The Philippine Economy: Performance, Challenges, & Outlook

Bien A. Ganapin  
National Policy and Planning Staff  
National Economic and Development Authority

I. Recent Economic Performance

The Philippine economy has been performing quite well recently, both relative to our economic targets and historical performance. Despite the series of natural disasters that hit in the latter part of 2013, the Philippine economy expanded by 7.2 percent, even faster than the 6.8 percent growth that was achieved in 2012. In 1991-2001 for instance, the economy grew an average of 2.9 percent which increased to 4.8 percent during the 2001-2010 period. In the last three years, the Philippine economy grew at an even higher average growth rate at 6.3 percent.

Figures 1 and 2 show the different dimensions of the Philippine growth experience. Looking at the growth rate over time, real GDP grew by 3.7 percent during the 1999-2000 period. We have, since then, seen an acceleration of the growth rate to 4.6 percent for the years 2001-2005 and 5.0 percent during the years 2006-2010. For the period 2011-2013, average growth rate was even higher at 5.9%, and in 2013, GDP expanded by 7.2 percent.
The other dimension is the source of the growth. On the supply side, the services sector still takes the lion’s share of economic growth, but industry, particularly manufacturing, is increasingly becoming a major growth driver. In 2013, more than 40 percent of the 7.2 percent growth was contributed by industry, where more than three-fourths was due to the acceleration of manufacturing activities.

Economic growth accelerated to 6.4 percent in the second quarter of 2014, bringing the first semester GDP growth in 2014 to 6.0 percent. The growth rate in the first semester of 2014, shows that the economy was able to sustain the high trajectory of growth registered in 2012 and 2013 and will likely be carried forward in the second half of 2014. The country continues to be one of the bright spots in the region, with a rate of growth that is faster relative to other major Asian economies. In the second quarter for instance, our GDP growth rate of 6.4 percent is tied with Malaysia’s performance and topped other major ASEAN countries such as Indonesia, with 5.1 percent, and Thailand with 0.3 percent.

Net exports contributed 2.7 percentage points and household consumption contributed 3.8 percentage points. This profile is in line with a more positive global economy, favorable business sentiment, and robust inflows of overseas Filipinos remittances.

On the supply-side, most sectors demonstrated strong growth, except for the construction sector. Agriculture grew by 2.2 percent, a rebound from the 1.6 percent registered in the first semester of 2013. This was due to the big turnaround in major crop harvests particularly in the second quarter. Industry grew by 6.6 percent, partly moderated by the weak performance of the construction industry which was dragged down by public construction. Still, it is notable that the gross value added in manufacturing accelerated to 8.8 percent in this period, buoyed by strong external demand and household final consumption. Meanwhile, the services sector expanded by 6.4 percent, mainly due to trade, real estate, renting and business activities, and transport, storage & communication.

The robust growth exhibited by the Philippine economy was supported by a favorable macroeconomic policy environment. This is marked by a stable inflation, low interest rates, declining non-performing loans of the banking sector, as well as a sustainable fiscal and external positions. In part, this good macroeconomic policy environment created positive expectations thus enabling the expansion of businesses and employment generation.

Inflation rate was kept at manageable levels, owing to lower food and oil prices in the international market. Meanwhile, banks’ NPL ratios continue to decline while the low interest rate environment provided opportunities to expand credit. Fiscal deficit continued to remain within program, thus allowing the government to have more fiscal space to fiancé needed expenditures given the recent reforms in tax collection, revenue administration, and debt
management. Also, the positive current account balance since 2003 (i.e. current account to GDP ratio of 3.8 percent (2013) and 2.9 percent (Jan-June 2014) provided enough room to respond to external shocks.

II. Challenges

Notwithstanding the gains, the Philippines, has a lot of catching up to do in terms of investment. Among the ASEAN 5, the Philippines has the lowest investment share as measured by the ratio of gross capital formation to GDP averaging at 22.5 percent compared to Thailand (27.6%), Vietnam (26.7%), Malaysia (25.4%), and Indonesia (23.3%) from 1960-2013.

One of the reasons for the weak investor sentiment in the country is the persistence of bottlenecks in the infrastructure sector. The country’s infrastructure facilities and systems continue to lag behind those of our counterparts in the Southeast Asian region. According to the World Economic Forum’s latest Global Competitiveness Report (2014-2015), the Philippines ranked 91st out of 144 countries in terms of the overall quality of infrastructure, way behind Malaysia (25), Thailand (48), and Indonesia (56). Furthermore, the high cost of doing business recorded in the previous years prior to the improvements made in 2013 also hampered the growth in investments.
Moreover, a stronger intervention to achieve inclusivity remains critical for growth to make a dent on poverty. The estimated poverty incidence among Filipinos improved by 3.0 percentage points (ppts) to 24.9 percent from 27.9 percent a year ago while the number of individuals in extreme poverty also declined 2.7 ppts to 10.7 percent from 13.4 percent a year ago. But these gains need to be evaluated against the urgency of the goal to lift more Filipinos out of poverty. Thus, we need to sustain and even accelerate those efforts that worked to reduce poverty, considering that only three major regions (i.e., Metro Manila, Central Luzon, and Southern Luzon) accounts for more than 60 percent of the country’s total output.

