Philippines

Growth moderated in 2018 but remained strong, buoyed by domestic investment. Even as the external environment weakens in 2019 and 2020, growth is expected to pick up in both years on strong domestic demand. Inflation surged last year but is forecast to be within the government's target range this year and next. The current account deficit will persist under investment-led growth. Agricultural reform to lift productivity and promote off-farm livelihoods promises to foster inclusive growth.

Economic performance

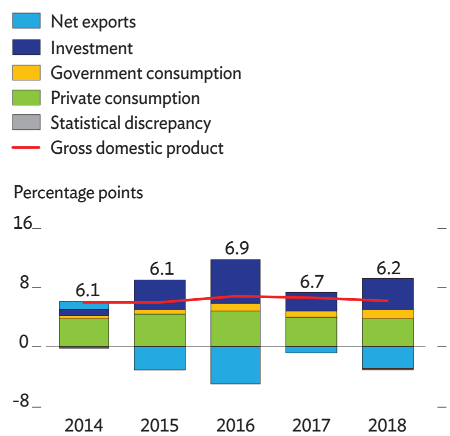
GDP growth moderated from 6.7% in 2017 to 6.2% in 2018, largely in line with average annual growth of 6.3% since 2010. Higher domestic investment and consumption partly offset a slowdown in growth of exports of goods and services.

Investment rose by 13.9% last year, improving on a 9.4% increase in 2017 and making in 2018 the largest demand-side contribution to GDP growth (Figure 3.28.1). Growth in public investment in construction rose from 12.7% in 2017 to 21.2% last year (Figure 3.28.2). Private investment remained robust as well, with a 12.9% rise in private construction and higher purchases of machinery and equipment. Consequently, fixed investment rose to equal 27.0% of GDP in 2018, its highest since the mid-1980s (Figure 3.28.3).

Private consumption growth softened from 5.9% in 2017 to 5.6%, finding support from a relatively low unemployment rate of 5.3%, steady remittances from overseas Filipinos, and a cut in the personal income tax rate for most workers. Remittances rose by 3.0% in 2018 to reach $32.2 billion, equal to 9.7% of GDP. Growth in government consumption quickened to 12.8%, with higher spending on social services and a hike in salaries for government employees. Meanwhile, growth in exports of goods and services slowed in real terms from 19.5% in 2017 to 11.5% last year, while imports rose rapidly in response to higher demand for investment and consumer goods.

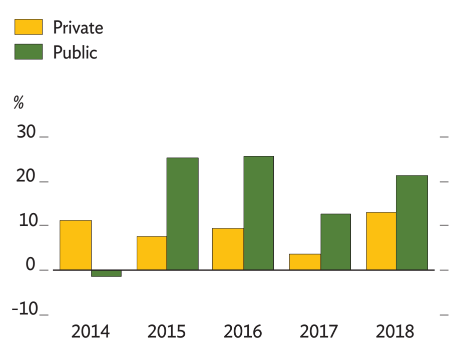
By sector, services and industry were the drivers of growth, despite slowing a bit from 2017 (Figure 3.28.4). Growth in services reached 6.6% in 2018, only slightly down from 6.8% in 2017, and generated nearly two-thirds of GDP growth last year. Sustained gains were posted in retail trade, tourism, business process outsourcing, real estate, and finance.

3.28.1 Demand-side contributions to growth



Source: CEIC Data Company (accessed 12 March 2019).

3.28.2 Growth in construction



Source: CEIC Data Company (accessed 12 March 2019).

This chapter was written by Teresa Mendoza of the Philippines Country Office, ADB, Manila.

Industry expansion eased from 7.2% in 2017 to 6.8%, with construction and manufacturing the main growth drivers. Construction contributed 16% of the increase in GDP, and manufacturing provided nearly a fifth, despite slowing from 8.4% in 2017 to 4.9% as growth in external demand slackened. Agriculture was stagnant as crop damage caused by several typhoons compounded long-term structural and policy impediments to the sector's productivity and growth.

