Monitoring the Philippine Economy
Year-End Report for 2012

Project of Angelo King Institute
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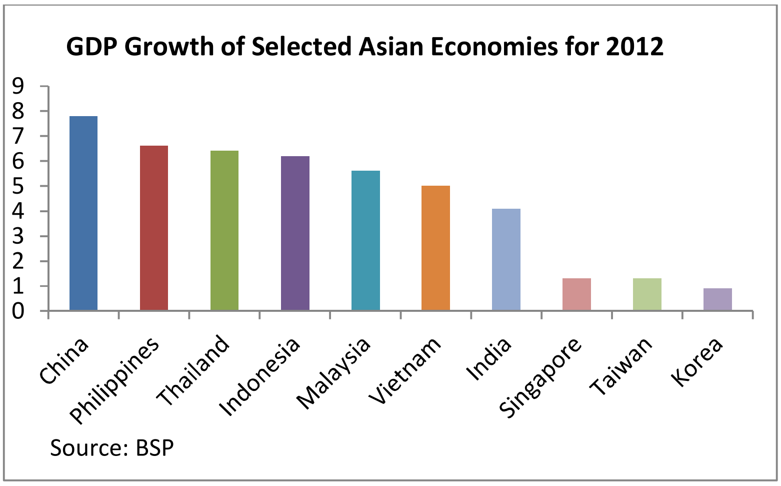
Despite the weakening global economy, the Philippine economy sustains itself with the strong performance of the services sector, household spending and government spending.

Economic performance: Where is growth mainly coming from?

- **Philippines' economic growth surpasses expectations with 6.6 percent in 2012.** Gross domestic product in 2012 soared to 6.6 percent year-on-year (y-o-y) compared to 3.6 percent the previous year, besting other Asian countries such as Singapore, Taiwan, and Korea, with only 1.3 percent, 1.3 percent and 0.9 percent respectively. The Philippines displayed the highest growth during the third quarter with 7.2 percent which was driven mainly by a surge in public spending. Due to the economy's performance, international institutions such as the IMF increased its forecast growth to 6 percent in 2013.



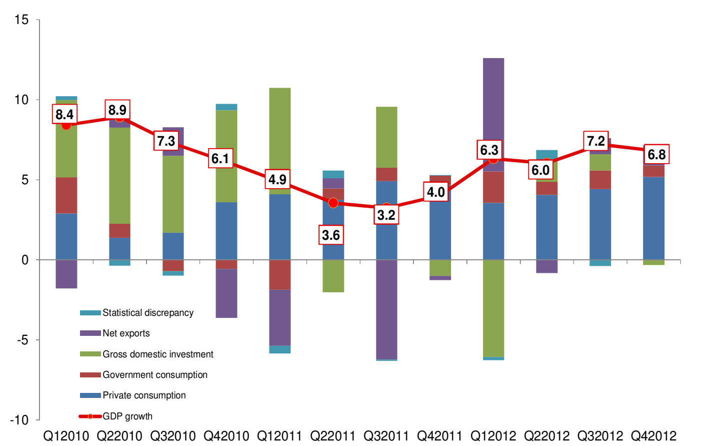
- **Major components of aggregate demand**
  - **Government spending recovers and tops the demand-side sources of growth for 2012.** Growth in 2012 was mainly driven by government spending which grew by 12 percent – a huge jump from the previous year's 1.7 percent. This was the

[1] The author would like to acknowledge the valuable contributions of Mikaela Yagin and Daniel Hofilena. Comments and questions should be directed to mitzie.conchada@dlsu.edu.ph

highest since the start of the Aquino administration. The World Bank reported that the increase was attributed to the government-wide salary increase and a surge in government disbursements for social service programs. The first quarter reported the highest y-o-y growth with 20.9 percent.

