Economic Report

SENATE ECONOMIC PLANNING OFFICE

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The Philippines posted a significant 7.3 percent economic growth for the first half of 2007, the highest in nearly two decades. The record-breaking performance was mainly driven by the ever growing services sector and the government's pump-priming activities geared towards the improvement of domestic infrastructure. However, some risks may prove to be detrimental and thus, a number of improvements must be initiated to sustain the impressive growth.

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Domestic Economy Posts an Impressive 7.3% 1st Sem Growth

1.0 Gross Domestic Product

1.1 The Philippine economy turned in its best performance in nearly two decades when it posted impressive GDP growth rates of 7.1 percent in the first quarter of 2007 and 7.5 percent in the second quarter, bringing the first semester growth to 7.3 percent. In the past, the Philippine economy has had difficulty attaining and sustaining higher than 6 percent growth rates. Much of the growth is attributed to the intensified infrastructure pump-priming of the government, as well as from increased consumption fueled by the May national elections.

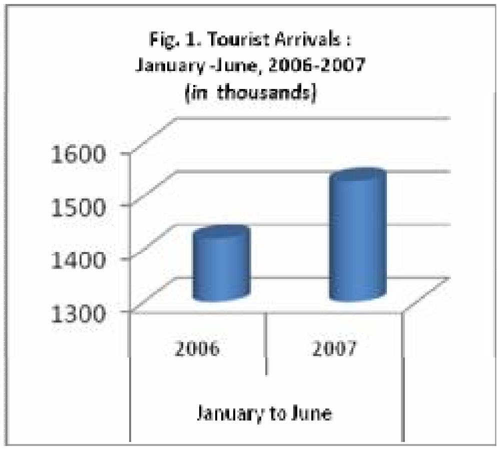
1.2 The 7.5 percent growth in the second quarter made the Philippines Asia's third best performer, lagging only behind China and Singapore which grew by 11.5 percent and 8.6 percent, respectively, during the said period.

1.3 On the production side, services remained the major growth driver, expanding by an average of 8.6 percent in the first half of the year, with almost all of its subsectors thriving.

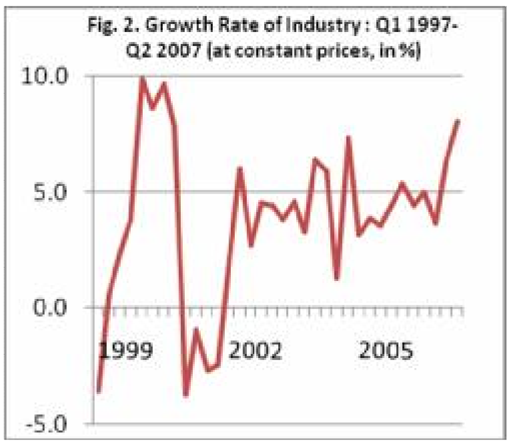
Among the services subsectors, finance grew the fastest at 13.3 percent as the Philippine Stock Exchange Index (PSEi) surged to a record high 3,718 points in June, while banks and other financial services providers posted higher earnings.

Fueled by the continued expansion of malls and the increased sales in appliances, the trade subsector grew by 8.6 percent, way higher than the 5.1 percent growth it posted last year.

Similarly stellar was the performance of the communications sector which registered a double-digit growth of 12.8 percent from January to June. Telecommunications firm Smart reported a gain of 2.9 million new cellular subscribers in the first half of the year which brings its total number of subscribers to 27.1 million, while Globe,



source: Department of Tourism



source: National Statistical Coordination Board (NSCB)

Table 1. Top Gainers and Losers in Manufacturing, First Semester 2006-2007

Top 5 Gainers	2006 Sem I	2007 Sem I
Food manufactures	3.9	6.4
Footwear & wearing apparel	-10.1	13.9
Non-metallic mineral prod.	4.4	18.2
Furniture and fixtures	14.6	21.3
Miscellaneous manufactures	12.4	8.8
Top 5 Losers	**2006 Sem I**	**2007 Sem I**
Electrical machinery	1.9	-5.6
Tobacco manufactures	-14.2	-18.5
Machinery except electrical	-18.4	-9.6
Leather and leather products	18.0	9.7
Chemical & chemical prod.	-2.2	0.2

source: NSCB

with its additional 2.5 million new users, now has a subscriber base of 18.1 million.

