

## Executive Summary

**Contrary to previous official estimates, the economy contracted between 2008Q4 and 2009Q1 but recovered moderately afterwards.** GDP grew by 0.9 percent in 2009 but contracted by 1 percent on a per capita basis. On the demand side, private consumption—partly driven by strong remittance inflows—and robust public spending have been the key growth drivers. Investment and net exports continue to be a drag on growth, but at a decelerating rate. On the supply-side, the typhoons profoundly impacted the agricultural sector in Q4 2009 while industry is gradually recovering.

**Amid bright spots, social and labor market indicators remain weak—reflecting the series of crises that have hit the country.** Unemployment and underemployment are both rising, as is the labor force participation rate as household seek additional income in response to falling real wages and hours worked. OFW deployment remained strong despite rapidly rising global unemployment, reflecting the high demand for and supply of Filipino workers in the global labor market, particularly in the sea-faring industry. However, the incidence of hunger reached record highs in Q4, with Manila particularly hard hit. This partly results from the hardship that typhoon Ondoy brought to the capital region's poor.

**Despite a series of diverse global shocks, the balance of payments remained strong throughout the past two years, thanks to strongly counter-cyclical workers remittance inflows.** The country's robust current account and BoP surpluses have permitted the BSP to accumulate substantial foreign exchange reserves in 2009 (\$20 billion), providing ample support to the country's trade and external payments needs. Trade recovered in late 2009 but exports are still at only 2005 levels. As expected, remittances accelerated in Q4, in part due to transfers to typhoon-affected relatives. The countercyclical nature of real peso remittances has been remarkable in the past three years; as the economy recovers, the strength of these remittances is projected to wane in 2010.

**The central bank has begun to implement an exit strategy from the extraordinary crisis-related liquidity-support and monetary easing.** As concerns about the liquidity and stability of the financial system have abated, and inflation measures are rising moderately, the BSP signaled in January a measured implementation of its exit strategy by realigning its rediscounting facility rate to the overnight RRP. Subject to fulfilling its inflation target, the BSP is expected to link the pace the monetary policy normalization to the strength of the economic recovery.

**The largest fiscal easing in over two decades weakened the structural fiscal balance; a clear and credible exit strategy is crucial to enabling a measured unwinding of the fiscal stimulus.** Thanks to previous fiscal consolidation efforts, for the first time in recent economic downturns, the government was able to undertake a counter-cyclical fiscal policy. The 2½ percent of GDP in fiscal easing was the largest since 1986 and clearly helped buffer the economy during the global recession. However, it generated a NG fiscal deficit to 4.1 percent of GDP in 2009 (GFS basis), mostly of a structural nature as permanent revenue-eroding and expenditure-increasing measures were introduced. To enable a measured unwinding of this fiscal expansion—so as to protect the nascent recovery—laying out a specific medium-term plan that takes into account the country's inclusive growth agenda is warranted.

**Real GDP growth is projected to reach 3.5 percent in 2010 and 3.8 percent in 2011.** This represents an upward revision from our previous *Philippines Quarterly Update* that reflects a stronger global outlook, stronger-than-expected OFW deployment in 2009, and a looser fiscal stance in 2010 than anticipated earlier, in part reflecting post-typhoon reconstruction activities. Our analysis shows that, so far, the size and pace of the peak-to-trough and the projected recovery in 2010 is closely aligned with past recessions in the Philippines. However, unless reforms address long-standing growth bottlenecks, the recovery's shape over the medium-term will move from V to  $\checkmark$ , i.e., stabilize at a lower equilibrium growth rate.