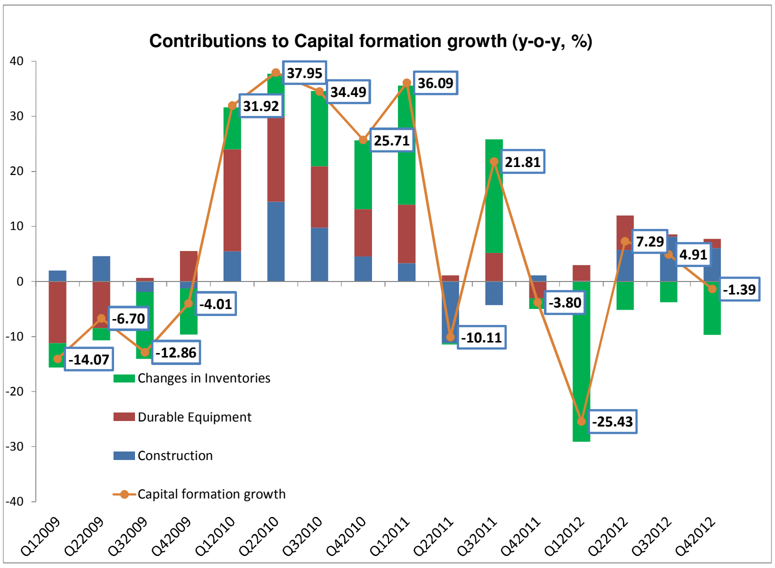
- **Household spending displays positive growth.** The second highest contributor to growth was the private consumption sector. It displayed a 6.1 percent y-o-y increase in 2012 driven by an improvement consumer confidence and lower prices especially during the first half of the year. Top contributors to growth were food and non-alcoholic expenditure, miscellaneous goods and services, and expenditure in utilities, with 5.3 percent, 7.3 percent and 5.9 percent respectively.

Contributions to GDP growth (y-o-y, %)



Source: NSCB

- **Domestic investment slows down amidst high economic growth rate.** Capital formation dropped 3.7 percent y-o-y in 2012 compared to the previous year's 10.9 percent y-o-y increase. Despite rapid construction in public infrastructure and private construction, growth was tempered by decline in fixed capital formation. The first quarter recorded the biggest plunge, with negative 25.4 percent due to a significant drop in changes in inventory as establishments reported big withdrawals in their inventories. Construction and investment in durable equipment stood at 13.5 and 5.8 percent y-o-y respectively for the entire year. With the country's improved credit rating, it is expected that not only foreign investments will improve but also domestic investment.



- **Philippine exports show mixed performance.** Total value of merchandise exports in 2012 amounted to USD 52,099 million, bringing its y-o-y growth to 8.4 percent. The growth was led by the expansion of export of services, specifically insurance, travel and transportation. The highest growth was recorded in September with 23.5 percent, the strongest since December 2010. By December, growth of the merchandise exports was recorded at 16.5 percent supported by an increase in non-electronic goods such as fresh bananas, petroleum products, metal components, tuna, and woodcrafts and furniture. Electronic export revenue declined 5.5 percent in December, mainly coming from a decline in demand for semiconductors.

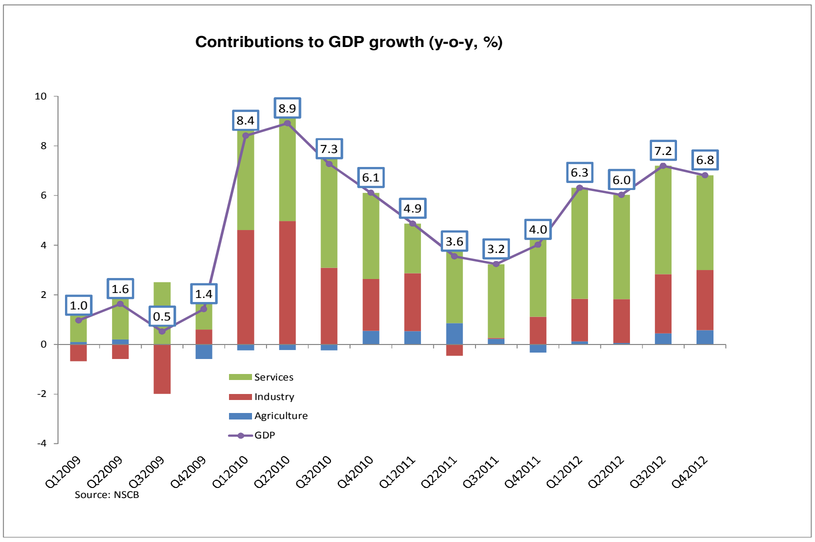
- **Relatively strong exports and weak growth in imports constrain trade deficit.** While exports grew 8.4 percent, imports increased only by 3.2 percent in 2012. Total value of merchandise exports for 2012 amounted to USD 52,099 million while total value of merchandise imports amounted to USD 62,128 million, resulting in a USD 10,029 million trade deficit. This year's trade deficit was lower than the previous year's USD 12,124 million. The World Bank reported that this was due to robust growth in exports and a weak demand for inputs in the electronics industry resulting in lower imports.

