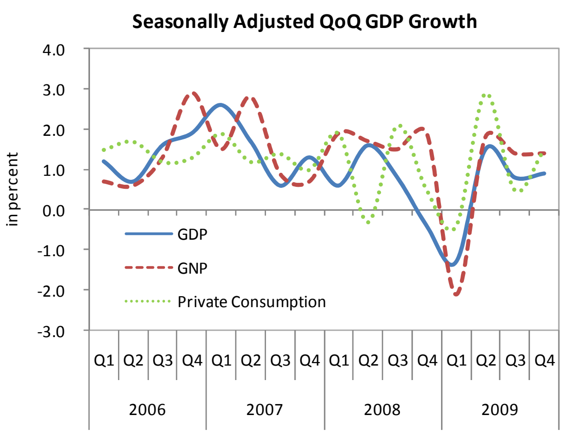
Recent Economic Developments[1]

Output and Demand

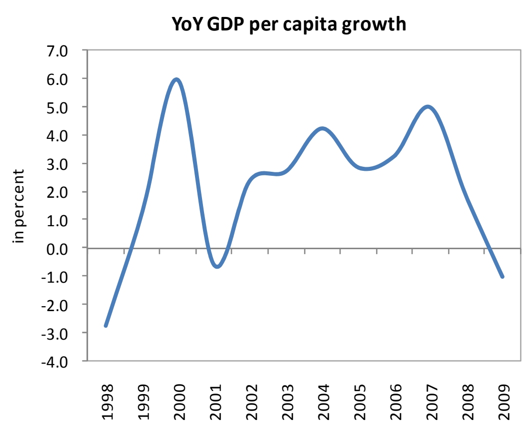
1. **Revised official GDP data reveal that the economy contracted for two quarters in late 2008/early 2009 and expanded moderately thereafter.** Revised GDP estimates show that, contrary to initial estimates, GDP actually fell on a seasonally adjusted basis for two consecutive quarters (2008Q4 and 2009Q1)—Figure 1.[2] A soft rebound in the following three quarters pushed the economy out of negative territory. In the fourth quarter of 2009, gains from the global economic recovery and a rebuilding of inventories were offset by agricultural losses caused by the massive typhoons-related flooding in Luzon island (where over two-third of domestic value added is created).[3] On a year-on-year basis, GDP managed to grow by 0.9 percent—the slowest pace since the Asian financial crisis in 1998—but on a per capita basis, it decreased by 1 percent (Figure 2 and Table 4).

Figure 1. The economy contracted for two quarters but recovered since



Source: National Statistical Coordination Board.

Figure 2. GDP per capita declined in 2009 1/



Source: National Statistical Coordination Board.
1/ The series contains data breack in both 2000 and 2004

2. **On the demand side, the recovery in private consumption and robust public spending have been the key growth drivers.** While the drop in private consumption in the first quarter of 2009 led to a temporary contraction in GDP, its recovery in the second quarter helped

[1] The Philippines Quarterly provides an update on recent economic developments and policies, and presents findings from ongoing World Bank work on the Philippines. The update is produced by a PREM team from the Manila office consisting of Eric Le Borgne (Senior Economist and task team leader), Sheryll Namingit, and Franz Loyola with support from the Philippines country team. Questions can be addressed to David Llorito (*dllorito@worldbank.org*).

[2] In terms of duration, the current technical recession is similar to that of the previous two recessions (2000 Q4-2001 Q1 and 1998 Q1-Q2), while in terms of depth it falls in between these two (i.e., worse than in 2000/2001 but better than during the Asian Financial crisis).

