Article

The Philippines: Poised for strong growth again

Asia Pacific Economic Outlook, Q4 2017

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Though private consumption growth has moderated, exports have kept up the momentum of GDP growth. Besides, continued government interest in the development of infrastructure translates into an increase in expenditure on public construction.

Introduction

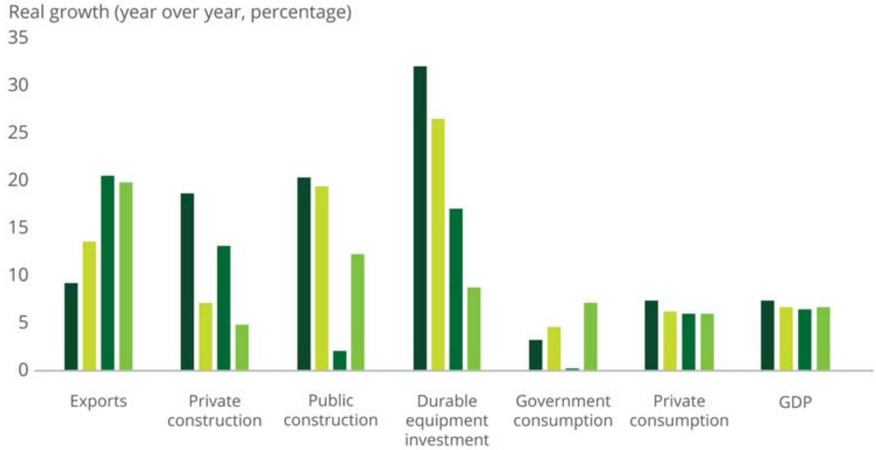
RECENT economic data from the Philippines throws no surprises. The growth momentum has continued in the first two quarters of this year, setting the stage for 6.5–7.0 percent annual GDP growth. The key drivers of growth have, however, changed a bit from last year. Private consumption growth has slowed while the contribution of exports to economic activity has gone up in the last three quarters. From a policy perspective, there appears to be no letup in the development of infrastructure—both soft and hard. Monetary policy has changed to a more cautious stance where central bank officials are keeping an eye on price pressures even as they focus on a data-driven rate path. What has also aided the central bank's position is global markets factoring in three to four rate hikes in the United States this year, thereby offering some predictability to global capital flows. [1]

Growth was strong in Q2 2017

The economy continued to perform well in Q2, expanding by 6.5 percent year over year—the second-fastest pace of growth in east and south-east Asia (excluding Macau), slightly up from a 6.4 percent rise in Q1. [2] As in the previous quarter, exports stood out in Q2 as well, increasing by 19.7 percent. The uptick in exports since late 2016 has come at the right time for the economy as private consumption growth slows to a more moderate pace: Although growth in private consumption was healthy at 5.9 percent, it is lower than the 7.0 percent registered in 2016. The economy also received a boost from government spending in Q2. While government consumption expenditure grew by 7.1 percent, public construction—a reflection of continued focus on infrastructure investments—grew by 12.0 percent during the quarter. The only dampener during the quarter was muted growth in investments. Gross domestic fixed capital formation grew by 9.4

percent in Q2, steadily weakening over the past year. Similarly, growth in spending on durable equipment and private construction also slowed during the quarter (figure 1).

Figure 1. GDP growth received a boost from exports and government spending in Q2



Source: Haver Analytics; Deloitte Services LP economic analysis. Deloitte Insights | Deloitte.com/insights

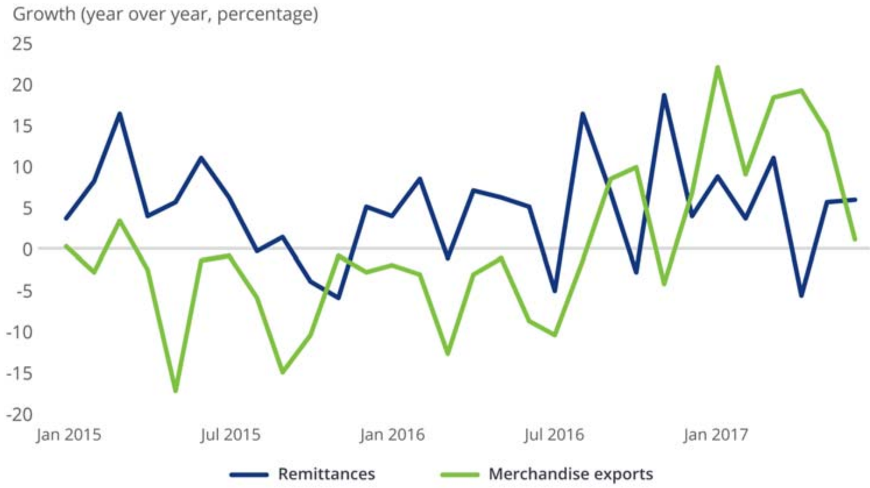
<https://dupress.deloitte.com/content/dam/dup-us-en/articles/APAC/2017-Q4/figures/Philippines_Figure1.png>