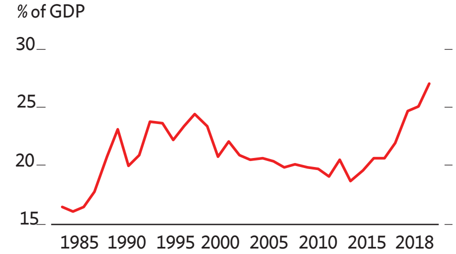
Inflation quickened to 5.2% in 2018, exceeding the target range of 2%–4% set by the government. Inflation was driven by constraints on food supply and by higher global oil prices. Increases in excise taxes on fuel, sugar-sweetened beverages, and cigarettes in January 2018 added to inflationary pressure last year. To ease food price inflation, the government removed administrative barriers to agricultural imports. Complementing this measure, Bangko Sentral ng Pilipinas, the central bank, raised its policy rate by a cumulative 175 basis points from May to November 2018 to address demand-side pressures and quell inflation expectations. These measures quickly eased inflation, which slowed from a peak of 6.7% year on year in October 2018 to 3.8% in February 2019. Core inflation also slowed, from a high of 5.1% in November 2018 to 3.9% in February 2019 (Figure 3.28.5). The higher policy rate reined in growth in broad money (M3) from 13.0% year on year in January 2018 to 7.6% a year later, as well as credit to the private sector from 17.1% to 13.7% over the same period.

The current account deficit widened from the equivalent of 0.7% of GDP in 2017 to 2.4% in 2018. In response to strong domestic investment, imports of machinery and equipment and of construction materials increased sharply. Imports thus rose by 9.4% in US dollar terms, while export earnings shrank by 0.3%, widening the trade deficit. Higher remittances and earnings from exports of services partly cushioned the merchandise trade deficit (Figure 3.28.6).

In the financial account, net inflows of foreign direct investment moderated from a high of $10.3 billion in 2017 to $9.8 billion in 2018, while net outflows of portfolio investment declined (Figure 3.28.7). The overall balance of payments deficit widened from the equivalent of 0.3% of GDP in 2017 to 0.7%. Foreign exchange reserves stood at $82.8 billion at the end of February 2019, providing cover for 7.3 months of imports of goods and services and income payments. The country's external payments position improved further as a broad downtrend in external debt brought it from the equivalent of 59.7% of GDP in 2005 to 23.9% last year.

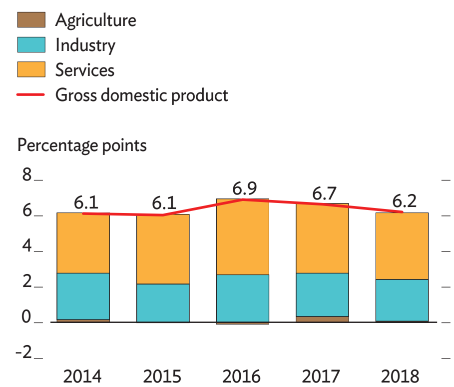
Fiscal policy was expansionary, with the fiscal deficit widening from the equivalent of 2.2% of GDP in 2017 to 3.2% last year. This took the deficit slightly above the government's ceiling of 3.0%, reflecting its higher infrastructure and social investments and also improved budget execution as

3.28.3 Fixed investment



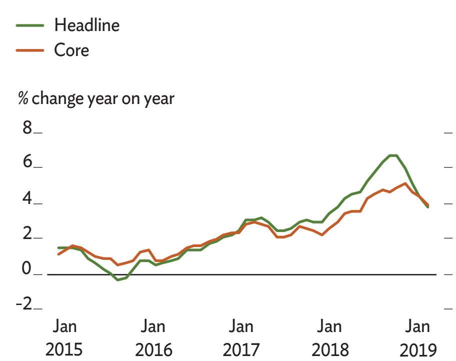
Sources: World Development Indicators online database; CEIC Data Company (both accessed 12 March 2019).

3.28.4 Supply-side contributions to growth



Source: CEIC Data Company (accessed 12 March 2019).