[3] For details on the impact of typhoons Ondoy (Ketsana) and Pepeng (Parma) on the Philippines' economic, financial and social sectors, see Box 1 of the November 2009 *Philippines Quarterly Update* as well as the November 2009 *Philippines Post-Disaster Needs Assessment* (PDNA). Both reports are at www.worldbank.org.ph

buoy the economy—as private consumption accounts for over 70 percent of GDP. Private consumption has grown more sensitive to shocks since the 2008 global food crisis when it first registered its negative growth since 1992. The rebound in private consumption was likely driven by strong remittances inflows (in real peso terms) and improved global outlook. While private spending registered a notable improvement in the Q4 2009, the quality and sustainability of this revival remains unclear as some of this additional spending in late 2009 was related to restoring damaged assets during the typhoons. The government's pump-priming efforts and the BSP's accommodative monetary policy have also been supportive of growth through 2009 (See policy sections).

3. **Investment and net exports continued to be a drag on growth, but at a decelerating rate** (Figure 3). In the fourth quarter of 2009, capital formation contracted by only 0.8 percent (year-on-year) compared to the double-digit contraction of the previous four quarters, pushing the full year contraction to 9.9 percent in 2009. The improved performance was driven by the slowdown in the contraction of durable equipment and inventory re-stocking, motivated in part by a need to replenish low stock levels in light of improved growth prospects as well as the need to replace core equipments and machineries damaged by typhoons Ondoy and Pepeng. However, in the fourth quarter both public and private construction shrank. For the former, the contraction was due to the frontloading of capital spending in the Government's Economic Resiliency Plan; for the latter it mainly stems from oversupply in both residential and commercial real estate (as discussed in our previous *Philippines Quarterly Updates*). As the global economy recovered, net exports have also increasingly contributed to overall growth since the third quarter of 2009 (See balance of payments section).

4. **On the supply-side, the typhoons had a profound adverse impact on the agricultural sector.** As estimated in the PDNA report,[4] agricultural production suffered heavily because of weather disturbances especially in the central and northern part of Luzon which are heavy producers of rice. Rice production, which account for 17 percent of the total agricultural production, contracted on a year-on-year basis by 14 percent in the last quarter of 2009. This contraction accounts for almost the agricultural sector's entire 2.8 percent decline (year-on-year basis) in that quarter and dragged down the full year growth to 0.1 percent from 2.9 percent in January to September 2009.

5. **Industry showed signs of a gradual recovery after three quarters of negative year-on-year growth** (Figure 4). With global recovery starting to take place, the manufacturing sector posted its first growth in the fourth quarter after three quarters of consecutive contraction. The utilities sector (electricity, gas and water), which is closely linked to manufacturing and commercial sectors, also improved from its negative contribution to growth in the last two quarters. The recent improvement, however, was not enough to prevent the overall industrial sector from contracting by 2.0 percent in 2009. The strength of the recovery is still uncertain based on seasonally adjusted growth.

6. **The service sector has proved resilient but growth was subdued throughout 2009.** The services sector slowed down considerably in the first half of 2009 but has started to recover

[4] *Philippines Post-Disaster Needs Assessment* (PDNA) report undertaken by the World Bank, other development partners and government agencies. November 2009.

in the third quarter. Its pace, so far, has remained moderate and uneven (Q4 2009 QoQ sa growth was slower than in the previous two quarters). Early election spending seems to have stimulated the services sectors. For example, private services grew by a robust 6.1 percent in Q4—the highest in eight quarters—with recreational services posting double digit growth.