Meanwhile, higher tourist arrivals and the aggressive tourism-related promo fares of domestic airlines accelerated the growth of the transport sector, particularly air transport, to more than double, from 4.9 percent to 11.1 percent. Tourist arrivals went up by 7.6 percent to 1.52 million in the first half of 2007. The continued demand of Business Process Outsourcing (BPO) and Knowledge Process Outsourcing (KPO) companies for office space, on the other hand, propped up the real estate subsector growth to 21.4 percent from 14.0 percent in the same period last year.

1.4 It was, however, the hefty 8 percent expansion of industry which proved to be the most remarkable in the second quarter. The last time industry reached an 8 percent growth was in the third quarter of 2000, nearly a decade ago. In the last six years, industry was only growing at an annual average of 3.2 percent whereas in the first half of 2007, it registered a growth of 7.2 percent.

1.5 The upturn in industry was mainly driven by the double digit growth of its construction, and mining and quarrying subsectors. Construction grew on account of the property market boom and the strong growth in public construction while mining and quarrying got a boost from the uptick in the demand for copper, nickel and other metallic mining minerals.

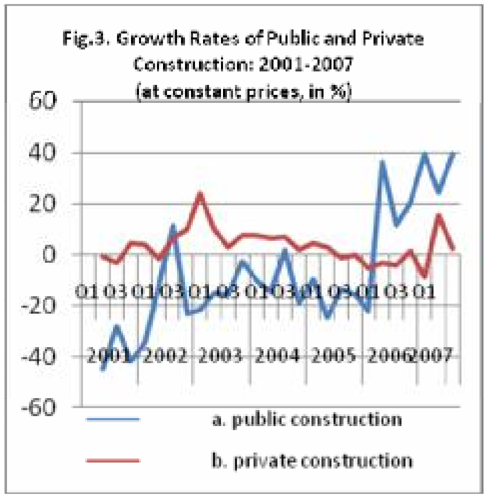
1.6 A cause of concern though is the continued slowdown in the manufacturing sector. This sector, which comprises more than two-thirds (67.5%) of industry's output and employs 3 million of the country's labor force, has been posting declining growth rates since last year. The biggest losers in manufacturing include the subsectors of electrical machinery whose growth decelerated because of the low demand for electronics overseas and chemical and chemical products, which were affected by the closing of several consumer companies.

1.7 The agricultural sector also slowed down, expanding by only 4.0 percent in the first semester, a far cry from its 5.24 percent growth over the same period in 2006. Because of the extended dry spell, nearly all agricultural subsectors recorded poorer performances. The crops subsector, which accounts for almost half of all agricultural production, only recorded a 2.63 percent growth for the first six months of the year as compared to 6.16 percent for the

Table 2. Selected Macroeconomic Indicators: First Semester 2006 & 2007, at constant prices, in %

INDICATOR	First Quarter		2nd Quarter		First Semester	
	2006	2007	2006	2007	2006	2007
GROSS DOMESTIC PRODUCT	5.7	7.1	5.5	7.5	5.6	7.3
GROSS NATIONAL PRODUCT	6.3	7.7	6.4	8.3	6.4	8.0
Production Side						
Agriculture, Fishery and Forestry	4.1	4.1	6.7	3.9	5.4	4.0
Agriculture & Fishery	4.1	4.0	6.9	3.8	5.5	3.9
Forestry	-9.2	23.1	-13.6	28.2	-11.4	25.7
Industry	5.3	6.3	4.4	8.0	4.9	7.2
Mining & Quarrying	1.8	13.2	3.3	33.3	2.6	23.3
Manufacturing	5.0	4.0	4.2	3.7	4.6	3.9
Construction	10.7	20.0	4.0	21.0	7.3	20.5
Electricity,Gas and Water	3.9	4.4	7.4	5.8	5.7	5.1
Services	6.7	8.8	5.7	8.4	6.2	8.6
Transport., Comm., Stor.	6.9	10.5	5.4	9.8	6.1	10.1
Trade	5.3	8.8	5.0	8.4	5.1	8.6
Finance	14.6	14.8	10.0	11.8	12.3	13.3
Ownership of Dwellings & Real Estate	3.4	5.5	5.2	6.3	4.3	5.9
Private Services	7.7	8.4	5.4	8.6	6.6	8.5
Government Services	3.7	2.3	4.9	2.8	4.3	2.6
Expenditure Side						
Personal consumption	5.3	5.9	5.4	6.0	5.3	6.0
Government consumption	7.6	9.9	3.3	13.5	5.5	11.7
Capital formation	0.3	6.9	1.5	8.2	0.9	7.5
Fixed capital	2.4	8.5	-1.0	10.0	0.7	9.3
Construction	8.0	18.5	2.4	18.9	5.2	18.7
Durable equipment	-0.7	2.3	-4.1	1.6	-2.4	1.9
Breeding stock & orchard dev't	-1.7	2.2	-1.7	5.2	-1.7	3.7
Exports	13.0	9.9	21.2	4.2	17.1	7.0
Merchandise Exports	11.4	10.7	21.7	5.9	16.5	8.3
Non-Factor Services	21.2	5.9	18.8	-4.6	20.0	0.6
Less : Imports	0.7	-2.1	4.0	-11.2	2.4	-6.6
Merchandise Imports	0.1	-3.4	4.1	-12.3	2.1	-7.9
Non-Factor Services	10.7	18.2	2.8	9.7	6.8	14.0

