Rabobank

# Country Report Philippines

Country Report
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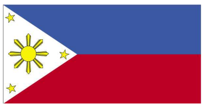


The Philippine government has recently managed to get a budget approved that will further increase investment in infrastructure and public service delivery. Growth prospects remain relatively good.

## Strengths (+) and weaknesses (-)

### (+) Relatively high growth underpinned by improvements in business environment

In the past years, the Philippines has been one of the fastest growing countries of South East Asia. The good growth performance has been underpinned by an improvement of the quality of governance and higher investment in infrastructure.

### (+) Solid and improving external (liquidity) position

Large and stable inflows of remittances (see also figure 2) have allowed the Philippines to maintain a surplus on the current account since 2003 and have helped to build up a large stock of foreign exchange reserves (of USD 79.8bn in January 2015).

### (-) Low level of development

Despite the progress booked in recent years, the institutions of the Philippines remain relatively weak. Poverty and inequality remain relatively high, as the population has continued to grow quickly, while the high growth of recent years has not significantly reduced underemployment.

### (-) Small tax base

Partially due to the fact that a large part of economic activity takes place in the informal sector, government revenues are low (15% of GDP in 2014), which continues to limit the ability of the government to provide basic public investment and services.

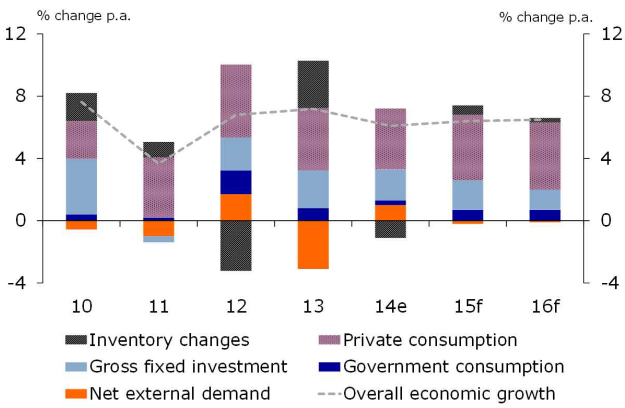
# Key developments

## 1. 2015 budget foresees further growth of government spending and income

In late December, President Benigno Aquino signed the 2015 budget into law. The budget foresees an increase of nominal spending by 15.1% to 2.6 trillion peso (or about USD 60bn). As government income is budgeted to grow rapidly as well, the 2015 fiscal deficit is likely to remain limited at about 2% of GDP. The small revenue basis of the Philippine government, tax income was just 12.1% of GDP in 2010, has traditionally severely constrained the ability of the government to invest in infrastructure and other basic public services, and thus also constrained the economic development of the country. However, the Aquino government has been able to increase government income and has also steadily increased public investment and service delivery. This is set to continue, as tax revenue is budgeted to increase to 15.5% of GDP and investment in infrastructure should increase to 4% of GDP, up from 1.8% of GDP in 2010, while spending on social services will increase to 6.8% of GDP, up from 4.6% of GDP in 2010. This augurs well for the near term economic and social prospects.

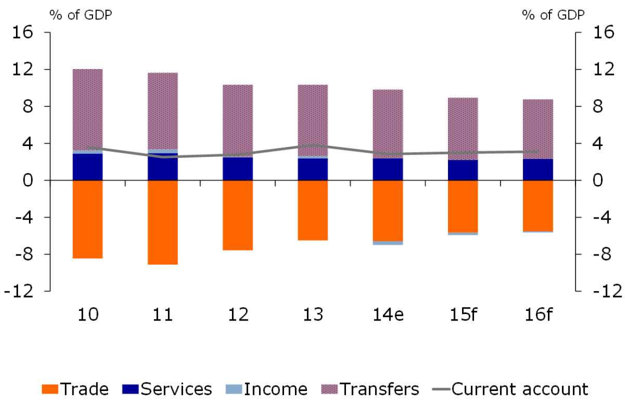
The budgetary process itself has also improved under the Aquino administration, although it remains to be seen whether the government will achieve its spending targets. While its predecessor consistently failed to get the budget approved by Congress before the beginning of the year, the current government managed to get the budget approved even though it faced an important setback. In July 2014, the Supreme Court declared unconstitutional the Disbursement Acceleration Programme (DAP), which allowed the government to move money from slowly moving projects to quicker progressing ones. According to the court, the DAP violated constitutional bans on the transfer of money from one budget item to another and across different branches of government. This weakened the position of the president. His popularity fell sharply and some unsuccessful impeachment complaints were filed. Afterwards, Aquino’s popularity once again increased. The government also managed to get another provision approved that will allow some more budgetary flexibility, despite the ban of the DAP. However, it remains to be seen whether the government will achieve its spending targets. Constraints on the capacity of the bureaucracy to implement projects, partially due to the fact that budgetary oversight has been tightened in recent years, may leave the government unable to execute its spending plans. In the first nine months of 2014, budgetary spending was no less than 16% below target.