3.28.5 Monthly inflation



Source: CEIC Data Company (accessed 12 March 2019).

government disbursements slightly exceeded the budget program—a reversal of underspending in the past, by 13% on average in 2014 and 2015 and by 3% in 2016 and 2017. On the revenue side, the ratio of tax collection to GDP improved from 14.2% in 2017 to 14.7% in 2018, supported by revenue increments from the Tax Reform for Acceleration and Inclusion (TRAIN) Law. Despite the higher fiscal deficit, national government debt stood at 41.9% of GDP in December 2018, in line with government objectives for fiscal sustainability (Figure 3.28.8).

Economic prospects

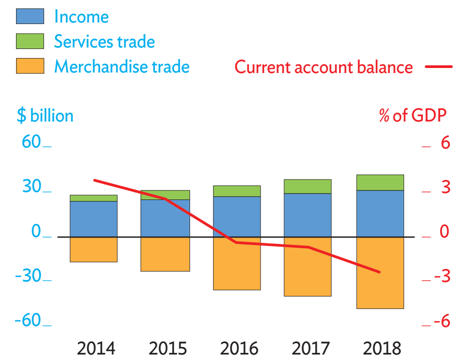
GDP growth is projected to pick up to 6.4% this year and next as strengthening domestic investment and consumption more than offset weakening external demand (Figure 3.28.9).

Private consumption should pick up with a low unemployment rate, growth in formal sector employment, a continued rise in remittances, and lower inflation. The unemployment rate fell to 5.2% in January 2019 with the creation of an additional 1.4 million jobs for wage-earners and salaried employees. Also boosting consumption is increased public expenditure on social services. The Universal Health Care Law, passed in February 2019, automatically enrolls all citizens in the national health insurance program and thus promises to expand health care services, which should give an impetus to consumption. Election-related spending ahead of a May 2019 midterm poll will modestly lift aggregate demand.

Public investment will drive domestic investment with the implementation of major public infrastructure projects such as bridges, expressways, ports, and railways. The government aims to raise public infrastructure outlays from a 2017–2018 average equal to 6.3% of GDP to 7% by 2022 under its Build Build Build infrastructure program. Efforts to improve budget execution continue with a focus on project preparation and implementation including procurement.

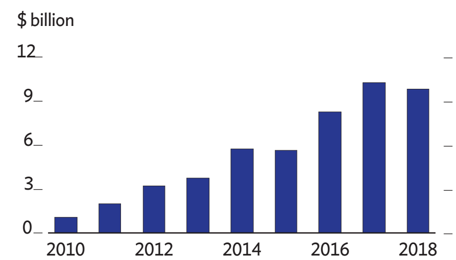
Prospects for private investment remain favorable. Imports of capital goods and credit to businesses have continued to grow. Momentum in private construction is sustained by continuing strong demand for office and retail space and for housing. Building permit approvals rose by 20.7% year on year in the fourth quarter of 2018. Recent reform, such as the Ease of Doing Business Act approved in 2018, streamlines procedures for government transactions, including for local governments. Additional reform approved in the first quarter of 2019 includes revision of the Corporation Code that relaxes certain provisions for setting up businesses, and another law establishing a one-stop shop for processing permits for energy projects including power generation, transmission, and distribution. The new Central Bank Act strengthens the

3.28.6 Current account components



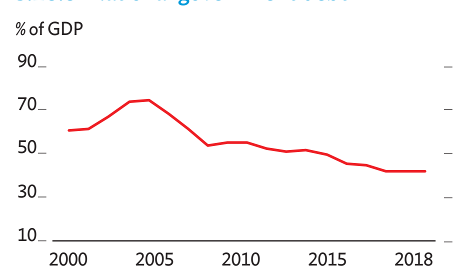
Source: CEIC Data Company (accessed 15 March 2019).

3.28.7 Foreign direct investment net inflows



Source: CEIC Data Company (accessed 12 March 2019).

3.28.8 National government debt



Source: CEIC Data Company (accessed 12 March 2019).

policy framework for promoting price stability, prudential regulation, and systemic risk management in the financial system. The effective implementation of these reforms should further boost private sector confidence and investment.