source: NSCB



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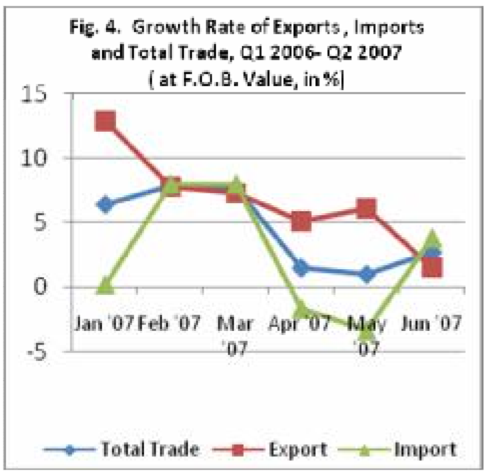

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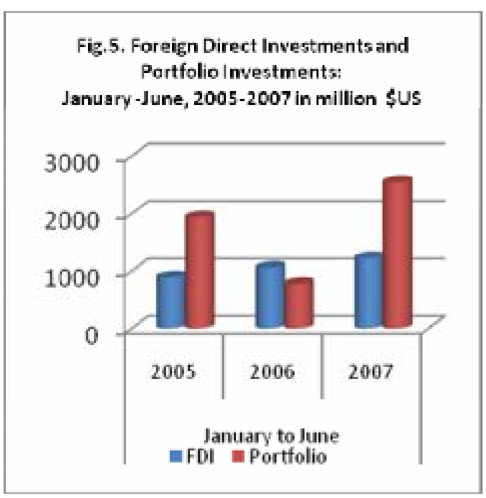


source: NSCB

same period last year. Palay production grew by only 2.88 percent for the period compared to 8.39% in 2006 while corn production grew by 5.69 percent, way below last year's growth rate of 31.9 percent for the same period.

1.8 On the demand side, the growth of personal consumption expenditure quickened from 5.4 percent to 6 percent aided by the low inflation environment, the continued influx of OFW remittances as well as the temporary increase in income brought by electoral spending.

1.9 Capital formation increased significantly during the first half of the year with large contribution from government construction spending. Public construction went up by 33.8 percent in the first half, as the government continued to embark on its major infrastructure projects. To date, 39 transport and 20 non-transport infrastructure projects are already under way with big-ticket items such as the Laguindingan airport and the *Tulay ng Pangulo* bridges included. According to NEDA, a total of P71.3 billion out of the P92.6 billion allotted for infrastructure outlay for 2007 has already been spent in the first six months of the year. This pump-priming partly contributed to the significant jump in government expenditures from 5.5 percent to 11.7 percent.

The growth of private construction spending, in contrast, was anemic at 2.5 percent, although there is still the accounting lag to consider which may warrant a growth revision in the next few months. In the first quarter, for instance, private construction growth was revised to 15.5 percent from the earlier announced 2.0 percent growth.