**Figure 1: Economic growth**




Source: EIU

**Figure 2: Current account balance**




Source: EIU

## 2. Economic prospects remain relatively favourable

The relatively high rates of economic growth the Philippines has achieved in recent years are likely to continue in the near future, though economic growth is likely to have been somewhat lower in 2014 than in the two preceding years (see also figure 1). Growth is likely to have been slightly above 6%, after being about 7% in 2012 and 2013. The reduction of the growth rate was primarily caused by the earlier mentioned low rates of budgetary execution and Typhoon Haiyan, which caused a lot of damage in November 2013 and resulted in significant supply disruptions. During the first three quarters of 2014, government expenditure and investment fell by 1.6% year-on-year. Meanwhile, private demand, in particular private investment, remained strong.

Economic growth is likely to strengthen somewhat in 2015. Low oil prices are likely to boost consumption, as the Philippines is a net oil importer. The increase of public investment will also boost growth in 2015. The economy could face supply constraints though, as projections suggest that electricity supply may not be able to match demand during the peak summer season. Meanwhile, a truck ban imposed in Manila to reduce traffic congestion resulted in higher shipping costs and less processing capacity at the Manila ports. All this underlines the importance of addressing supply constraints. Meanwhile, lower than expected growth in Japan, the most important export market of the Philippines, and the Middle East, the second most important source of remittances for the Philippines after the US, pose clear downside risks to the growth outlook.

## 3. Deadly attack in southern Philippines

In December 2014, 10 bus passengers were killed and 42 wounded in a bomb attack in the southern Philippines. According to an army source, the Bangsamoro Islamic Freedom Fighters (BIFF), a splinter rebel group, was responsible. However, a BIFF spokesman declined involvement. In March 2014, the government and the Moro Islamic Liberation Front (MILF), the main rebel group on the southern island of Mindanao, signed a comprehensive peace agreement. The new attack could be an attempt to derail this peace process.

**Factsheet of Philippines**

**Philippines**

| National facts | |
|---|---|
| Type of government | Republic |
| Capital | Manila |
| Surface area (thousand sq km) | 300 |
| Population (millions) | 98.4 |
| Main languages | Filipino |
| | English |
| Main religions | Catholic (81%) |
| | Muslim (5%) |
| | Evangelical (3%) |
| Head of State (president) | Benigno Aquino |
| Head of Government | Benigno Aquino |
| Monetary unit | Philippine peso (PHP) |

| Economy | | 2013 |
|---|---|---|
| *Economic size* | *bn USD* | *% world total* |
| Nominal GDP | 286 | 0.37 |
| Nominal GDP at PPP | 693 | 0.65 |
| Export value of goods and services | 77 | 0.33 |
| IMF quotum (in m SDR) | 1,019 | 0.47 |
| *Economic structure* | *2014* | *5-year av.* |
| Real GDP growth | 6.1 | 5.3 |
| Agriculture (% of GDP) | 11 | 12 |
| Industry (% of GDP) | 32 | 32 |
| Services (% of GDP) | 58 | 56 |
| *Standards of living* | *USD* | *% world av.* |
| Nominal GDP per head | 2,860 | 25 |
| Nominal GDP per head at PPP | 6,918 | 43 |
| Real GDP per head | 1,649 | 19 |

| Social and governance indicators | rank / total |
|---|---|
| Human Development Index (rank) | 114 / 187 |
| Ease of Doing Business Index (rank) | 108 / 185 |
| WEF Global Competitiveness Index (rank) | 59 / 148 |
| Corruption Perceptions Index (rank) | 94 / 177 |
| Press Freedom Index (rank) | 149 / 179 |
| Gini index (income distribution) | 43 |
| Population below $1.25 per day (PPP) | 19% |

| Foreign trade | | | 2013 |
|---|---|---|---|
| *Main export partners (%)* | | *Main import partners (%)* | |
| Japan | 20 | China | 13 |
| US | 14 | US | 11 |
| China | 12 | Japan | 9 |
| Hong Kong | 8 | South Korea | 8 |

| *Main export products (%)* | *2014* |
|---|---|
| Electronic products | 45 |
| Garments | 3 |
| Coconut oil | 2 |
| Petroleum products | 1 |
| *Main import products (%)* | *2014* |
| Capital goods | 25 |
| Mineral fuels | 18 |
| Chemicals | 9 |
| Manufactured goods | 8 |
| *Openness of the economy* | *2014* |
| Export value of G&S (% of GDP) | 27 |
| Import value of G&S (% of GDP) | 31 |
| Inward FDI (% of GDP) | 1.3 |