Much to cheer about exports and remittances

For the economy, there is much to cheer on the external front. Trade is back in the limelight with the value of merchandise exports (in USD) going up in both the first (16.3 percent year over year) and second (11.0 percent) quarters of the year. Although growth slowed in June due to a slowdown in manufacturing exports, this is likely to be a temporary hiccup. The overall outlook for trade is positive, especially given an expected uptick in external demand and higher global growth this year. [3] The pickup in trade comes along with healthy growth in remittances—a key driver of consumer spending growth in the economy. Remittances by overseas Filipino workers went up by 5.7

percent year over year in June, pushing up total remittances in the first six months of the year by 4.7 percent to USD 13.8 billion (figure 2). Like trade, remittances growth is likely to remain strong despite tensions between members of the Gulf Cooperation Council (GCC), a region that accounted for about 27.0 percent of total remittances into the Philippines in 2016.

Figure 2. Exports and remittances will continue to support the economy this year



Source: Haver Analytics; Deloitte Services LP economic analysis. Deloitte Insights | Deloitte.com/insights

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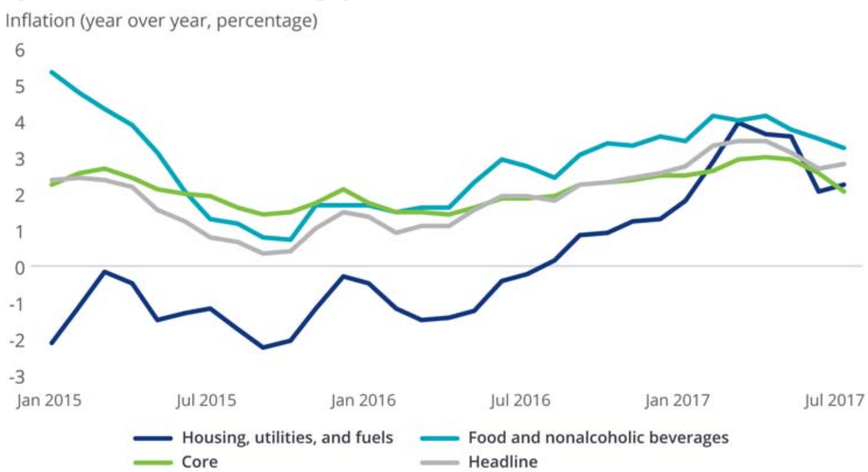
The central bank turns its gaze on inflation

In its August 10 meeting, the Bangko Sentral ng Pilipinas (BSP) kept its key policy rate unchanged, keeping an eye on rising inflation and inflation expectations. In July, inflation moved up to 2.8 percent year over year from 2.7 percent in June; the figure has been flitting around the midpoint of the central bank's target range of 2–4 percent this year. The uptick in inflation in the last two quarters is due to multiple reasons. First, food and energy prices have been going up, albeit with a slight moderation of late (figure 3). Second, domestic demand has been growing at a fast pace over the past few years—by an average of 9.4 percent year over year in the last 10 quarters—thereby putting upward pressure on core inflation. Third, the peso has weakened against the US dollar since mid-2016 (by 6.9 percent in the 12 months to July 2017), adding to imported inflation. On a positive note, however, the worst of the peso weakening seems to be over as global markets see more clarity in the US Federal Reserve's interest rate path. Finally, with inflation staying low until mid-2016, a low base effect is also playing its part. Given these factors, it is no surprise that BSP raised its inflation forecast for 2017 and 2018 from 3.1 percent and 3.0 percent, respectively, to 3.2 percent. [4] With its focus now on inflation, BSP is not expected to move to an accommodative stance any time soon. Instead, if price pressures increase further and the peso drops sharply due to any external shock, BSP is likely to tighten policy, possibly starting with a 25-basis-point hike later this year.