Figure 3. GDP growth rebounded thanks to private consumption

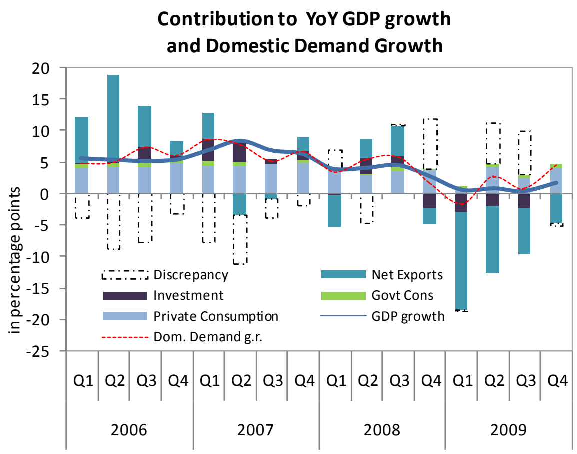
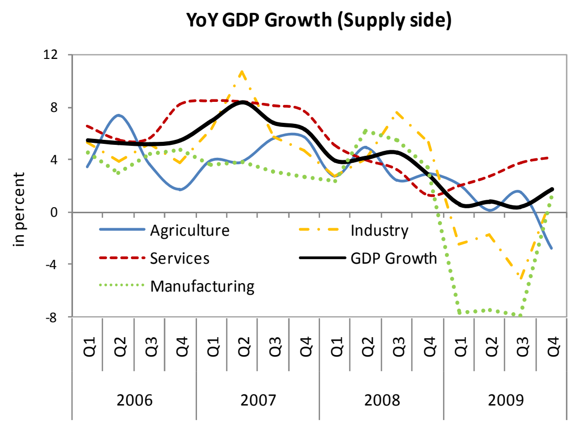


Figure 4. Except for agriculture, all productive sectors all posted moderate improvements



Sources: National Statistical Coordination Board and Department of Budget and Management

Employment and Poverty

7. **While total employment continued to grow, the labor market continues to weaken.** Thanks, in part, to the Government's fiscal stimulus and particularly to the Comprehensive Livelihood and Emergency Employment Program (CLEEP) that employed 389,769 low income Filipinos from October 2008 to January 2010, net job creation remained robust in 2009 (through October), mostly due to the services sector (Figure 5). More generally, despite the rising number of jobs created since 2007, this has not been sufficient to offset the rapid increase in the working-age population and in the labor force (Figure 5). As a result, labor market indicators have worsened since the economy decelerated from its 7.1 real GDP growth rate. These include a steady increase in unemployment and, with a lag, in under-employment (Figure 6), a fall in the share of full time jobs (Figure 5) and in the average hours worked (Figure 7), and a steady increase in the labor force participation ratio (Figure 7). Labor Force Survey data also reveal that daily real wages declined noticeably through the first half of 2009 (latest available data).

8. **Robust deployment of workers overseas partly reflects global recession-induced global staffing restructuring and the strong value-proposition of Filipino workers in the global labor market.** After posting a strong 17 percent growth in deployment in 2008, deployment growth slowed down but remained robust, at 11.7 percent through November 2009 (Figure 8). This good performance could be partly related to an acceleration of global staffing recruitment towards more cost efficient sources. For example, in the sea-faring industry—which has been, and continues to be, sharply affected by the global recession and the collapse in global trade and cruise ship tourism—the pressure to drastically reduce costs has led some companies to

accelerate their staff sourcing from countries such as the Philippines which has a large pool of comparatively cheap, English-speaking, and well qualified sea-farers. As a result, sea-farers' deployment increased by about 23 percent in the year through November 2009 (against an average of 14 percent during 2005-2008).

Figure 5. Strong job creation but not enough to offset rapidly rising working-age population