Source: EIU, CIA World Factbook, UN, World Economic Forum, Transparency International, Reporters Without Borders, World Bank.

# Background information

After the Second World War, the Philippines was one of the richest countries in Asia. However, though the country managed to develop a sizeable electronics sector, it largely failed to make a structural transformation towards manufacturing. As a result, income per capita is still relatively low. The productivity in the agricultural sector is low, which employs about one-third of the workforce, but accounts for only 11% of GDP. The fact that 10.5m to 13.5m Philippines work overseas is also an expression of underemployment within the country. At the same time, the remittances sent home by these workers (almost 10% of GDP) provide a stable source of foreign income. Meanwhile, the fact that English is widely spoken has boosted the development of the business process outsourcing sector. Thanks to a gradual fall of the high fertility rates, the country could benefit from the demographic dividend, while the growing economic integration within the ASEAN Economic Community (AEC) could also boost the development of the country. However, the country remains vulnerable to natural disasters and lacks a well-developed and comprehensive infrastructure, something the 7,107-island archipelago desperately needs. Large parts of the economy thereby have an oligopolistic structure and are controlled by a few influential families. A few powerful families also still dominate the political landscape. The Philippines has a turbulent political history and was ruled by the dictator Ferdinand Marcos from 1965 until 1986, but the political environment has become markedly more stable in recent years. While the standards of governance have improved somewhat in recent years, politics in the Philippines remains more driven by personality than by ideology. On the external front, the country has strong political relations with the US, while its relations with China are more strained.

