

# Philippines Monthly Economic Developments

December 2016



- The World Bank upgraded the Philippines growth projection for 2016 from 6.4 percent to 6.8 percent, and for 2017 from 6.2 percent to 6.9 percent, given higher-than-expected third quarter growth and improved outlook assumptions.
- In October, manufacturing activities continued to expand, pushing utilization levels near full capacity.
- Remittances remain a key growth driver as both personal and cash remittances reached their highest levels so far.
- Prospect of an interest rate hike by the US Federal Reserve resulted in losses in the local stock index and contributed to a weakening peso.
- Inflation inched up further in November driven by increasing food and utility prices.
- The banking system continues its expansion through strong credit growth, and Philippine banks received a stable outlook rating from Fitch Ratings on December 8.
- The fiscal balance weakened in January-October as expenditure growth continued to outstrip revenue growth.

## **The World Bank revised the growth projection for the Philippines upward: for 2016 from 6.4 percent to 6.8 percent, and for 2017 from 6.2 percent to 6.9 percent.**

Growth in the third quarter of 2016 was higher than expected with investment and private consumption growth accelerating. This continued the strong growth performance of the first half of the year, which was marked by the government pre-election stimulus. It trend illustrates high confidence among investors and consumers, and provides the base for the more optimistic outlook for the remainder of 2016 and for 2017. Strong performance of high-frequency indicators in October and November, and continued policy commitment to the planned increase in public infrastructure spending are expected to carry the economy's growth momentum over to 2017-2018.

## **The Philippine economy expanded in the third quarter by 7.1 percent year-on-year.**

The country registered the highest quarterly growth in three years, and among its East Asian peers remains the strongest growth performer in quarter three of 2016. On the production side, the manufacturing and services sectors continued to drive growth in the third quarter, accelerating by 8.6 and 6.9 percent year-on-year, respectively. In manufacturing, the durable equipment industry and the construction sub-sector performed particularly well. Growth was further supported by a recovery in agriculture, where growth rebounded in the third quarter by 2.9 percent year-on-year, given higher output in crops and livestock. On the demand side, capital formation was the main growth engine in quarter three, expanding by 20.0 percent. Private consumption continued to be supported by robust remittances and benign inflation trends, leading to growth of 7.3 percent year-on-year, in the third quarter. However, government consumption slowed in the third quarter as the country entered the post-election budget cycle. Government consumption grew moderately at 3.1 percent year-on-year

after four consecutive quarters of double digit growth when the government front-loaded expenditures for the May 2016 general elections. Meanwhile, net exports remained a drag on economic growth, as the softer-than-expected recovery among major economies and commodity exporters led to weak external demand for the Philippines' exports.

## **In October, manufacturing activities continued to expand, pushing utilization levels to near full capacity.**

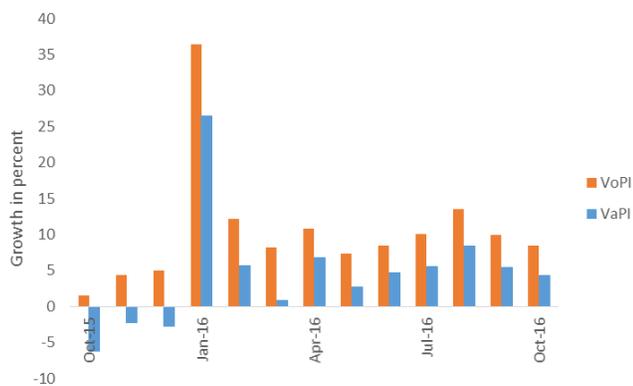
The Volume Production Index for manufacturing grew 8.4 percent year-on-year in October compared to 1.5 percent in the same month a year ago. Manufacturers for petroleum products, machinery, transport equipment and food products performed especially well and drove this result. The Nikkei ASEAN Manufacturing Purchasing Manager's Index for the Philippines registered continued robust expansion sentiments in November at 56.3, albeit slowing slightly for the second month from 57.5 in September and 56.5 in October. However, the enduring expansion in manufacturing activities resulted in a continued increase in the average capacity utilization rate, which reached 83.7 in October 2016, compared to 83.6 in the past two months and 83.5 in October 2015. Securing investment in the expansion of existing production capacity is now crucial, so as not to constrain medium-term output growth.

