Philippines Monthly Economic Developments

August 2017

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- The Philippine Stock Exchange index (PSEi) posted solid gains in July, yet net foreign buying weakened.
- The Philippine peso traded for most of July around the Php/US$50 level and reached its weakest level in over ten years.
- In June, Philippine external trade slowed, with export growth moderating significantly and imports contracting.
- Manufacturing activities continued to expand at a slower pace in June and average capacity utilization remained elevated.
- Inflation picked up slightly to 2.8 percent in July.
- Credit expansion remained uninterruptedly high, in line with growth in domestic liquidity.
- The government's fiscal balance widened in the first six months of 2017 as expenditure growth picked up in the second quarter of the year.
- The government submitted its proposed 2018 national budget to Congress, with expenditure priorities broadly in line with the previous year's budget.

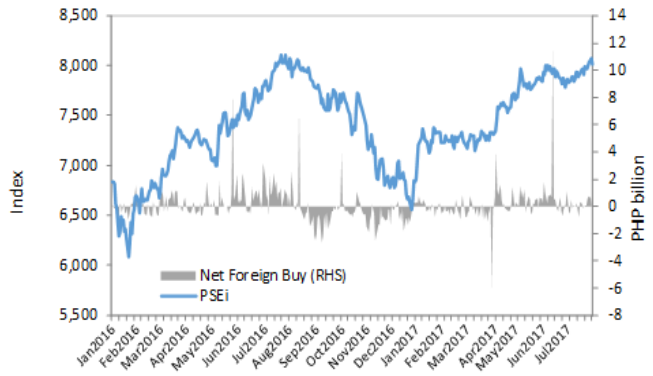
The Philippine Stock Exchange index (PSEi) posted solid gains in July, yet net foreign buying weakened. In the first seven months of 2017, the PSEi has increased by 17.2 percent, in line with top performing major stock indexes in the Asia-Pacific region. In July, the PSEi improved by 2.2 percent month-on-month and closed at 8,018, its highest level so far in 2017. The PSEi also grew on a yearly basis (0.7 percent), but foreign participation weakened significantly. In July, total net-foreign buying decreased to Php1.9 billion, compared to Php19.1 billion in May and Php19.6 billion registered a year ago, when the PSEi came close to the 2015 record high of 8,127.

The Philippine peso traded for most of July around the Php/US$50.00 level and reached its weakest level in over ten years. It closed the month at Php/US$50.58, marking a 0.2 percent month-on-month depreciation compared to June. This also represented a marked 7.4 percent year-on-year depreciation. The central bank reportedly intervened during July to temper excessive volatility in the foreign exchange market. As a result, the gross international reserves slipped to US$80.8 billion in July from US$81.3 billion in June (compared to US$85.5 billion in July 2016). International reserves cover 8.6 months' worth of goods imports and payments of services and primary income. It is also equivalent to 5.5 times the country's short term external debt based on original maturity, and 3.7 times based on residual maturity.

In June, Philippine external trade slowed, with export growth moderating significantly and imports contracting. Exports grew at its slowest pace in 2017, expanding by 0.8 percent year-on-year. This marks a notable reduction from the 13.7 percent growth reported in May. The moderation in export growth was a result of the stagnation in growth of exports of manufactured goods, which accounted for 85.9 percent of total exports. Exports of wood manufactures, garments, and processed food and beverages contracted. At the same time, electronic goods exports, which make up about half of the total export bill, increased by 4.4 percent year-on-year. Especially semi-conductors and electronic products for data processing grew at healthy rates. Meanwhile, imports shrank by 2.5 percent year-on-year, compared to robust growth in May at 17.8 percent. The contraction was a result of the decline in the imports of capital goods, and raw materials and intermediate goods, which shrank by 3.5 percent and 6.9 percent year-on-year, respectively. On the other hand, consumer goods imports continued to grow, but growth slightly moderated in June to 7.0 percent year-on-year from 8.3 percent in May.

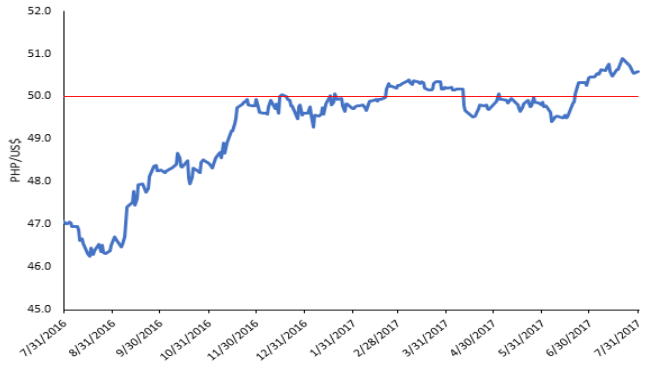
Manufacturing activities continued to expand at a slower pace in June and average capacity utilization remained elevated. The volume of production index (VoPI) for manufacturing grew in June by 8.1 percent year-on-year, slower than the revised 9.8 percent growth in May. Production activities in most sectors remained robust and exceptionally strong for the footwear and apparel sector, and for metal production which expanded annually at 340.4 percent and 154.2 percent, respectively. Factory output for chemical production, and for rubber and plastic production, however, was weaker and declined. Signaling a potential slowdown, the July Nikkei Philippines Manufacturing Purchasing Managers' index (PMI) slid further to 52.8, compared to 53.9 in June and 54.3 two months earlier. Nonetheless, the July PMI stayed in expansionary territory with solid reports on output and new orders. At the same time, average capacity utilization remained elevated in July at 83.8 percent, amplifying the need to invest into new capacity in the manufacturing sector.

