Philippines Monthly Economic Developments

March 2017

- The Philippine stock exchange index weakened in February as uncertainty abroad weighs heavy on market sentiment.
- The Philippine peso came under renewed pressure, hitting another record-low in February.
- January exports accelerated at its fastest pace in nearly three years, while import growth moderated.
- Manufacturing activities expanded at a slower rate in January with many industries operating at full capacity.
- Rising food and energy prices continued to fuel the 12-month average Consumer Price Index in February.
- Credit growth remains upbeat and further accelerated its pace.
- Expansionary fiscal policy in 2016 led to a wider fiscal deficit as government expenditure grew rapidly while revenues fell as a percent of GDP.
- On February 20, the Philippine Development Plan (PDP) 2017-2022 was approved.

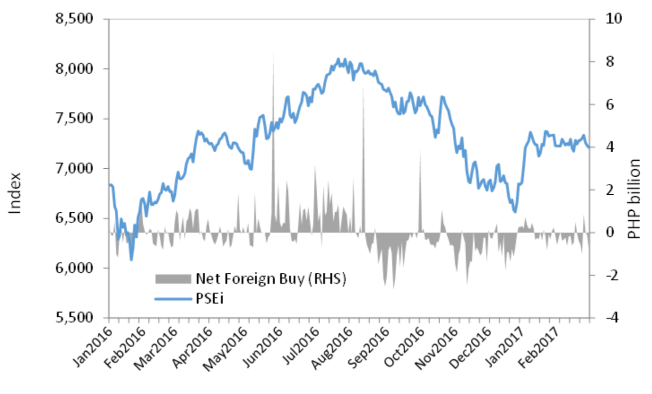
The Philippine stock exchange index weakened in February as uncertainty abroad weighs heavy on market sentiment. The Philippine Stock Exchange index (PSEi) closed at 7,212.1 in February, declining by 0.2 percent month-on-month after having posted a 5.7 percent growth in January. Net foreign selling increased to Php5.1 billion, a reversal from the Php272.8 million net foreign buying recorded in the previous month. Cautious trading throughout the month persisted as investors priced-in the likelihood of another interest rate hike by the US Federal Reserve in March and also awaited clarity on US economic policy decisions.

The Philippine peso came under renewed pressure, hitting another record-low in February. The Philippine peso once again breached the Php/US$50.00 mark on February 21st, and dropped further to close the month at Php/US$50.26. This was the second significant drop since November 2016, and represents a new record-low since 2006. The month-on-month depreciation from the January closing of Php/US$49.72 was 1.1 percent. The weakening against the US Dollar happened as a result of an increase in US Treasury yields in the last week of February, coupled with the expectation of the US Federal Reserve announcing another interest rate hike in March. There was limited effort from the central bank to soften the depreciation: international reserves settled at US$81.1 billion at end-February, US$0.25 billion lower than at end-January. The present reserves cover 9.2 months-worth of imports of goods and payments of services, and are equivalent to 5.9 times the country's short term debt based on original maturity.

January exports accelerated at its fastest pace in nearly three years, while import growth moderated. Goods exports increased by 22.5 percent year-on-year in January 2017, the highest growth since 2014, compared to a much weaker 4.5 percent in December 2016. The sharp increase in goods export growth coincided with a strong recovery of electronics exports, the country's main export commodity. Electronics exports, which account for nearly half of total goods exports, expanded by 10.4 percent year-on-year, after contracting by 2.8 percent in December 2016. Meanwhile, import growth moderated to 9.1 percent year-on-year in January 2017, from 19.1 percent in December 2016, because capital goods imports contracted by 11.0 percent year-on-year compared to an expansion of 36.9 percent in December 2016. However, consumer goods imports, which account for nearly a fifth of the total import bill, expanded strongly by 22.8 percent year-on-year (compared to 13.2 percent in December 2016).