## **Remittances remain a key growth driver as both personal and cash remittances reached their highest levels so far.**

Personal remittances from overseas Filipinos grew in September by 6.3 percent year-on-year, reaching the highest monthly level in 2016 so far of US\$2.6 billion (while they amounted to US\$22.1 billion in the first three quarters of 2016—a 4.7 percent increase compared to the same period in 2015). Likewise, cash remittances reached their highest monthly level in September (growing by 6.7 percent year-on-year), reaching US\$20.0 on a cumulative basis in the first nine months of 2016, which is 4.8 percent higher than in the same period a year ago.

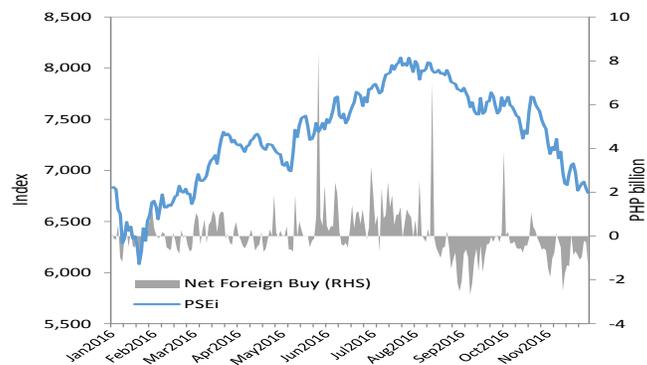


Figure 1: Manufacturing output growth remains robust ...



Source: Philippine Statistics Authority (PSA)

Figure 2: ... but foreign portfolio investment has been volatile.



Source: Philippine Stock Exchange

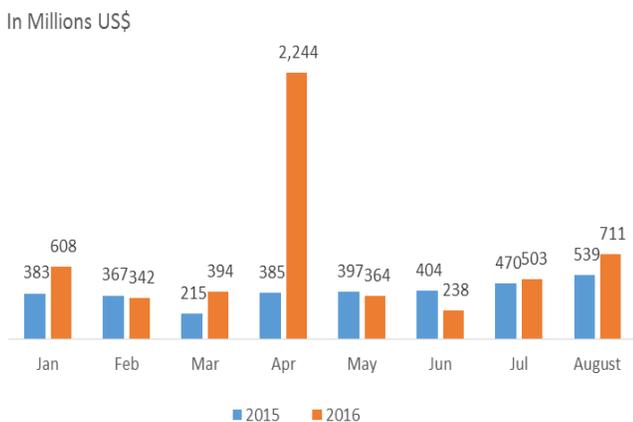
**Prospect of an interest rate hike by the US Federal Reserve resulted in losses in the local stock index.**

The Philippine Stock Exchange index (PSEi) declined by 8.4 percent month-on-month from 7,350 to 6,781 by end-November as foreign investors sold-off US\$383 million in portfolio stocks from the Philippines. The increasing likelihood of an interest rate hike by the US Federal Reserve in December led to investors shifting their focus to the US markets in anticipation of higher yields on US government bonds. On an annual basis, the PSEi has decreased by 2.1 percent as of end-November. How this will be reflected in foreign direct investment (FDI) trends will be revealed soon in the next Balance of Payment data from the *Bangko Sentral ng Pilipinas (BSP)*. Until August, FDI inflows remained strong, recording net inflows of US\$5.4 billion in the first eight months of 2016—an increase of 71.1 percent year-on-year. In August alone, net FDI inflows stood at US\$711 million with equity capital infused mainly to the real estate, manufacturing, and wholesale and retail trade sectors.

**As investors priced in the prospect of an interest rate hike by the US Federal Reserve, regional currencies, including the Philippine peso, weakened.**

The currencies of Malaysia, Indonesia, Singapore and Thailand weakened last month. By end-November, the Philippines peso depreciated by 2.8 percent month-on-month, and by 5.5 percent year-on-year. The exchange rate broke the Php/US\$50.00 mark on November 24, falling to the lowest level in ten years, but has since stabilized and closed the month at Php/US\$49.67. The *BSP* likely intervened during November in the exchange market to support the peso. As a result of outflows arising from foreign exchange operations, lower gold valuations and payments made by the government for maturing foreign exchange obligations, the international reserves declined by end-November by US\$2.38 billion to US\$82.7 billion compared to a month ago. They remain at comfortable levels, covering 9.6 months of imports and are equivalent to 5.9 times the country’s short-term external debt based on original maturity.

Figure 3: Until August foreign direct investment was strong.