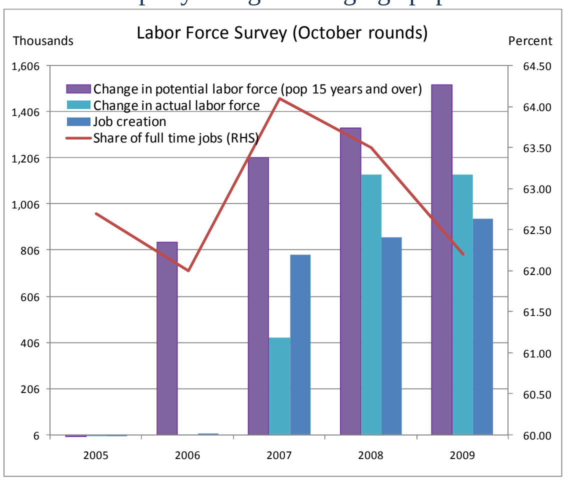


Figure 6. Rising unemployment and under-employment

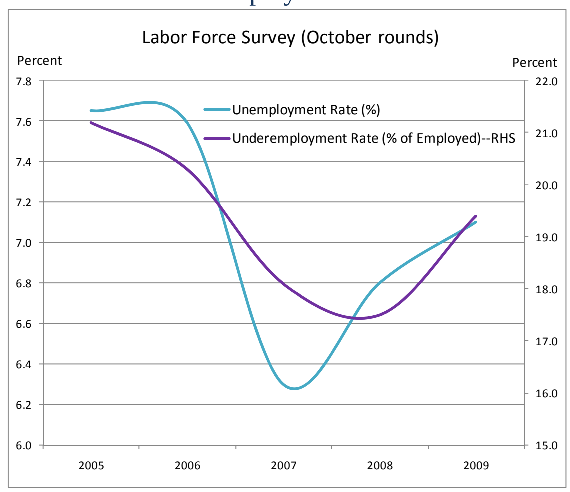


Figure 7. Falling hours worked and rising labor force participation

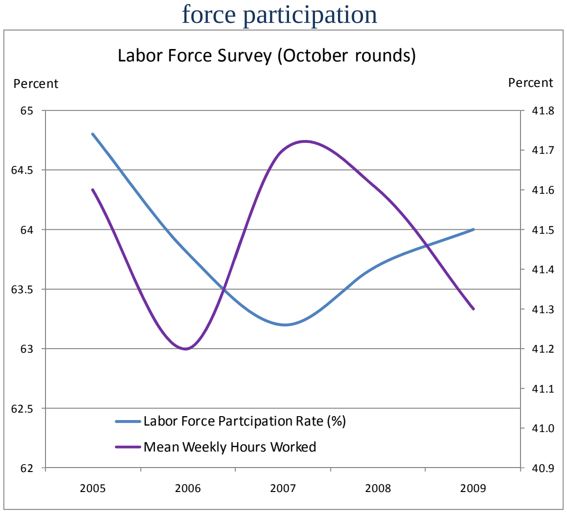
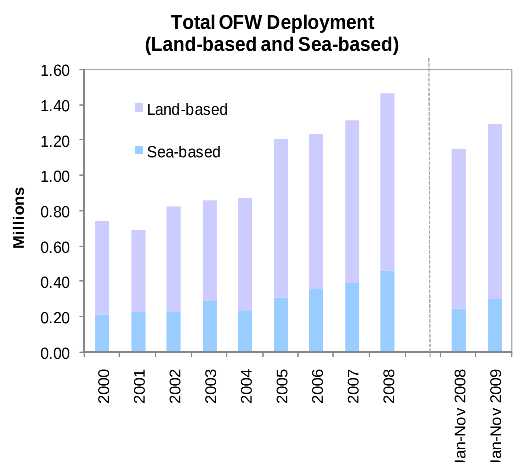


Figure 8. Robust overseas deployment partly reflects global staffing restructuring



Source: National Statistics Office, October Labor Force Surveys.

Source: POEA

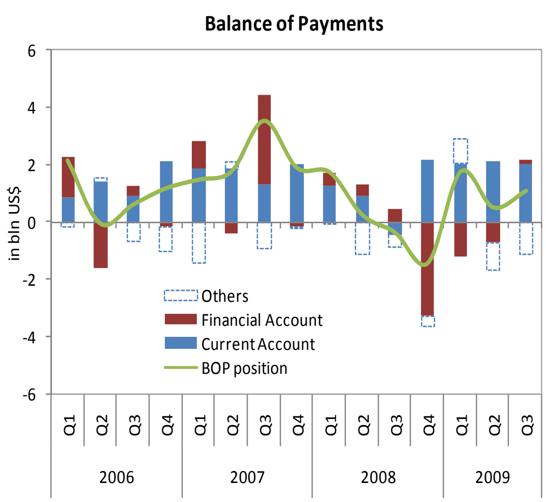
9. **Hunger incidence reached record highs in the fourth quarter of 2009; Manila fared particularly badly, mostly on account of the typhoons.** A Social Weather Station (SWS) survey showed that hunger reached a record-high of 24.0 percent in December 2009 from 18.8 in October 2009 and from its previous record of 23.7 percent in December 2008. A significant rise was noted in Metro Manila. The jump in incidence might seem surprising at first as the impact of typhoons Ondoy and Pepeng (September 26 and October 5) did not have any notable impact