2.0 External Sector

2.1 In the first half of this year, exports amounted to $24.5 billion and grew by only 6.6 percent (in current prices) as against last year's 18.2 percent. This prompted the Bangko Sentral ng Pilipinas (BSP) to lower its 2007 growth forecast for exports to 8.0 percent from 11.0 percent, and imports to 7.0 percent from 11.0 percent. Export of electronic products, which accounts for 18.4 percent of the Philippines' total exports, went down by 1.7 percent due to the weakened demand in the external market as well as the strong peso.

Imports, on the other hand, increased by 2.3 percent, and amounted to $25.3 billion, bringing the total trade deficit to $776 million, almost double the deficit posted in the same period last

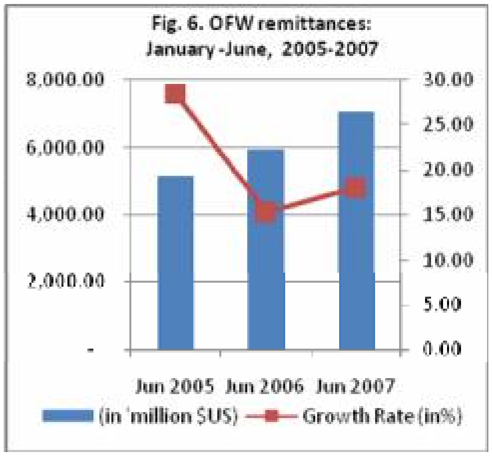


Fig. 6. OFW remittances: January -June, 2005-2007

source: Bangko Sentral ng Pilipinas (BSP)

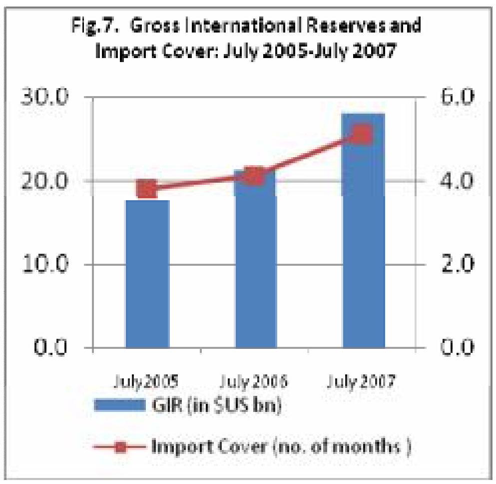


Fig.7. Gross International Reserves and Import Cover: July 2005-July 2007

source: BSP

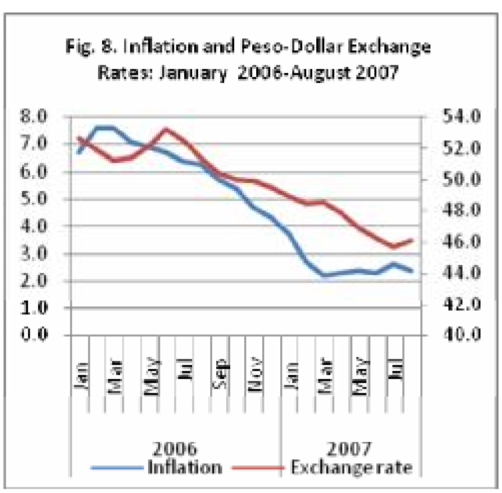


Fig. 8. Inflation and Peso-Dollar Exchange Rates: January 2006-August 2007

source: BSP

2.2 The wait and see attitude of the investors during the May national elections caused foreign direct investments to decelerate to 16 percent compared to last year's 19.2 percent. Nevertheless, the actual FDI net inflows of US$ 1.22 billion for the first six months of the year remained on track relative to the US$2.1 billion projected FDI net inflows for 2007. Meanwhile, net inflows of foreign portfolio investments rose to $2.6 billion, 3.3 times than the $773.8 million net inflow for the first semester of 2006.

2.3 Even with lower OFW deployment, remittances from abroad sustained a double-digit growth of 18.1 percent, or a total of $US7.0 billion for the first six months of 2007. The US$ 1.16 billion remittance posted in June actually marked the 14th straight month that remittances have been above US$1 billion. This is primarily attributed to the provision of more efficient remittance transfer services by banks and the expanding number of remittance centers and tie-ups abroad. The government is expecting remittances to reach US$ 14 million in 2007.