- **Major components of aggregate supply**

  - **Services sector boosts supply side growth.** Services sector reported the highest growth in 2012. It grew at an average of 7.5 percent mainly coming from the subsectors transportation, real estate, and financial intermediation. Gross value added of communication under the transportation subsector grew 9.8 percent while transport and storage grew 6.1 percent. Gross value added for real estate, on the other hand, grew only 7.7 percent compared to last year's 13.6 percent due to a slowdown in the growth of business process outsourcing and ownership of dwellings. Lastly, gross value added for financial intermediation rose by 7.2 percent driven by banking institutions, non-bank financial intermediation, and insurance.

  - **Industry sector accelerates on performance of construction subsector.** The second largest sector was the industry sector that had a moderate growth of 6.5 percent, driven by the construction subsector. The National Statistical Coordination Board reported an 18.4 percent y-o-y growth for the construction subsector brought about by a robust private sector.

- **Agriculture sector displays positive growth.** Despite weather disturbances, the agricultural sector grew 2.6 percent with improvements in production of major crops and livestock and poultry farming. The expansion of harvest areas, yield improvement, and sufficiency of irrigation and adequate fertilizers in Central Luzon, Cagayan Valley and the Ilocos region were main factors of the increase in production of major crops such as palay (NSCB). Production of palay and corn grew 10.2 percent and 6.3 percent respectively.



Policy responses

- **BSP policy rates settles at a steady rate.** The Monetary Board raised policy rates four times in 2012, bringing the main policy rate from 4.5 at the end of 2011 to 3.5 percent by December. The decision to implement an expansionary monetary policy was mainly caused by a manageable inflation outlook and efforts to support domestic demand against global economic pressures.

Other economic news

- **The Philippines receives higher credit rating in 2012.** All three major international credit rating agencies – Fitch Ratings, Standard and Poor's, and Moody's – raised the country's rating to one notch towards investment grade starting in July. Moody's outlook for the country was "Stable" while Standard and Poor's was "Positive", all indicators of a healthy economy worthy of improved investor confidence. The improvement in the credit rating is due to the fiscal developments such as increased tax collection, intensified government spending, growth of the outsourcing industry, better business environment, and robust private consumption that is highly dependent on remittances.

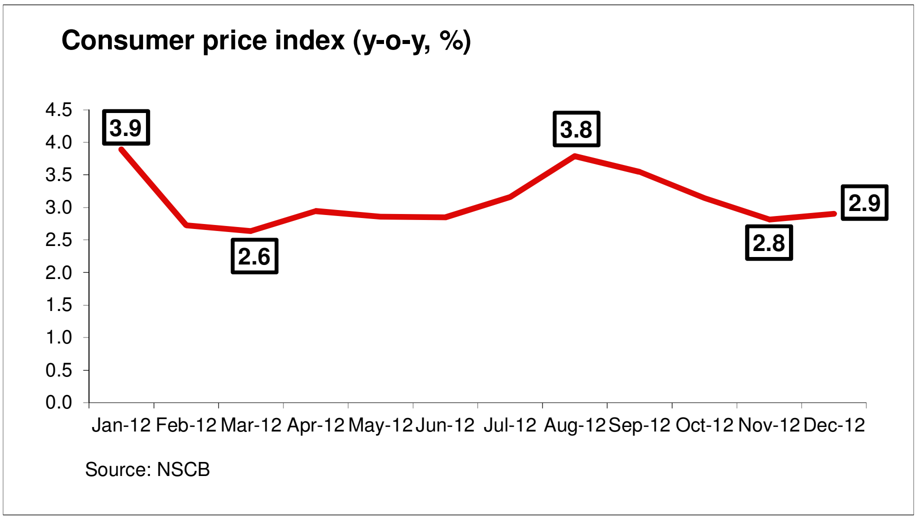
- **More government infrastructure projects seen underway.** Under the Private-Public Partnership program, the government approved 5 infrastructure projects for the fourth quarter of 2012. The board approved the Cavite-Laguna Expressway and NLEX-SLEX connector road which costs P35.58 billion and P25.56 billion respectively. Other projects that were approved are the Pasa Small Reservoir

Irrigation Project, Change in Scope of the Second Cordillera Highland Agricultural Resources Management Project (CHARMP II) and the National Community-Driven Project.