Agriculture will likely continue to languish—especially as El Niño weather disturbances are expected to prolong dry spells this year—but services, construction, and manufacturing will all drive growth higher in the near term. Within services, retail trade will continue to benefit from strong consumption. International tourist arrivals, having risen by 7.7% to 7.1 million in 2018, are projected to rise further to 8.2 million this year, the increase supported by airport modernization in the provinces and other infrastructure improvement. Business process outsourcing will continue to expand, particularly outside Manila. Growth in manufacturing is expected to hold up well, supported by domestic demand, with a modest expansion indicated in the February 2019 manufacturing purchasing managers' index. Steady foreign direct investment inflows to manufacturing bode well for the sector's growth prospects in the near term. Spurred by public infrastructure projects, construction is forecast to remain buoyant.

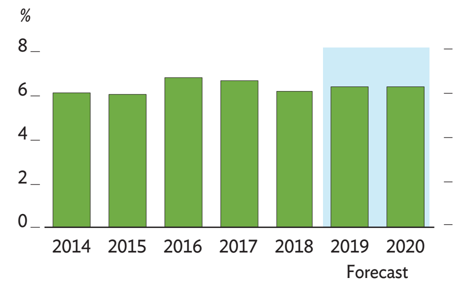
Despite strengthening GDP growth and a tightening labor market, inflation is projected to moderate to 3.8% in 2019 and 3.5% in 2020 as global oil prices decline and last year's monetary tightening continues to be effective (Figure 3.28.10). A second round of excise tax rises on fuels in 2019 and a possible decline in agricultural output this year may add to inflationary pressure, though food supply should improve following the approval in February 2019 of a law that replaces quantitative restrictions on rice imports with tariffs.

As prospects for export growth soften, accelerating domestic investment and consumption should continue to draw in imports, keeping the merchandise trade and current account in deficit. However, continued strength in net service exports and lower international prices for oil should cushion the deficit somewhat. On balance, the current account deficit is forecast at 2.3% of GDP in 2019 and 2.4% in 2020.

As inflation stays within the government's target range of 2%–4%, monetary policy is likely to remain unchanged for some time. The fiscal deficit, meanwhile, has a ceiling set at the equivalent of 3.2% of GDP for 2019 and 3.0% for 2020. Legislating the government's proposed tax reform is vital to sustaining higher public infrastructure and social investments.

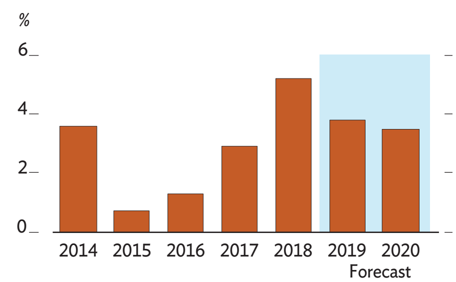
Risks to the growth outlook tilt to the downside. External risks would stem from an unexpectedly deep slowdown of economic growth in the advanced economies, which are major export markets and sources of foreign direct investment for the Philippines (Figure 3.28.11). Uncertainties from global trade tensions and potential heightened volatility in international financial markets pose another set of

3.28.9 GDP growth



Source: *Asian Development Outlook* database.

3.28.10 Inflation



Source: *Asian Development Outlook* database.

3.28.1 Selected economic indicators (%)

	2019	2020
GDP growth	6.4	6.4
Inflation	3.8	3.5
Current account balance (share of GDP)	–2.3	–2.4

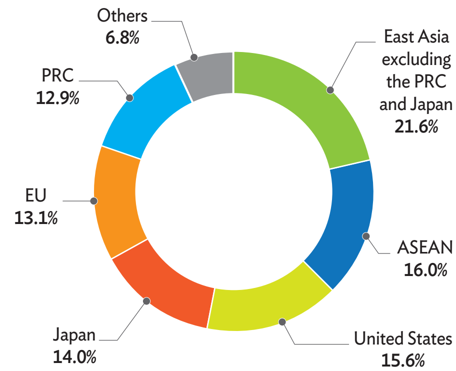
Source: ADB estimates.

external risks. Domestic risks to growth would be severe or prolonged El Niño dry spells and a delay in approving the 2019 budget, which could slow the implementation of new large infrastructure projects and social programs this year.

