.8	11.6	8.3	10.9	6.2	10.2	11.4	13.0	9.1
Consumer Price Index (y-o-y, %)	0.4	1.1	1.5	1.3	0.9	1.1	1.1	1.6	1.9	1.9	1.8	2.3
Exports (y-o-y, %)	-10.8	-1.1	-3.0	-3.9	-4.5	-14.2	-2.8	-3.8	-11.4	-12.3	-3.0	5.5
Imports (y-o-y, %)	16.9	11.4	-16.7	30.8	1.2	23.9	39.2	53.4	15.8	-1.7	12.2	13.5
Trade Balance, US$ million	-1,944	-977	604	-2,638	-1,104	-1,747	-2,306	-2,021	-2,098	-2,058	-1,952	-1,890
Total Reserves (less gold), US$ billion	74	73	74	74	74	75	76	75	77	77	78	78
Policy Rate	4	4	4	4	4	4	4	4	3	3	3	3
Fiscal Balance (million pesos)	-27,022	6,029	30,400	-3,474	-34,626	-74,388	55,022	-17,656	-45,194	-50,667	32,607	-75,327
Quarterly/Annual Economic Indicators	**2013**	**1Q2014**	**2Q2014**	**3Q2014**	**4Q2014**	**1Q2015**	**2Q2015**	**3Q2015**	**4Q2015**	**1Q2016**	**2Q2016**	**3Q2016**
Real GDP (y-o-y, %)	6.9	5.6	6.8	5.7	6.7	5.0	5.9	6.2	6.5	6.8	7.0	7.1
- Private Consumption	5.6	6.3	5.7	4.9	5.3	6.1	6.4	6.1	6.5	7.0	7.4	7.3
- Government Consumption	8.1	3.4	1.5	-1.1	11.0	0.2	2.4	15.7	15.8	11.8	13.5	3.1
- Gross Capital Fixed Formation	27.3	8.6	7.7	-0.2	5.7	12.5	21.4	14.5	13.3	26.6	25.0	20.0
Current Account (% of GDP)	2.7	2.3	4.4	4.8	5.9	3.2	3.1	0.1	4.8	0.9	0.1	1.3
Financial Account (US$ million)	-2,135	4,098	696	810	4,480	152	1,258	-291	1,404	995	-1,039	308
- Net Direct Investments, US$ million	-970	-487	-543	842	977	358	-476	-11	7	-1,119	-1,030	-498
- Net Portfolio Investments, US$ million	-783	2,811	-649	-903	1,202	-459	3,375	2,202	-361	1,573	787	-843
Overall BOP position (US$, million)	1,537	-4,475	330	712	574	877	807	124	809	-210	843	1,014
Unemployment rate	7.1	7.5	7	6.7	6	6.4	6.5	5.6	5.8	5.8	5.4	4.7
Others	**Oct-15**	**Nov-15**	**Dec-15**	**Jan-16**	**Feb-16**	**Mar-16**	**Apr-16**	**May-16**	**Jun-16**	**Jul-16**	**Aug-16**	**Sep-16**
Overseas Filipinos' Remittances (US$, million)	2,164	1,871	2,470	1,997	2,098	2,362	2,213	2,188	2,334	2,131	2,319	2,383

… = not available

Source: Bangko Sentral ng Pilipinas, Philippine Statistical Authority, Asian Development Bank.

Table 2. Level of Philippine GDP, 2015Q3 – 2016Q3

	Nominal GDP (million current pesos)		Real GDP (million constant 2000 pesos)	
	2015Q3	**2016Q3**	**2015Q3**	**2016Q3**
Agriculture and Forestry	248,771	275,104	124,661	129,916
Fishing	53,577	51,467	30,997	30,194
Mining and Quarrying	24,846	29,395	16,449	16,379
Manufacturing	579,185	618,779	400,662	428,372
Construction	208,354	244,763	106,211	122,680
Electricity Gas and Water Supply	95,076	100,522	69,086	75,661
Transport Communication and Storage	197,598	209,659	128,651	134,948
Trade and Repair of Motor Vehicles Motorcycles Personal	648,888	709,056	338,276	360,104
Financial Intermediation	254,183	280,304	130,698	141,288
Real Estate Renting & Bus. Actvt	442,420	494,514	222,210	241,865
Public Administration & Defense: Compulsory Social Security	126,210	133,776	72,967	75,638
Other Services	305,275	332,888	182,231	194,954
Sum = GDP	**3,184,384**	**3,480,227**	**1,823,097**	**1,951,997**

Source: Philippine Statistical Authority, 2016

Table 3. Industry Contributions to Philippine GDP Growth, 2015Q3 – 2016Q3

	TRAD	PGE	PCE	GEN
	GDP Growth			GDP Growth
	(percent)	(percent)	(percent)	(percent)
		(1)	(2)	(1)+(2)
GDP Growth	**7.07**	**7.15**	**-0.08**	**7.07**
Industry Growth Contribution				
Agriculture	**0.24**	**0.29**	**0.27**	**0.55**
Agriculture and Forestry	0.29	0.33	0.32	0.65
Fishing	-0.04	-0.04	-0.06	-0.10
Industry	**2.78**	**2.55**	**-0.49**	**2.07**
Mining and Quarrying	0.00	0.00	0.13	0.12
Manufacturing	1.52	1.26	-0.41	0.85
Construction	0.90	1.01	-0.03	0.99
Electricity Gas and Water Supply	0.36	0.28	-0.18	0.11
Services	**4.05**	**4.31**	**0.14**	**4.45**
Transport Communication and Storage	0.35	0.30	-0.06	0.25
Trade and Repair of Motor Vehicles Motorcycles Personal	1.20	1.31	0.12	1.44
Financial Intermediation	0.58	0.65	-0.01	0.64
Real Estate Renting & Bus. Actvt	1.08	1.23	0.09	1.32
Public Administration & Defense: Compulsory Social Security	0.15	0.15	0.01	0.15
Other Services	0.70	0.67	-0.01	0.65

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, 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 3.