on hunger incidence in October.[5] A likely explanation for the initial subdued impact on hunger was the large immediate relief operation that was established by the government (561 evacuation camps providing food and shelter to over half a million people at the peak of the crisis—including a large share of poor households who were living in the shantytowns; see Box 1 of our November 2009 *Philippines Quarterly Update* for details). These operations greatly helped struggling households in providing immediate relief but the spike in hunger incidence reveal that several months after the typhoons struck, poor households in Manila have not been able to fully recover.

Balance of Payments and External Debt

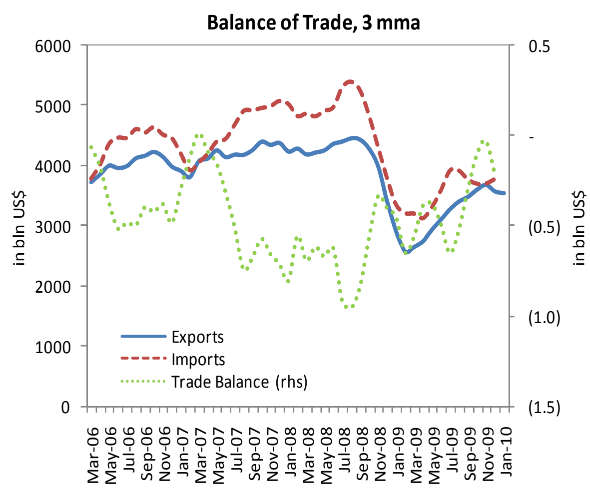
10. **The overall balance of payments was hardly affected by the global crises despite deep contraction in exports and some capital outflows especially in late 2008 / early 2009.** The balance of payments remained resilient through the third quarter of 2009 at 2.9 percent of GDP, thanks to a strong current account which stood at 5.4 percent of GDP (Figure 9). The trade sector was hit considerably by the global recession but with the contraction in imports greater than that in exports, the impact on the trade balance through the September 2009 was positive (Figure 10). Moreover, the resiliency of nominal dollar remittances which grew by 5.6 percent in 2009 helped buoy the current account. Strong capital outflows occurred in Q4 2008 but were gradually reversed and turned positive by Q3 2009.

Figure 9. A resilient current account surplus



Source:Bangko Sentral ng Pilipinas

Figure 10. External trade is recovering but remains well below pre-crisis level



Source:National Statistics Office

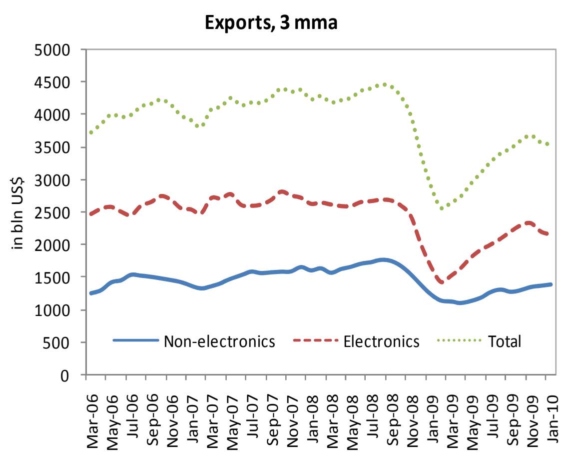
11. **Exports are recovering but this reflects base effects as December data are still at 2005 levels.** While both exports and imports have been posting strong year-on-year growth in Q4 (e.g., exports grew, on a year-on-year basis, by 24 percent in December and 43 percent in January), this reflects a strong base effect as export had contracted by 40.3 percent in December

[5] The fourth quarter of 2009 Social Weather Station survey was conducted from December 5 to 10 and asked about the family's experience of hunger, self-rated poverty, and self-rated food-poverty in the last three months. The third quarter survey was conducted from October 24 to 27, three to four weeks after the typhoons.