Figure 1: The PSEi posted solid gains throughout July.



Source: Philippine Stock Exchange

Figure 2: The Philippine peso hovered around Php/US$50 and reached its weakest level in over ten years.

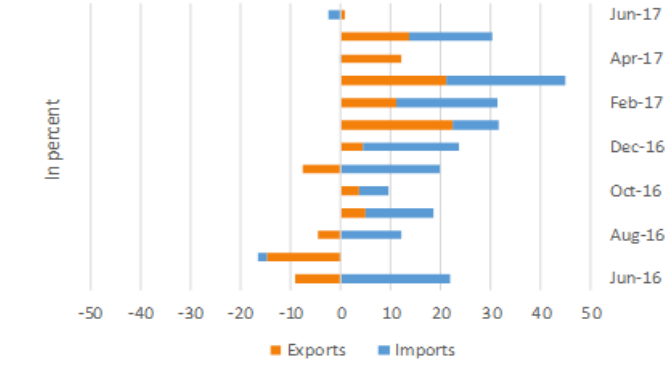


Source: Philippine Statistics Authority (PSA)

Inflation picked up slightly to 2.8 percent in July. The 12-month Consumer Price Index rose marginally compared to the downward-revised 2.7 percent in June (previously 2.8 percent). The uptick in the CPI inflation was brought about by higher prices in the transport sector. Here price increases for domestic petroleum products and fare adjustments for the Philippine National Railways drove up inflation. At the same time, food inflation continued its deceleration and slowed in July to 3.3 percent year-on-year from 3.5 percent in June, and compared to its peak of 4.0 percent in March. This was due to slower price rises for key food items such as meats, oils and fats, and fruits and vegetables. In the first seven months of the year, headline inflation averaged 3.1 percent while core inflation averaged 2.7 percent, remaining within the central bank's 2-4 percent target range. In early August, the central bank issued a statement on the medium-term inflation path, citing a manageable inflation outlook over the near-term policy horizon. With this signal it is likely that it will maintain the key policy rate at 3.0 percent in the near term.

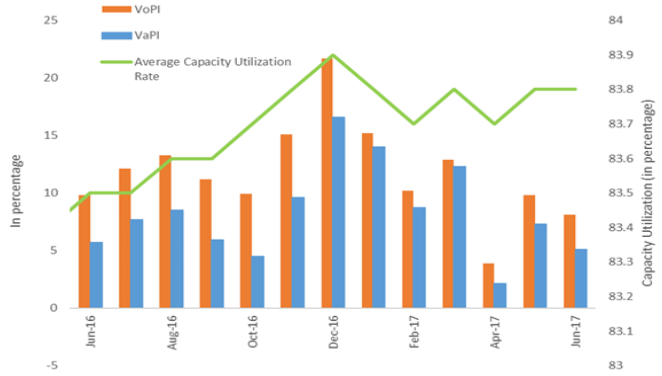
Credit expansion remained uninterruptedly high, in line with growth in domestic liquidity. Domestic liquidity (M3) growth accelerated further in June to 13.2 percent year-on-year, compared to 11.3 percent in May. Credit expansion is the principal driver of growth in money supply as loans of commercial banks, net of reverse repurchase placements (RRPs), grew in June by 20.0 percent year-on-year from 18.7 percent in May. Loans to firms dominate the banks' loan portfolio and constitute net of RRPs 88.5 percent of the aggregate loan portfolio and were primarily driven by real estate activities, manufacturing, and wholesale and retail trade. Household loans continued to grow at around 18 percent year-on-year. The banking system remains stable with a registered annual asset growth of 13.4 percent, funded by sustained inflows of deposits. Banks maintained a strong capital adequacy ratio of 15.4 percent.

Figure 3: Imports contracted and exports posted its lowest growth so far in 2017.