2.4 With the ample foreign exchange flows from exports of goods and OFW remittances, the Balance of Payments (BOP) continued to post a surplus, albeit at a lower level. The BOP surplus amounted to US$1.4 billion in the first quarter of the year, lower by 33.1 percent from the same period a year ago. The sustained foreign exchange inflows also enabled the BSP to further build up its end-July reserves even after pre-paying the national government debt. The current Gross International Reserves is now enough to cover 5.6 months of imports of goods and payments of services.

3.0 Inflation and Exchange Rate

3.1 Amidst the increase in oil prices during the first half of the year, prices of goods and services managed to remain stable as inflation further slowed down to 2.6 percent in the first half of 2007 from 7.1 percent in the first semester of 2006. The July and August inflation rates continue to be low at 2.6 and 2.4 percent, respectively, raising the likelihood that the year-end inflation, notwithstanding the risks, will be comfortably below BSP's full-year target of 4 percent to 5 percent.

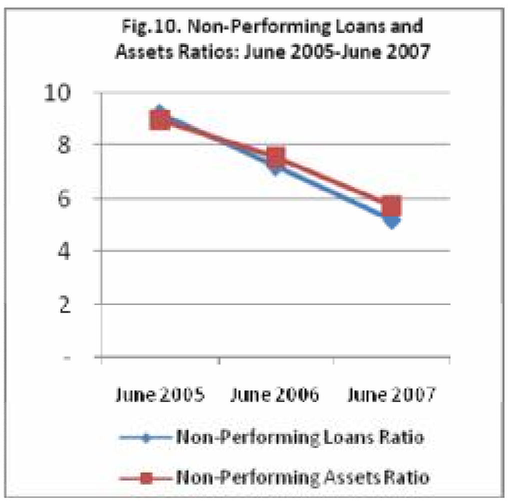
3.2 The inflationary pressure from January to June was assuaged by favorable supply conditions such as the positive growth in agriculture and the continued influx of cheaper goods from China. The strong dollar inflows which further strengthened the local currency to an end-of-June average of P47.614 to a dollar from P52.295 a year ago also helped in quelling inflationary pressure.

4.0 Financial Sector

4.1 The Philippine financial sector further strengthened in the first semester as equity prices in the first six months of the year surged to record-breaking highs and most banks report higher earnings and improved asset quality.

source: BSP

The Philippine Stock Exchange index, which opened at 2,983 in the start of the year, grew by 24 percent in the first half and reached a new peak of 3,718 in June. The local bourse was also able to raise a total of P45.4 billion from the initial and follow-on offerings held in the first semester, up by 78 percent from January to June of 2006. Net foreign buying totaled P64.4 billion, a 155 percent increase from the same period last year. Like most Asian stock markets, however, the PSEI succumbed to the subprime mortgage crisis that rocked the United States and plummeted to a low of 2,884 in August 16 before rising back to its end of the month closing of 3,320.

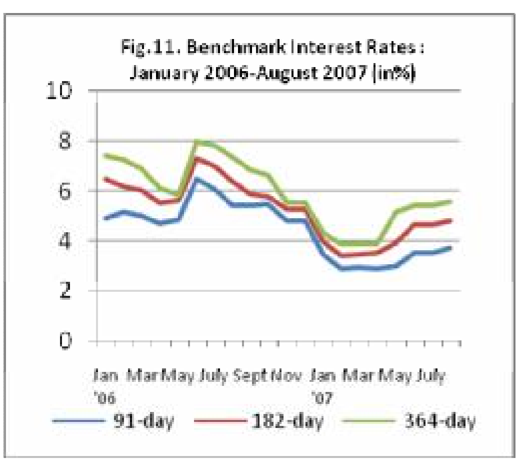


source: BSP

4.2 Meanwhile, the banking sector grew steadily at 13 percent in the first semester as most major banks reported substantial gains during the period: the Bank of the Philippine Islands increased their profits by 24 percent to P5.7 billion; Metrobank by 34 percent to P3.7 billion; PNB by 46 percent to P622 million; and RCBC by 245 percent to P1.81 billion.

After years of stagnation, the demand for credit has finally started to pick up with bank lending posting a year-on-year growth of 5.1 percent in June this year compared to the 1.3–percent growth last year.

The banks' asset quality also continued to improve as non-performing loans (NPLs) and non-performing assets ratios of universal and commercial banks further dropped from 9.22 percent and 8.99 in June 2005 to 5.21 and 5.73 in June 2007, respectively.