2008 and by 40.6 percent in January 2009 (Figure 10). Electronic and semi-conductors exports—accounting for about 60 percent of total Philippines exports—have posted a sustained recovery (again from a low base) and the industry is confident that the uptrend is no longer due to re-inventory stocking (Figure 11).

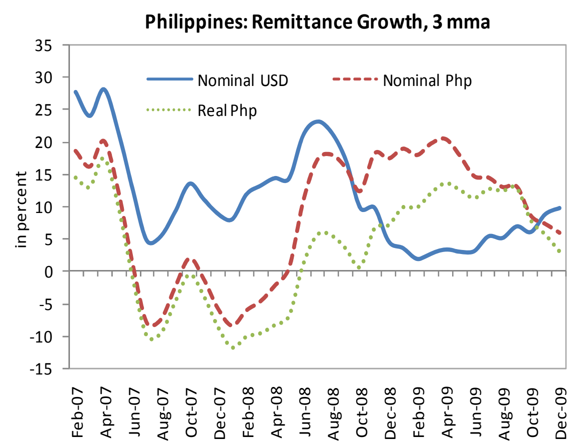
12. **Remittance growth accelerated in the latter part of 2009, in part due to OFWs sending money to typhoons-affected relatives.** Remittances in nominal dollar terms grew briskly in both November to December compared to the rest of 2009 (Figure 12). As discussed in our November 2009 *Philippines Quarterly Update*, the uptick was expected as remittances in the Philippines act as insurance to households affected by natural disasters. Recent research based on Philippines data shows that an average of 60 percent of household income lost through natural disasters is replaced by remittances (Yang and Choi, 2007).[6] Notwithstanding the resiliency of the dollar value of remittances during 2009, the real peso value of these remittances has steadily (and rapidly in Q4) decreased during the year (Figure 12).

Figure 11. After a sharper decline, electronic exports are posting a stronger recovery than other exports



Source: North American Semiconductor Equipment Industry

Figure 12. Remittances have been strongly countercyclical in real peso terms



Source: Bangko Sentral ng Pilipinas

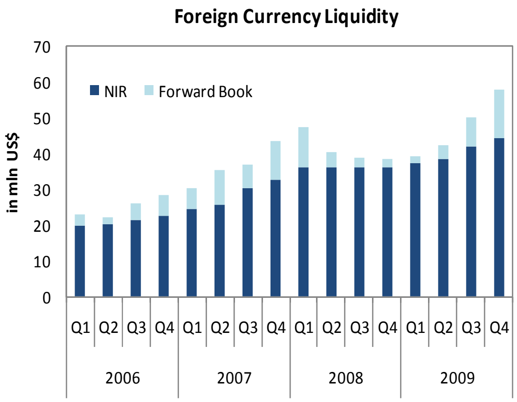
13. **The Philippines showed a remarkable resiliency during 2009 on the external front.** Aside from a balance of payments and current account in surplus, the country's foreign exchange reserves have also continued to rise to record-highs through 2009 and in early 2010. As of January 2010, gross international reserves stood at $45.7 billion, thereby providing the country with ample liquidity (GIR can cover 9.3 months of imports and more than four times short-term external debt by residual maturity—Figure 13). More remarkable is the $20 billion increase in total reserves (NIR and the forward book of the BSP) from Q4 2008 to Q4 2009 (Figure 13).[7] As of November 2009, external debt as a ratio of GDP (BSP definition) rose slightly by more than one percentage point as the public sector tapped global bond markets. This increase

[6] Yang, Dean, and HwaJung Choi, 2007, "Are Remittances Insurance? Evidence from Rainfall Shocks in the Philippines," *World Bank Economic Review*, Vol. 21(2), pp. 219-48.