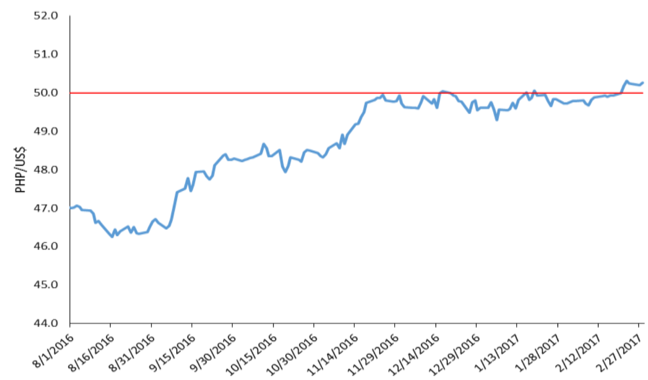
Manufacturing activities expanded at a slower rate in January with many industries operating at full capacity. The volume of production index (VoPI) opened the year at a slower growth of 9.3 percent in January from 23.0 percent in December 2016 and compared to 36.4 percent in January a year ago. Production activities remained upbeat for wood and wood products, basic metals, and footwear and apparels. The Nikkei ASEAN Manufacturing Purchasing Managers' Index (PMI) indicated a stronger expansion in February, increasing to 53.6 from 52.7 in January, reflecting improved expectation for new orders, stock purchases, and output in the manufacturing industry. This ended a previous index decline of four consecutive months. Average capacity utilization remains close to record-highs, registering 83.8 percent in January, compared to 83.5 percent in January 2016. Eleven out of the 20 major industries are operating at 80 percent or above capacity utilization, which constitutes in effect full capacity. This makes ongoing investments in new production capacity of key importance, as to allow for medium-term output expansion and growth prospects.

Figure 1: The PSEi ended flat in February after a strong recovery in January …



Source: Philippine Stock Exchange

Figure 2: … while the Philippine peso came under renewed pressure.

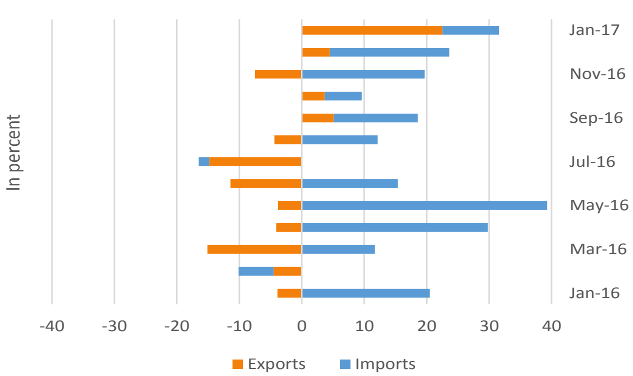


Source: Philippine Statistics Authority (PSA)

Rising food and energy prices continued to fuel the 12-month average Consumer Price Index in February. Headline inflation accelerated to 3.3 percent year-on-year in February 2017 from 2.7 percent in January (compared to 0.9 percent in February a year ago). This was mainly driven by price increases for food items to 4.1 percent year-on-year in February from 3.4 percent a month ago. Prices of oils, meat and fish increased at the fastest pace among food commodities. Meanwhile, energy and fuel prices increased by 2.9 percent year-on-year from 1.8 percent in January. This impacted transport prices which rose in part due to the approved Php1 hike in jeepney fares that took effect on February 10 in select regions of the country. Excluding food and energy prices, core inflation also inched up to 2.7 percent year-on-year growth in February from 2.5 percent in January, and compared to 1.5 percent in February 2016. The next *Bangko Sentral ng Pilipinas*'s Monetary Board meeting will take place on March 23.

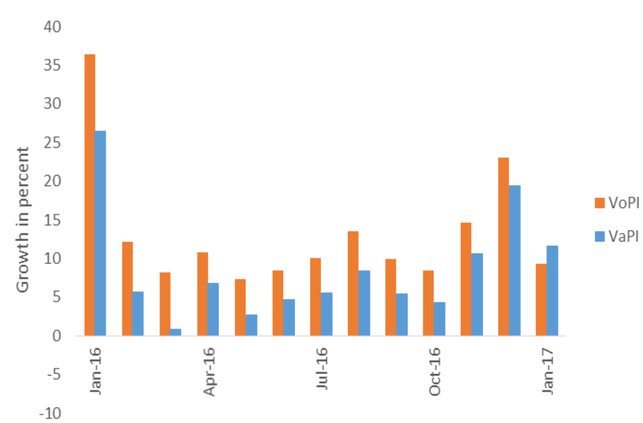
Credit growth remains upbeat and further accelerated in pace. Commercial bank lending grew at 18.0 percent year-on-year in January further increasing from 17.2 percent in December 2016. Household credit inched up further to 23.7 percent year-on-year in January from 22.8 percent in December 2016. Household loans for car purchases marked the highest increase at 1.3 percent on an annual basis. Firm credit grew by 17.5 percent year-on-year in January from 16.8 percent in December 2016. Credit growth at the firm level was primarily driven by increasing financing demand of the real estate, wholesale and retail trade sectors. Meanwhile, non-performing loans as a share of the total loan portfolio for the Philippine banking system remained low at 1.9 percent year-on-year, compared to 2.1 percent in December 2015. The latest available capital adequacy ratio of 15.6 percent also indicates stability of the Philippines banking sector.