Figure 3. Inflation has been heading up since 2016



Source: Haver Analytics; Deloitte Services LP economic analysis. Deloitte Insights | Deloitte.com/insights

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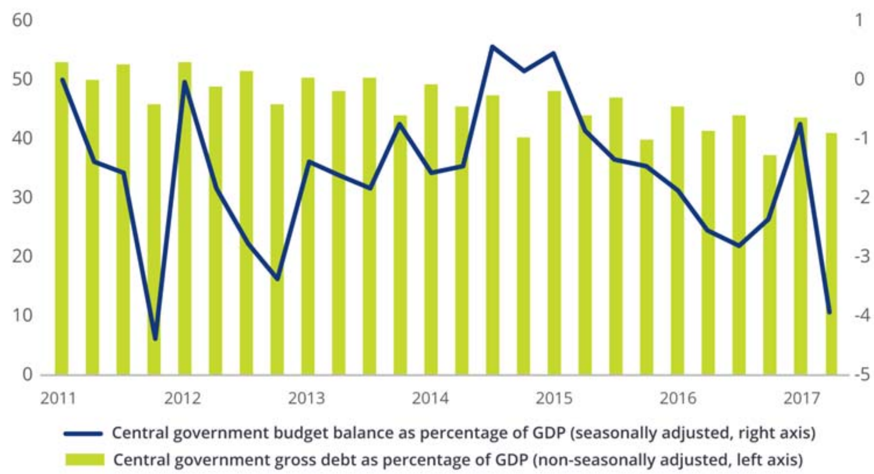
Q4/figures/Philippines_Figure3.png>

Moving toward long-term gains

Rising inflation will weigh on real income gains and thereby, consumer spending growth. The slight moderation in private consumption growth in the last two quarters is likely a result of higher price pressures. Policy makers would be wary of this and BSP in particular would continue to focus on inflation over the next year. Despite these inflation concerns, consumers appear upbeat—about their current situation, the next three months, and the year ahead—given continued economic momentum. [5] This augurs well for domestic demand, which will also benefit from government spending. However, the continued focus on infrastructure spending combined with a slight slowing of revenue growth in Q2 will have some impact on the budget deficit. Government finances will also likely be dented by USD 2 billion a year due to a new law, which allows free tuition in state universities and colleges. [6] But, with low levels of debt and deficit as a percentage of GDP (figure 4), any increased burden due to higher spending on education and infrastructure will not be a major cause for worry, especially given the long-term benefits of such spending on investments and productivity growth.

Figure 4. Government finances are healthy despite a rise in the deficit



Note: Series is seasonally adjusted by Haver Analytics.
Source: Department of Statistics via Haver Analytics; Deloitte Services LP economic analysis.
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Acknowledgements

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Endnotes

1. Dr. Daniel Bachman and Dr. Rumki Majumdar, ***United States Economic Forecast: 2nd Quarter 2017*** < *https://dupress.deloitte.com/dup-us-en/economy/us-economic-forecast/2017-q2.html*> , Deloitte University Press, June 13, 2017.
2. All data is sourced from Haver Analytics, unless mentioned otherwise.
3. Akrur Barua, " **Asian exports: Time to bet on a strong show** < *https://dupress.deloitte.com/dup-us-en/economy/asia-pacific-economic-outlook/2017/q4-strong-show-in-Asian-exports.html*> ," *Deloitte University Press* , September 28, 2017.

4 Siegfrid Alegado, Ditas B Lopez, and Norman P Aquino, " **Espenilla holds Philippine rate, raises CPI outlook in debut** <https://www.bloomberg.com/news/articles/2017-08-10/espenilla-holds-philippine-interest-rate-in-debut-policy-meeting> ," *Bloomberg* , August 10, 2017.

5 Bangko Sentral np Pilipinas and Department of Economic Statistics, *Consumer Expectations Survey* , sourced through Haver Analytics, August 2017.

6 Andreo Calonzo and Cecilia Yap, " **Duterte approves free state college fees opposed by budget chief** <https://www.bloomberg.com/news/articles/2017-08-04/duterte-approves-free-state-college-fees-opposed-by-budget-chief-j5xchqxe> ," *Bloomberg* , August 4, 2017.