[7] The IMF's increased SDR allocation, deposits from global bond issuances, valuation gains and loan disbursements from multilateral organizations have been important contributors to the rise in reserves.

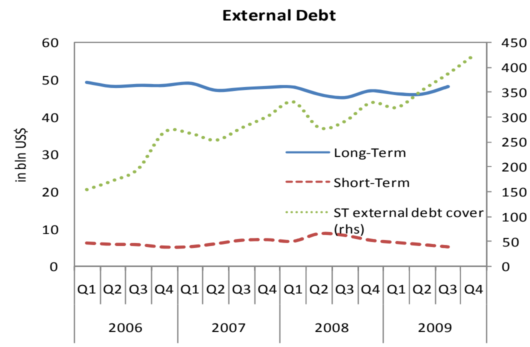
notwithstanding, the share of short-term external debt to total debt declined to 10 percent at end Q3—Figure 14.

Figure 13. Reserves have surged by $20 billion since 2008Q4 due to strong BoP



Source: Bangko Sentral ng Pilipinas

Figure 14. The external debt position remains comfortable



Source: Bangko Sentral ng Pilipinas

Financial Markets and Corporate Sector

14. **The impact of the global financial crisis and recession proved short-lived in both the Philippines' equities and debt markets** (Figures 15 to 18). The Philippines Stock Exchange index (PSEi) continued to surge beyond the 3,000 level through mid February, posting a 79 percent gain from its post Lehman Brothers trough in October 2008. As global risk appetite recovered, nonresident net inflows in the first two months of 2010 continued to be positive. Similarly, sovereign spreads have narrowed significantly since Q4 2008, notwithstanding the country's deteriorating structural fiscal balances. They are now lower than prior to Lehman Brothers' collapse partly due to temporary supply and demand conditions (a reduction in the aggregate supply of global bonds in East Asia and ample demand for such bonds; the latter stems from the ample global liquidity thanks to central banks large quantitative easing and easy monetary policies, but also reflects the relative better performance of public finances in the region than in other parts of the world).

15. **Except for small and medium enterprises, and the property and mining sector, the profitability of the corporate sector continued to improve**.[8] Listed companies in the Philippines Stock Exchange posted a robust recovery in profits (through Q3 2009 profits grew by 61 percent year-on-year; Table 1). The financial, industrial, holding firms and services sectors continued to grow their bottom line at double digit rates as both international and domestic conditions normalize. On the other hand, listed SMEs and mining companies posted negative profit growth during the same period. The property sector continued to be loss making as inventories remain large and price pressures have materialized in all segments of the market.

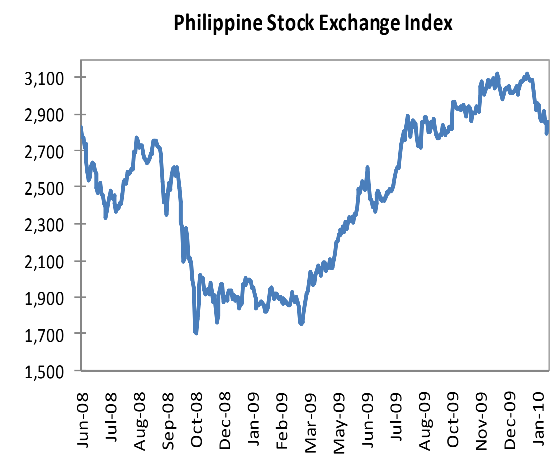
[8] Companies listed on the PSE are not representative of the overall Philippines corporate sector as they are concentrated in a few sectors.