## Economic indicators of Philippines

| Philippines | | | | | | | |
|---|---|---|---|---|---|---|---|
| Selection of economic indicators | 2010 | 2011 | 2012 | 2013 | 2014e | 2015f | 2016f |
| *Key country risk indicators* | | | | | | | |
| GDP (% real change pa) | 7.6 | 3.7 | 6.8 | 7.2 | 6.1 | 6.4 | 6.5 |
| Consumer prices (average % change pa) | 4.1 | 4.7 | 3.2 | 2.9 | 4.4 | 3.9 | 3.7 |
| Current account balance (% of GDP) | 3.6 | 2.5 | 2.8 | 3.8 | 2.8 | 3.0 | 3.1 |
| Total foreign exchange reserves (m USD) | 55,363 | 67,290 | 73,478 | 75,689 | 72,442 | 84,860 | 95,940 |
| *Economic growth* | | | | | | | |
| GDP (% real change pa) | 7.6 | 3.7 | 6.8 | 7.2 | 6.1 | 6.4 | 6.5 |
| Gross fixed investment (% real change pa) | 19.1 | -1.9 | 10.8 | 11.9 | 9.4 | 8.6 | 6.0 |
| Private consumption (real % change pa) | 3.4 | 5.6 | 6.6 | 5.7 | 5.6 | 6.1 | 6.2 |
| Government consumption (% real change pa) | 4.0 | 2.1 | 15.5 | 7.7 | 2.6 | 6.5 | 6.3 |
| Exports of G&S (% real change pa) | 21.0 | -2.5 | 8.5 | -1.1 | 7.4 | 6.1 | 6.9 |
| Imports of G&S (% real change pa) | 22.5 | -0.6 | 4.9 | 5.4 | 5.0 | 6.3 | 6.9 |
| *Economic policy* | | | | | | | |
| Budget balance (% of GDP) | -3.5 | -2.0 | -2.3 | -1.4 | -1.5 | -2.3 | -2.2 |
| Public debt (% of GDP) | 52.4 | 51.0 | 51.5 | 49.2 | 48.9 | 48.0 | 47.6 |
| Money market interest rate (%) | 3.5 | 1.3 | 1.5 | 0.3 | 1.2 | 1.7 | 3.5 |
| M2 growth (% change pa) | 10.4 | 7.0 | 9.4 | 33.5 | 10.6 | 15.5 | 10.8 |
| Consumer prices (average % change pa) | 4.1 | 4.7 | 3.2 | 2.9 | 4.4 | 3.9 | 3.7 |
| Exchange rate LCU to USD (average) | 45.1 | 43.3 | 42.2 | 42.4 | 44.4 | 43.5 | 43.0 |
| Recorded unemployment (%) | 7.3 | 7.0 | 7.0 | 7.1 | 7.0 | 7.0 | 7.1 |
| *Balance of payments (m USD)* | | | | | | | |
| Current account balance | 7,179 | 5,643 | 6,949 | 10,393 | 8,131 | 9,830 | 11,410 |
| Trade balance | -16,859 | -20,429 | -18,927 | -17,702 | -18,841 | -18,570 | -20,190 |
| Export value of goods | 36,772 | 38,277 | 46,384 | 44,512 | 52,109 | 58,900 | 65,380 |
| Import value of goods | 53,631 | 58,705 | 65,311 | 62,215 | 70,950 | 77,470 | 85,570 |
| Services balance | 5,766 | 6,562 | 6,178 | 6,427 | 6,857 | 7,200 | 8,520 |
| Income balance | 678 | 941 | 197 | 685 | -1,161 | -830 | -470 |
| Transfer balance | 17,596 | 18,568 | 19,501 | 20,980 | 21,277 | 22,040 | 23,560 |
| Net direct investment flows | -1,642 | -343 | -959 | -151 | 800 | 1,200 | 2,050 |
| Net portfolio investment flows | 1,954 | 854 | -320 | -1,526 | -378 | 670 | 3,320 |
| Net debt flows | 4,881 | 2,360 | 4,505 | 1,100 | 960 | 1,810 | -380 |
| Other capital flows (negative is flight) | 5,758 | 4,416 | -1,647 | -10,460 | -12,258 | -1,590 | -5,820 |
| Change in international reserves | 18,130 | 12,930 | 8,528 | -644 | -2,745 | 11,910 | 10,580 |
| *External position (m USD)* | | | | | | | |
| Total foreign debt | 60,775 | 61,023 | 61,390 | 58,636 | 58,149 | 58,050 | 57,400 |
| Short-term debt | 6,295 | 7,013 | 8,483 | 8,576 | 8,103 | 9,040 | 10,000 |
| Total debt service due, incl. short-term debt | 15,463 | 15,977 | 12,809 | 15,830 | 15,611 | 15,280 | 16,670 |
| Total foreign exchange reserves | 55,363 | 67,290 | 73,478 | 75,689 | 72,442 | 84,860 | 95,940 |
| International investment position | -26,303 | -24,534 | -34,123 | n.a. | n.a. | n.a. | n.a. |
| Total assets | 97,880 | 106,454 | 119,675 | b.a. | n.a. | n.a. | n.a. |
| Total liabilities | 124,183 | 130,988 | 153,798 | n.a. | n.a. | n.a. | n.a. |
| *Key ratios for balance of payments, external solvency and external liquidity* | | | | | | | |
| Trade balance (% of GDP) | -8.4 | -9.1 | -7.6 | -6.5 | -6.6 | -5.7 | -5.5 |
| Current account balance (% of GDP) | 3.6 | 2.5 | 2.8 | 3.8 | 2.8 | 3.0 | 3.1 |
| Inward FDI (% of GDP) | 0.5 | 0.9 | 1.3 | 1.3 | 1.3 | 1.2 | 1.1 |
| Foreign debt (% of GDP) | 30 | 27 | 25 | 22 | 20 | 18 | 16 |
| Foreign debt (% of XGSIT) | 77 | 73 | 65 | 60 | 55 | 50 | 45 |
| International investment position (% of GDP) | -13.2 | -10.9 | -13.6 | n.a. | n.a. | n.a. | n.a. |
| Debt service ratio (% of XGSIT) | 20 | 19 | 13 | 16 | 15 | 13 | 13 |
| Interest service ratio incl. arrears (% of XGSIT) | 4 | 4 | 3 | 2 | 2 | 2 | 2 |
| FX-reserves import cover (months) | 10.1 | 11.4 | 11.1 | 11.6 | 9.8 | 10.5 | 10.8 |
| FX-reserves debt service cover (%) | 358 | 421 | 574 | 478 | 464 | 555 | 575 |
| Liquidity ratio | 179 | 181 | 187 | 187 | 178 | 185 | 186 |

Source: EIU

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