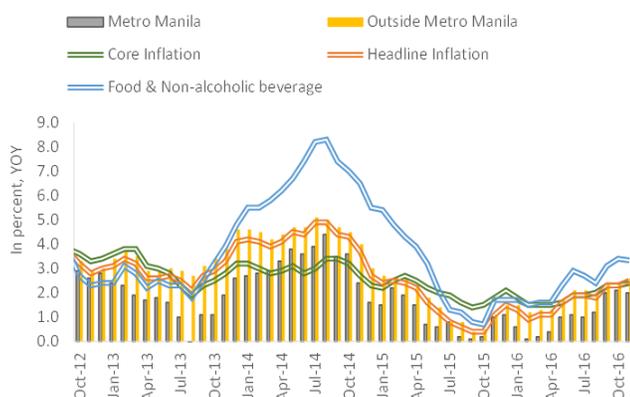
Source: PSA

Figure 4: The peso weakened to its lowest level in 10 years.



Source: Bloomberg

Figure 5: Inflation continues to rise.

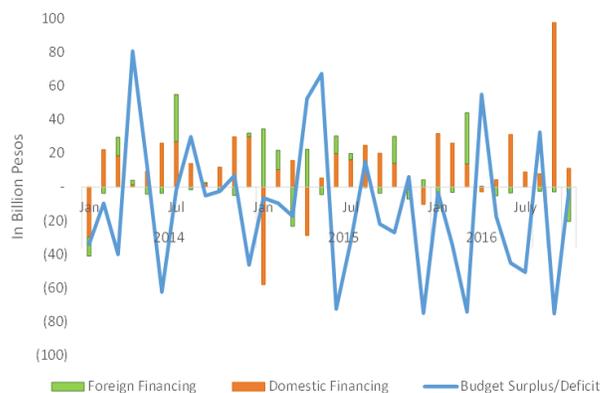


Source: PSA

**Inflation inched up further in November, driven by increasing food and utility prices.** The 12-month Consumer Price Index accelerated in November to 2.5 percent year-on-year, exceeding the *BSP* forecast range of 1.6-2.4 percent, but remaining within the 2-4 percent inflation target. Inflation rates have continued to rise throughout the year: average inflation increased to 1.7 percent year-to-date, compared to 1.4 percent in January-November 2015. Food inflation remained the main driver of headline inflation, at 3.3 percent year-on-year in November (3.4 percent in October). Inflation in utility prices picked-up to at 1.3 percent year-on-year, from 0.9 percent in October. Core inflation also remained stable at 2.4 percent year-on-year (2.3 percent in October).

**Strong domestic credit growth endured as commercial lending continued its rapid expansion** at 17.7 percent year-on-year in October, the same as in September. Firm credit sustained double-digit growth (17.4 percent), with the strongest growth in administrative support services, ITC and entertainment activities. Household credits grew by 22.0 percent in October year-on year (12.8 percent in October 2015), with salary loans persisting as the fastest growing segment. At the same time, the performance of banks remained strong with stable margins and low non-performing loans (1.61 percent as a share of the total loan portfolio compared to 1.81 in October 2015). The *BSP* deposit facility auction on December 1 was for the first time since its introduction in June undersubscribed due to increased yields and the banks' preference for cash given the holiday season and uncertainties around monetary policy decisions in the US and Europe.

Figure 6: Fiscal balances weakened.



Source: PSA

**On December 8, Philippines' banks received a stable outlook rating from Fitch Ratings.** Fitch expects local Philippine banks to remain healthy in 2017 and reap the benefits from economic growth and the expansion of credit. Improvements in regulations and risk management could also strengthen the banks' overall credit profiles, if healthy balance sheets and financial metrics are maintained. Meanwhile, the overall liquidity position is projected to remain comfortable in 2017 as credit creation and foreign remittance inflows would help cushion against debt and currency market uncertainties.

**The fiscal balance weakened in January-October as expenditure growth continued to outstrip revenue growth.** Total government expenditures expanded by 11.9 percent year-on-year in the first ten months of 2016, reaching Php2.0 trillion. This however, fell by 17.0 percent short of the Php2.4 trillion spending target as budget execution constraints remain an issue. Government revenues grew at a much slower pace, by 3.0 percent to Php1.8 trillion. Total revenue grew due to higher tax revenues, which expanded by 8.0 percent year-on-year in the first ten months given higher collections from the *Bureau of Internal Revenue*. This generated in October a year-to-date budget deficit of Php216.0 billion, more than four times larger than the Php52.6 billion over the same period last year. The primary balance (net interest payments) remained in surplus at Php49.8 billion pesos as of end-October 2016, but was 77.0 percent lower than the primary surplus recorded in the same period in 2015.

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