Figure 3: Exports accelerated at its fastest pace in nearly three years …



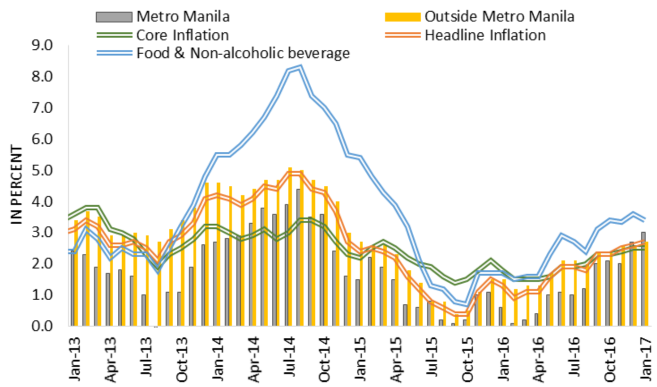
Source: PSA

Figure 4: … while manufacturing activities expanded at a slower rate in January.



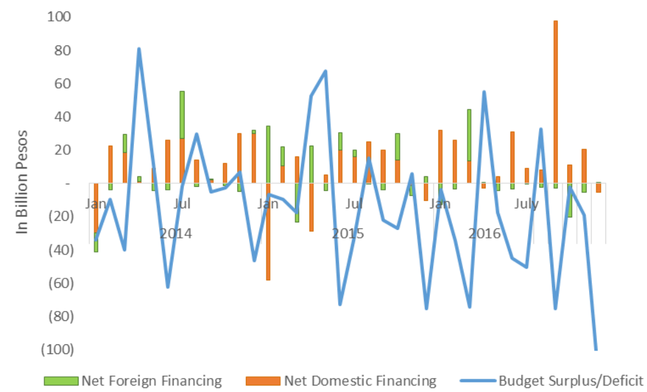
Source: PSA

Figure 5: Rising food and energy prices continued to fuel inflation in February.



Source: PSA

Figure 6: Expansionary fiscal policies resulted in the largest fiscal deficit since 2010.



Source: Bureau of the Treasury

Expansionary fiscal policy in 2016 led to a wider fiscal deficit as government expenditure grew rapidly while revenues fell as a percent of GDP. Government spending expanded by 14.3 percent year-on-year, increasing to 17.6 percent of GDP in 2016 from 16.8 percent of GDP in 2015. Expenditure growth in 2016 was the result of the roll-out of big-ticket infrastructure projects in roads, education, and health. Budget execution also improved significantly, with underspending estimated to decrease to 3.6 percent of the programmed amount compared to 12.8 percent in the previous year. Revenues decreased slightly as a percent of GDP from 15.8 percent in 2015 to 15.2 in 2016, but tax collections rose by 9.1 percent year-on-year, compared to 5.6 percent in 2015 despite the absence of new tax policy measures. This was largely due to tax administration improvements and the streamlining of processes at the Bureau of Internal Revenue which led to increased efficiency both in collecting and monitoring taxes. However, as a share of GDP, tax revenue effort only inched up slightly to 13.7 percent of GDP compared to 13.6 in 2015. As a result, the government's fiscal deficit more than doubled in 2016 to 2.4 percent of GDP, from 0.9 percent of GDP in 2015. However, this remained within the deficit target of 2.2-2.7 percent of GDP for 2016 year.

On February 20, the Philippine Development Plan (PDP) 2017-2022 was approved. The PDP is the new government's medium-term development plan that is guided by the country's long-term vision embodied in the *AmBisyon Natin* 2040. Under the PDP 2017-2022, the government aims to turn the Philippines into an upper-middle income country by 2022 through the implementation of priority policies and programs anchored on the government's 0-10 point socio-economic agenda. The National Economic and Development Authority (NEDA) is being tasked to coordinate the implementation of the PDP among government agencies at the national level and lead the prioritization of policies and programs.

On February 28, the President signed the Investment Priorities Plan (IPP) which provides a blue-print for priority investments across the country. The memorandum order No. 12, effective as of March 12, lists the priority investment activities of the administration for 2017-2019. The IPP identified the following preferred investment areas: agriculture; forestry and fishery; manufacturing, including agri-processing; infrastructure and logistics, including through public-private partnership; and export businesses. The IPP also plans to bring greater attention to the Autonomous Region of Muslim Mindanao, and micro-, small-, and medium-term enterprises (MSME) initiatives while providing continued fiscal incentives to the Business Operations Outsourcing industry to create more jobs outside of Metro Manila.

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