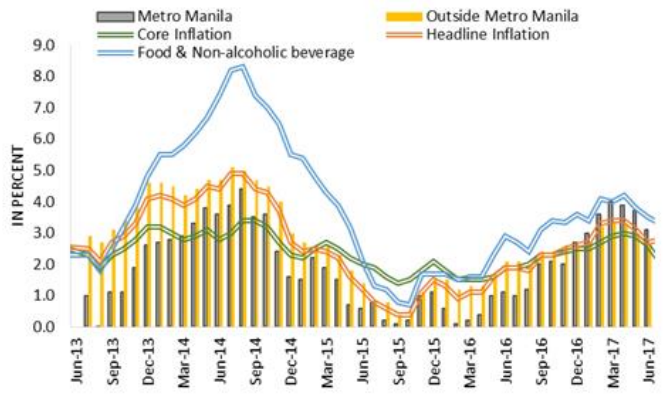
Source: PSA

Figure 4: Manufacturing activities expanded at a slower pace in June.



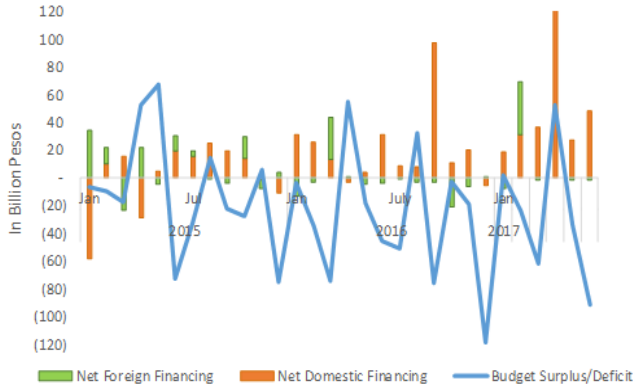
Source: PSA

Figure 5: Headline inflation rose slightly in July.



Source: PSA

Figure 6: The fiscal deficit widened in the first six months of 2017 as spending picked up.



Source: Bureau of the Treasury

The government's fiscal balance widened in the first six months of 2017 as expenditure growth picked up in the second quarter of the year. In the first half of 2017, revenues improved by 6.8 percent year-on-year in nominal terms, compared to 1.4 percent a year ago, reaching PHP1.1 trillion. Tax revenue growth stood at 8.8 percent year-on-year in nominal terms, slightly lower compared to 10.1 percent in the same period of 2016. Both the Bureau of Internal Revenue and the Bureau of Customs narrowly missed their collection targets in the first six months of this year. Meanwhile, government expenditures soared to PHP1.2 trillion, increasing in nominal terms by 9.0 percent year-on-year in the first half of 2017, compared to 13.9 percent a year ago. Recurrent cost, specifically salary and pension spending, and the expansion in capital outlays drove this growth in equal parts. While personnel cost expanded by 13.1 percent, capital outlays rose by 12.3 percent year-on-year in nominal terms. As a result, the fiscal gap increased in the first half of 2017 by 28.4 percent year-on-year in nominal terms, reaching Php154.5 billion. This gap was financed primarily through domestic sources with net domestic financing increasing by more than three times in size compared to the same period in 2017.

The government submitted its proposed 2018 national budget to Congress, with expenditure priorities broadly in line with the previous year's budget. The President submitted the proposed Php3.77 trillion national budget, equivalent to 21.6 percent of GDP, after the President's second State of the Nation Address on July 24, 2017. The 2018 national budget represents a 12.4 percent increase over the Php3.35 trillion budget for 2017 and will continue the government's focus on increasing investment in human capital accumulation and infrastructure. The budget for the education sector accounted for 18.3 percent of the total budget, the largest among all sectors. Meanwhile, the government's infrastructure program is proposed to expand in 2018 by 27.8 percent year-on-year, increasing to Php1.1 trillion (estimated at 6.3 percent of GDP) from Php858.1 trillion (estimated at 5.3 percent of GDP) in 2017. Deliberations by the House Committee on Appropriations on the proposed 2018 national budget began on August 1, 2017, and are expected to last until late August. The House of Representatives is targeting to send its approved version of the budget, the General Appropriations Act, to the Senate of the Philippines by September 21, 2017 to conduct its own set of deliberations.

The Asia-Pacific Group (APG) on Money Laundering removed the Philippines from its watch list of vulnerable jurisdictions. In July, the Philippines was removed from the APG's list of jurisdictions needing further evaluation, citing the country's significant progress in addressing gaps in legislation and regulation in curbing money laundering. The APG acknowledged the passing of Republic Act No. 10927 on July 14, 2017, which requires all casinos to report daily transactions of at least Php5 million to the Anti-Money Laundering Council. As a result, the Philippines avoided to be included in the APG's black list of countries, which would carry penalties on the country's financial transactions.

Please contact Birgit Hansl: bhansl@worldbank.org

Prepared by a World Bank team under the guidance of Birgit Hansl, consisting of Kevin Chua, Kevin Thomas Cruz and Griselda Santos.