- **Unemployment rate continues to be stable throughout 2012.** The National Statistics Office reported a 6.8 percent unemployment rate by end of the fourth quarter. The National Capital Region had the highest unemployment rate while Cagayan Valley of Region 2 reported the lowest. An estimated number of 2.8 million people were recorded unemployed with most of them in the National Capital Region. Fourth quarter figures are, however, slightly higher than last year's 6.4 percent.

- **Philippine remittance hits USD21 billion by end of 2012.** The Bangko Sentral ng Pilipinas announced that cash remittances amounted to USD21.39 billion despite the tenuous economic conditions in advance economies. This could be attributed to the steady deployment of skilled and professional Filipino workers coupled with commercial banks' continued efforts to strengthen its network with remittance business partners.

- **Inflation eases as prices of basic commodities slow down.** Average headline inflation for 2012 was recorded at 3.1 percent, lower than last year's 4.4 percent. The National Statistics Office reported that this was due to higher annual rates in food and non-alcoholic beverages and alcoholic beverages, and tobacco indices. Inflation rate was the lowest in March with 2.6 percent. Prices remained low despite power plant problems in Mindanao.



- **Overall Balance of Payment position drops.** The country's overall BOP position stood at USD 9,236 million at the end of 2012. This was reportedly lower than the previous year's USD 11,400 million, resulting in a decrease of 19 percent caused by outflows owing to debt service payments. The Euro Zone crisis affecting capital inflows also contributed to lower BOP. Current account stood at USD 7,126 million while financial account was recorded at negative USD 6,131 million.

- **Gross international reserves continue to build up.** The gross international reserves (less gold) by end of December stood at USD 73.5 billion. The continuous increase in the total reserves is attributed to the inflows from foreign exchange operations and income from investments of BSP. According to the World Bank, bulk of the reserves was held in foreign investments (84 percent). The country's gold reserves amounted to 12.4 percent of total reserves.

Featured article: European Valkyries and Asian Tigers[2]

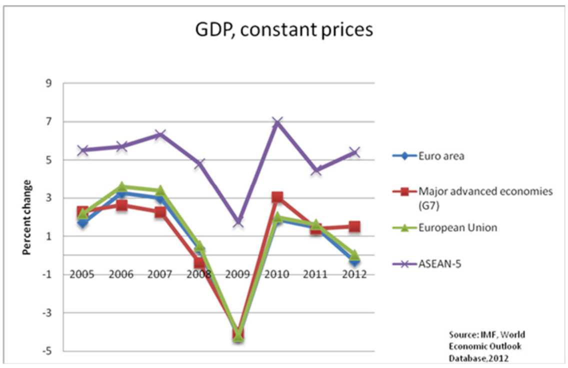
Since the crisis that hammered the European Union (EU), Europe has been in a gripping economic spiral. The flashpoint was Greece. The country reached alarming levels of debt, equivalent to 113 percent of Gross Domestic Product. The new Greek administration also uncovered unethical accounting practices of the former government. This dissipated the credibility of the monitoring of the European Commission. Investors then started to lose confidence in Portugal, Ireland, Greece, and Spain. To prevent a domino effect, the European Financial Stability Facility (EFSF) was created to ensure the credibility of the euro & to prevent sovereign defaults. The subsequent actions of the EU yielded ambiguous results in 2012.

Unemployment in Europe reached 10.8 percent compared to an average unemployment rate of G7 countries of 7.4 percent. Spain and Greece experienced high levels of unemployment, with 25 percent and 24.3 percent, respectively. Standard & Poor's and Moody's also downgraded the EFSF fund as a response to the loss of the investment grade rating of France and a ratings downgrade of Italy, Spain, Portugal, and several other EU members, thus increasing the costs of borrowing for the Euro area. Things got worse in the first quarter of 2013 when Cyprus finally fell off the cliff. Fortunately, on the 25th of March, the island nation was saved by a last minute (yet painful) bailout. The conditions attached were to shut down the Cyprus Popular Bank Pcl. with investors whose deposits exceeded the EU insured limit of 100,000 euros taking the losses, and the Bank of Cyprus to undergo a restructuring.