GDP growth prospects for this year and next are supported by recent government reform to lay the foundation for raising growth potential in the medium term. Besides a massive infrastructure program, the government has implemented the TRAIN Law, the first package of comprehensive reform to make the tax system more equitable and efficient. Other recent reforms aim to improve the ease of doing business in the Philippines. Social protection reform and universal health care will support human capital development and help narrow wide household income disparities. The rollout of a national identification system that unifies all government identification cards into one will help facilitate financial inclusion and improve access to social services by the poor.

Another reform, the Bangsamoro Organic Law in 2018, creates an autonomous area on the large southern island of Mindanao and could spur development over the long term.

3.28.11 Merchandise export markets, 2018



ASEAN = Association of Southeast Asian Nations, EU = European Union, PRC = People's Republic of China.
Source: CEIC Data Company (accessed 12 March 2019).

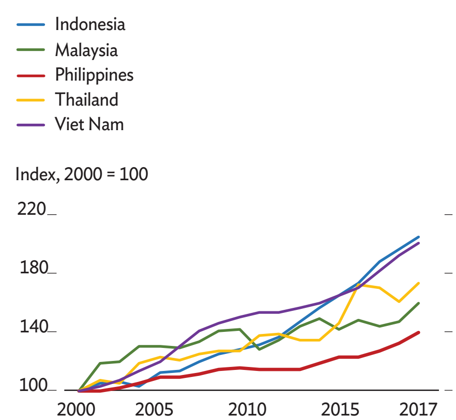
Policy challenge—pursuing agricultural reform and off-farm incomes

The rapid rise in food price inflation in 2018 reflected, at least in part, structural and policy impediments to agriculture growth. Annualized food price inflation reached a high of 9.7% year on year in September 2018 and averaged 6.8% in 2018. Growth in agriculture value added was essentially stagnant in 2018. Indeed, agriculture has been underperforming for the past 2 decades. It grew by an average of 2.9% annually from 2000 to 2010, then growth slowed by half to 1.5% from 2011 to 2018. Improvement in labor productivity in Philippine agriculture compares poorly with that of its regional peers (Figure 3.28.12).

Notwithstanding its lackluster performance, agriculture remains the livelihood of many rural families. Half of the population resides in rural areas, and nearly one quarter of all employment is in agriculture. Poverty in rural areas is higher than the national average and especially high for farm households. According to a 2015 family income and expenditure survey, almost 35% of farmers and fisherfolk live below the national poverty line. As such, both farm and off-farm income-generating activities are critical for fostering inclusive growth.

While typhoons and droughts have played a role in erratic growth in agriculture and periodic food price instability, policy shortcomings have also weighed on the sector's development.

3.28.12 Labor productivity in agriculture



Note: Data are based on constant 2010 $.
Source: ADB estimates using data from World Development Indicators online database (accessed 15 March 2019).

These include trade restrictions on some agricultural products, notably rice; inadequate extension services to farmers; poor water resource management; and underinvestment in rural infrastructure.

The implementation of the 2019 law liberalizing the trading of rice is a major first step toward improving farm productivity and incomes. The law replaces quantitative restrictions on rice imports with tariffs, which should help stabilize domestic rice prices. It also restructures the National Food Authority, notably by transferring its main functions to other government agencies, and establishes the Rice Competitiveness Enhancement Fund, financed with revenue from tariffs on rice imports. The fund aims to raise farm productivity by, among other strategies, financing the modernization of farm practices, developing high-quality rice seed, beefing up extension services, and enhancing credit to rice farmers.

The law and the Rice Competitiveness Enhancement Fund together provide a unique opportunity to lift rural incomes by enhancing farm productivity and helping marginal rice farmers to switch to cultivating higher-value crops. But more can be done to enhance productivity. These include increasing investments in rural infrastructure that connect farm communities and urban growth centers, better irrigation, crop insurance against typhoons and droughts, and innovation that will engage the support of private sector providers of extension services to farmers in the transition to higher-value crops.

At the same time, it is important for the government to support emerging growth industries in rural areas that generate sustainable off-farm income. Tourism could be a catalyst as it has significant links with agriculture, construction, and retail services. Such a transition would require further improvement of rural tourism infrastructure and the business climate in rural areas, as well as investment in skills development.