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Ave 2010</th>
<th>Ave 2012</th>
<th>Ave 2013</th>
<th>July 2013</th>
<th>July 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Labor Force Participation Rate (%)</td>
<td>64.1</td>
<td>64.2</td>
<td>63.9</td>
<td>63.9</td>
<td>64.4</td>
</tr>
<tr>
<td>Employment Level (‘000)</td>
<td>36,035</td>
<td>37,600</td>
<td>38,118</td>
<td>37,390</td>
<td>38,451</td>
</tr>
<tr>
<td>Unemployment Level (‘000)</td>
<td>2,859</td>
<td>2,826</td>
<td>2,905</td>
<td>2,961</td>
<td>2,778</td>
</tr>
<tr>
<td>Unemployment Rate (%)</td>
<td>7.3</td>
<td>7.0</td>
<td>7.1</td>
<td>7.3</td>
<td>6.7</td>
</tr>
<tr>
<td>Underemployment Level (‘000)</td>
<td>6,762</td>
<td>7,514</td>
<td>7,371</td>
<td>7,169</td>
<td>7,050</td>
</tr>
<tr>
<td>Underemployment Rate (%)</td>
<td>18.8</td>
<td>20.0</td>
<td>19.3</td>
<td>19.2</td>
<td>18.3</td>
</tr>
</tbody>
</table>

Source: PSA

Latest indicators shows that while employment situation in the Philippines is improving, more still need to be done given that unemployment and underemployment remain relatively high at 6.7 percent and 18.3 percent respectively.

III. Outlook and Risks

The economy is targeted to grow by 6.5 to 7.5 percent in 2014, 7 to 8 percent in 2015, and 7.5 to 8.5 percent in 2016. Industry sector is projected to grow the fastest, while services is expected to remain robust during the period.

On the supply side of the economy, growth will be driven by the following:

- More vibrant manufacturing, buoyed by food, garments, and wood furniture and fixtures;
- Robust construction, led by the public sector as the government starts with the construction of major infrastructure projects and intensifies reconstruction efforts in disaster-affected areas;
- Domestic and local tourism development, expected to accelerate with greater interconnectivity of regions;
- Upbeat wholesale and retail trade due to strong domestic demand;
- Robust Business Process Management (BPM) fueling growth in the real estate, renting, and business activities sector; and
- Agribusiness will be facilitated by the removal of supply chain bottlenecks

On the other hand, the demand side of the economy will be buoyed by the following growth drivers:
- Fixed capital formation mainly due to higher public construction, including infrastructure and reconstruction; and robust private investment in construction and durable equipment;
- Strong household consumption due to strong remittance inflows, better employment opportunities, and improved consumer confidence;
- Stronger export of services with good prospects on business process management; and
- Improvement of external trade conditions

### Table 2: Selected Macroeconomic Indicators

<table>
<thead>
<tr>
<th>Selected Indicators</th>
<th>Actual 2013</th>
<th>Actual 1H 2014</th>
<th>Annual Projections</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>2014</td>
</tr>
<tr>
<td>Gross Domestic Product (%)</td>
<td>7.2</td>
<td>6.0</td>
<td>6.5 -7.5</td>
</tr>
<tr>
<td>By Industrial Origin</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture</td>
<td>1.1</td>
<td>2.2</td>
<td>(0.9)-0.1</td>
</tr>
<tr>
<td>Industry</td>
<td>9.3</td>
<td>6.6</td>
<td>7.5-8.7</td>
</tr>
<tr>
<td>Services</td>
<td>7.2</td>
<td>6.4</td>
<td>7.2-8.1</td>
</tr>
</tbody>
</table>

*Source: PSA; National Economic and Development Authority (as of June 2014)*

Although growth prospects in 2014 and 2015 remain upbeat, the government remains on guard to provide the necessary measures to mitigate if not prevent the effects of the following risks:

**External**
- Mixed signals from United States’ Quantitative Easing (QE) Program;
• Slowdown in large emerging economies, particularly China;
• Still fragile growth recovery in Japan and the Euro Area; and
• Geopolitical tensions in the Middle East and Russia-Ukraine region.

**Domestic**
• Disasters arising from natural hazards (e.g., typhoons, prolonged monsoon rains, El Ñíno);
• Possible spike in commodity prices (e.g., petroleum, power, food); and
• Delays in infrastructure and reconstruction projects;