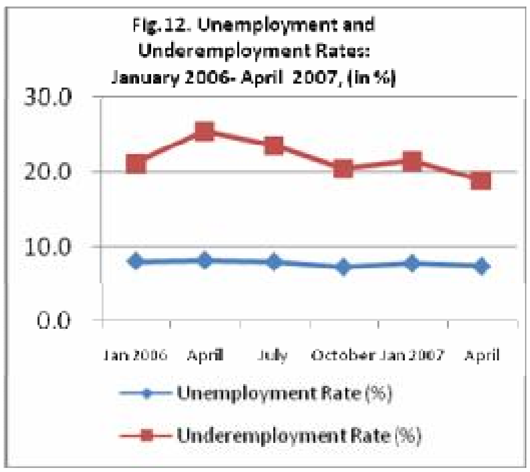


source: BSP

4.3 Benchmark interest rates remained stable in the first half of 2007. The 91-day Treasury bill settled to a low of 3.55 percent in June 2007, but picked up to 3.7 percent in August at the back of global credit and domestic fiscal concerns. Short-dated instruments are also being preferred over longer-term investments as leftover worries from the US subprime market made investors wary about longer-term investments.

Confident of a continued low-inflation outlook, the BSP cut the overnight borrowing rate to 6.0 percent from 7.5 percent, and the overnight lending rate to 8.0 percent from 9.75 percent in July. To neutralize this move, the bank, at the same time, lifted the three-tiered system, a system which pays lower yields on large short-term deposits. Whether there will be another rate cut in October is still uncertain. Analysts point out that the current-risk adverse attitude among offshore investors could lead to a possible credit crunch even as the BSP assures that the impact of the US subprime woes on the Philippine banking sector would be minimal because of its low exposure to collateralized debt obligations (CDO). CDOs are a type of security that serves as an important funding vehicle for portfolio investments in risky assets like the subprime mortgage market in the United States. The BSP estimates the investments of Philippine banks in CDOs at a mere 0.2 percent of the total banking assets.

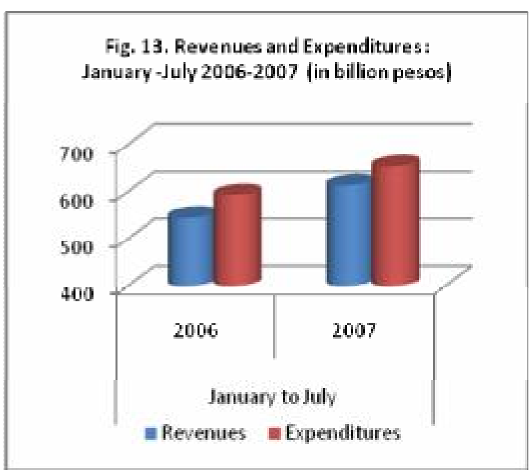
5.0 Employment



source: National Statistics Office

The latest result of the Labor Force Survey in April 2007 showed a marked improvement in the jobs situation. Unemployment and underemployment rates went down from 8.2 percent and 25.4 percent to 7.4 percent and 18.9 percent, respectively. More than one million jobs were generated, though there is an apparent deterioration in the quality of employment as more than half (524,000) of these were actually unpaid family workers.

6.0 Fiscal Sector



source: Bureau of the Treasury (BTr)

6.1 All eyes are on the fiscal sector as the country struggles to meet the P63 billion target deficit it has set for the year. The recorded January to July deficit of P39.4 billion is still way below the target deficit for the period. The narrower deficit, however, has been achieved mainly because of government underspending rather than higher revenue collection. Revenue collection has been weak as the Bureau of Internal Revenue and Bureau of Customs fell short of their collection targets by P49.5 billion and P37.7 billion, respectively. The revenue collection would have been lower if not for higher privatization proceeds and better-than-expected income of the Bureau of the Treasury.