On a lighter note, European markets recovered & the euro strengthened on the third quarter of 2012 when the European Central Bank (ECB) announced the implementation of the Outright Monetary Transactions program (OMT). This allowed the ECB to buy, theoretically, unlimited short-term sovereign debt of troubled EU-states provided that they undergo a full macroeconomic adjustment program or a precautionary program.

The question that plagues the ASEAN is whether the misfortunes that befell Europe will spread to the Asia Pacific region. Will the European Valkyries visit Asia?

Looking at the growth rate of GDP in the advent of the crisis in 2009 and its development in 2012, the GDP of the ASEAN-5 countries grew 2 to 5 times more than the average growth rate in the European Union. What can explain this growth spurt amidst a global slowdown? Why is it that the growth of these export reliant economies did not slow down when the currencies of the ASEAN-5 appreciated against the euro between 15-30 percent in 2009-2010 (relative to the value of the exchange rate from 5/4/2008)?



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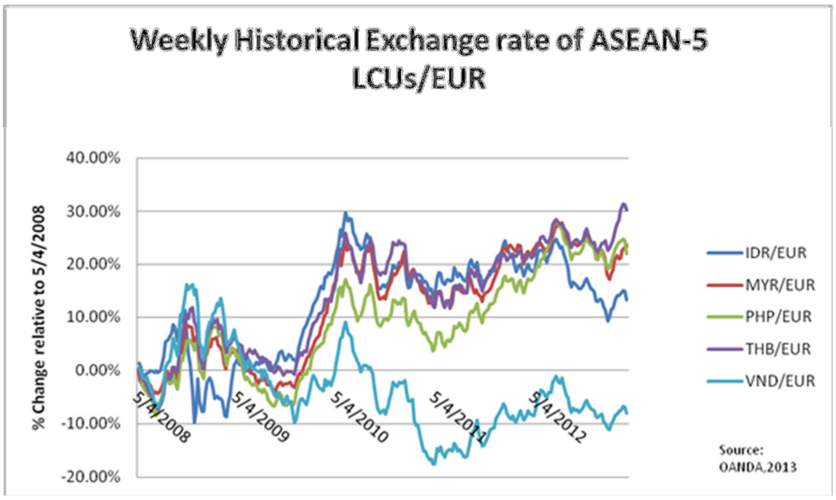
A close examination of the trade data reveals that the EU's highest imports from the ASEAN-5 were from Malaysia, with a total import value of 33,120.1 million euros, a mere 1 percent of its total imports. Although Europe ranks as the second major importer of ASEAN goods, its total share is only 11 percent of total ASEAN exports, which declined by 2 percent since 2007. Majority of ASEAN exports to the EU, which are office equipment and telecommunication equipment, was hit by massive business shutdown.

Analyzing at the data between 2007 and 2011, EU's share of the total imports in the ASEAN played between 9.9 percent (2010-2011) and 11.4 percent (2009), amounting to a slight decrease of 1.5 percent. This is because majority of exports of the EU to the ASEAN consists of industrial machinery, power generators, and machine parts – a result of the pressing need to increase the productive capacity of domestic firms to accommodate the growth in consumer demand.

Looking at the demographics, of the 12.869 million recorded migrants from South East Asia, only 11.4 percent went to Europe while 33.6 percent went to the Americas and 30.8 percent went to countries within the region. Tourist arrivals in ASEAN countries primarily came from within the region, comprising 46.5 percent in 2011 while tourists from the EU only accounted from a mere 9 percent.

In conclusion, the resilient growth of ASEAN countries, specifically the ASEAN-5, during 2009-2012, was primarily driven by inter-regional trade and an increase in regional demand. The low levels of economic interaction between the EU and the ASEAN makes regional growth stable amidst the worsening economic conditions of the member states of the European Union. Though the Eurozone's lingering and deepening crisis poses challenges to the region, particularly the Philippines, a strong domestic economy sustained by sound fiscal and monetary policies protects it from external shocks.