Table 1. Philippines Stock Exchange Index and Its Components, 2008-2009

	Net Income			Revenues		
	Jan-Sep 2009	Jan-Sep 2008	% change	Jan-Sep 2009	Jan-Sep 2008	% change
PSEi	188.55	132.03	42.81	1,175.94	1,097.79	7.12
Financials Sector	34.20	22.81	49.91	232.58	204.29	13.85
Industrial Sector	105.94	57.29	84.91	879.97	911.55	-3.46
Holding Firms Sector	52.94	26.96	96.40	408.94	352.63	15.97
Property Sector	19.63	20.63	-4.86	87.40	86.44	1.11
Services Sector	68.73	44.33	55.03	321.34	317.57	1.19
Mining & Oil Sector	2.32	4.45	-47.78	26.94	25.60	5.23
Small and Medium Enterprises	0.00	0.01	-60.73	0.06	0.06	2.35
Total	283.76	176.48	60.79	1,957.22	1,898.13	3.11

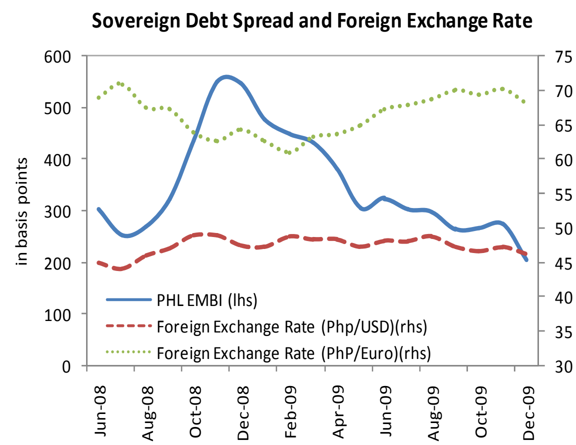
Source: Philippine Stock Exchange

Figure 15. Equities have surged past their pre-Lehman Brothers level…



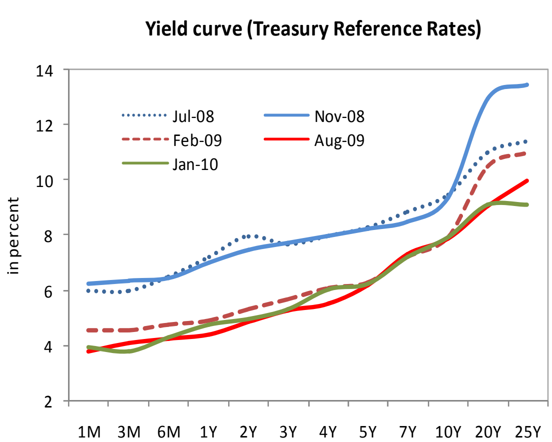
Source: CEIC database

Figure 16. … as have spreads on dollar debt



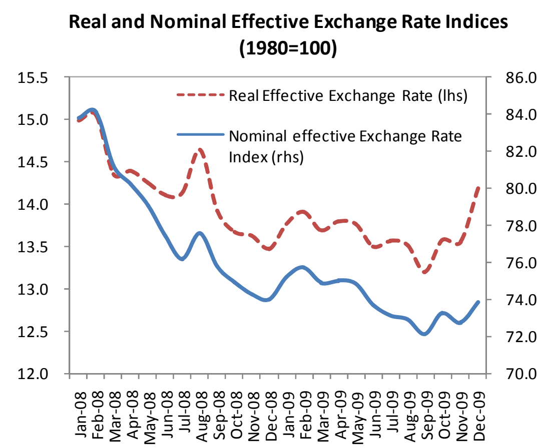
Source: Bangko Sentral ng Pilipinas, CEIC database

Figure 17. ….and similarly for domestic financing



Source: Philippine Dealing and Exchange Corporation

Figure 18. The Peso is rapidly appreciating following a long period of steady depreciation 1/



Source: bsp. 1/ Against major trading partners (US, Japan, European Monetary Union, United Kingdom).