6.2 To help abate the fiscal slippage, the government is planning to privatize more state assets. It is set to privatize the geothermal arm of Philippine National Oil Company (PNOC), its shares in San Miguel Corp. and its 29 percent stake in Meralco, among others.In addition,

Table 3. Selected Fiscal Indicators: January-July 2006 & 2007

In billion pesos	January-July 2006	January- July 2007		Variance vs. Program	Growth Rate
	Actual	Actual	Program		
SURPLUS/DEFICIT	-48.5	-39.4	-52.3	-12.9	-18.8
REVENUES	544.7	614.3	645.1	-30.8	12.8
Tax Revenues	483.8	512.1	561.6	-49.5	5.9
BIR	367.3	393.4	431.1	-37.7	7.1
BOC	111.1	113	125.2	-12.2	1.7
Other Offices	5.4	5.7	5.3	0.4	5.6
Non-Tax Revenues	60.9	102	83.5	18.5	67.6
BTr Income	41.5	39.6	35.3	4.3	-4.7
Others	3.3	21.3	-	-	538.4
of which: fees and charges	18.9	11.1	22.9	-11.8	-41.1
Privatization	0.4	41.2	25.3	15.9	9,589.20
Grants	0	0.1			480
EXPENDITURES	593.2	653.6	697.4	-43.8	10.2

source: BTr

Table 4. Fiscal Position: 2006-2008 (in billion pesos)

PARTICULAR	2006	2007	2008
Revenues	979.6	1,118.8	1,236.2
Disbursements	1,044.4	1,181.8	1,236.2
Surplus/(Deficit)	(64.8)	(63.0)	-
Financing Account	64.8	63.0	-
Percent of GDP			
Revenues *	16.2	16.9	16.5
Disbursements	17.3	17.9	16.5
Surplus/(Deficit)	(1.1)	(1.0)	-

source: BTr

it plans to collect higher revenues from fees and charges collected by government agencies. Last month, the BIR issued a new regulation which increased by 2, 638 percent the minimum gross receipts from where the commoncarrier's tax is based, although its implementation was temporarily put on hold. Another plan is to implement the expanded value-added tax (E-VAT) on tollways.

6.3 With lower than assumed interest and foreign exchange rates, debt payments went down by 16 percent from January to July of this year from the same period in 2006 due to huge savings on interest payments. The government paid P159.5 billion worth of principal debt and interest , P31 billion less than it paid last year.

6.4 The Congress is set to deliberate on the P1.227 trillion budget of 2008, which, for the first time in more than a decade, is formulated with income projected to exceed expenses. The P1.227 trillion budget is premised on the assumption that the economy will grow by 6.1 percent to 6.8 percent next year. Revenues totaling P1.236 trillion - P1.108 trillion in tax revenues and more than P127 billion in non-tax income - will support next year's expenditures. The BIR has been tasked to raise P885 billion from P766 billion in 2007, while the BOC should collect P254 billion, up from 228 billion last year.

7.0 Prospects for the Rest of the Year

A number of risk factors threatens the growth outlook in the second semester. The lingering effects of the dry spell on agriculture, for instance, and the impact of the subprime problems on the Philippine financial sector, points to a likely slowdown in the second half. In addition, while there is an anticipated surge in OFW remittances during the period, there is also a contraction in Japan and the US markets, the country's major export destinations, which could affect the growth of Philippine exports. Moreover, as the government has already spent 70 percent of the total 2007 budget for infrastructure, it has less room to pump prime the economy.

However, because a 7.3 percent economic growth is already in place, the economy only needs to expand by no lower than 5 percent in the second half of the year to reach the low-end of its 6.1 to 6.7 target for the year. Hence, the government is still safe for 2007, as far as its growth targets are concerned. But can it duplicate the same feat next year?

For 2008, the government projects the GDP to be between 6.3 to 7.1 percent, just slightly higher than the 2007 target. However, the electoral spending which figured in significantly in this year's growth will no longer be present in 2007. Remittances, which have historically been a key driver of consumption growth, are also projected to decelerate to 5 percent next year, against this year's 10 percent in the wake of an anticipated economic recession in the US. With a 22 percent projected growth in infrastructure budget for next year, pump-priming will likely remain as one of the government's growth strategies, but even this is imperiled unless the revenue-generating agencies improve their collections. Privatization could only contribute so much to the state coffers and should only be seen as a stop gap measure. It does not provide a stable and consistent source of revenues in the long run.

The government should also initiate and sustain efforts to invigorate the manufacturing and agriculture sectors which seem to have been left behind in the growth rally. More investments in agriculture, in particular, will benefit the poor as two-thirds of their lot can be found in the rural areas.

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Philippine National Bank
Philippine Overseas and Employment Administration
Philippine Stock Exchange
Rizal Commercial Banking Corporation
Smart Communications

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