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Philippines Economic Data												
Monthly Leading Indicators	**Jan-12**	**Feb-12**	**Mar-12**	**Apr-12**	**May-12**	**Jun-12**	**Jul-12**	**Aug-12**	**Sep-12**	**Oct-12**	**Nov-12**	**Dec-12**
Industrial Production (y-o-y, %)	2.6	7.8	11.7	4.8	-3.4	10.7	3.8	2.4	10.8	19.8	10.6	10.7
Consumer Price Index (y-o-y, %)	3.9	2.7	2.6	2.9	2.9	2.8	3.2	3.8	3.5	3.1	2.8	2.9
Retail Sales (y-o-y, %)	5.9	1.0	5.1	7.6	2.9	5.1	0.3	-0.3	10.3	13.0	9.8	13.7
Broad Money (y-o-y, %)	7.2	7.2	5.8	9.0	7.8	7.1	8.6	7.1	8.4	9.4	10.6	10.9
Exports (y-o-y, %)	3.1	14.6	-0.7	7.6	20.1	4.5	6.7	-7.6	23.5	7.9	7.3	16.5
Imports (y-o-y, %)	-3.1	6.6	-3.3	-13.3	10.2	13.3	1.0	5.2	3.7	5.1	3.7	14.4
Trade Balance, US$ million	-1,016.00	-568.00	-1,046.00	-153.00	-454.00	-789.00	-43.86	70.99	-58.30	-6.94	-3.68	8.39
Total Reserves (less gold), US$ billion	68.46	68.12	65.69	66.15	66.35	66.15	69.68	70.18	70.99	71.23	73.30	73.48
Policy Rate	4.25	4.25	4.0	4.0	4.0	4.0	3.75	3.75	3.75	3.5	3.5	3.5
Fiscal Balance (million pesos)	-15,943	10,655	-28,621	31,024	-19,901	-11,696	-39,249	2,523	-32,834	-11,664	-11,475	-115,745
Quarterly/Annual Economic Indicators	**2007**	**2008**	**2009**	**2010**	**1Q2011**	**2Q2011**	**3Q2011**	**4Q2011**	**1Q2012**	**2Q2012**	**3Q2012**	**4Q2012**
Real GDP (y-o-y, %)	6.6	4.2	1.1	7.6	4.9	3.6	3.2	4.0	6.3	6.0	7.2	6.8
- Private Consumption	4.6	3.7	2.3	3.4	5.9	5.6	7.4	6.4	5.1	5.9	6.3	6.9
- Government Consumption	6.9	0.3	10.9	4.0	-15.8	6.0	8.9	7.6	20.9	6.8	12.0	9.1
- Gross Capital Fixed Formation	-0.5	23.4	-8.7	31.6	36.1	-10.1	21.8	-3.8	-25.4	7.3	4.9	-1.4
Current Account (% of GDP)	4.8	2.1	5.6	4.5	1.9	3.4	4.4	2.9	0.7	3.7	3.7	3.1
Financial Account (US$ million)	3,503	-1,702	-1,731	7,290	3,624	35	2,430	-1,032	-4,821	722	510	-2,542
- Net Direct Investments, US$ million	-620	1,285	1,604	682	406	464	-78	461	-898	80	-42	-92
- Net Portfolio Investments, US$ million	4,623	-3,627	-625	4,365	2,674	2,199	722	-71	-1,248	-363	-61	-1,851
Overall BOP position (US$, million)	8,557	89	6,421	14,308	3,493	1,523	4,705	458	1,243	73	4,515	3,405
Unemployment rate	7.8	7.4	7.7	7.3	7.4	7.2	7.1	6.4	7.2	6.9	7.0	6.8
Others	**Jan-12**	**Feb-12**	**Mar-12**	**Apr-12**	**May-12**	**Jun-12**	**Jul-12**	**Aug-12**	**Sep-12**	**Oct-12**	**Nov-12**	**Dec-12**
Overseas Filipinos' Remittances (US$, million)	1,557	1,587	1,698	1,701	1,774	1,811	1,809	1,797	1,838	1,928	1,918	1,975
… = not available												

Source: Bangko Sentral ng Pilipinas, National Statistics Office, *International Financial Statistics* , IMF, Asian Development Bank.