Philippines Monthly Economic Developments

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- The Philippine stock exchange index closed 2016 weaker than the previous year amidst increasing global and local market uncertainties.
- Manufacturing activities expanded in November but the growth momentum may have started to moderate.
- A large net outflow of funds pulled the November year-to-date Balance of Payments from surplus to a US$0.2 billion deficit.
- Exports contracted following two months of growth while imports retained its strong expansion.
- Despite rising inflationary pressure, the Central Bank did not change its key policy rates in December.
- The fiscal deficit widened in January-November as the government accelerated spending, outpacing revenue growth.
- The 2016 unemployment rate dropped to a decade low as the country's robust economic performance fueled strong job creation.

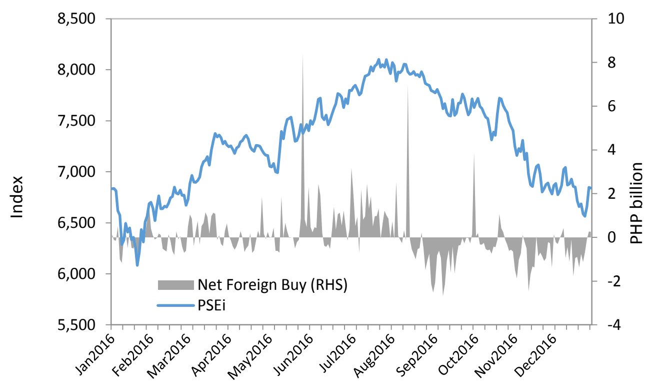
The Philippine stock exchange index (PSEi) closed 2016 weaker than the previous year amidst increasing global and local market uncertainties. The PSEi closed 2016 at 6,841, by 1.6 percent year-on-year weaker than 6,952 at end-2015. It ended a highly volatile year for the stock market, influenced by investors' anticipation of rate hikes by the US Federal Reserve, China's slowing growth, and a general weakening of investor sentiments in the region. However, market capitalization grew by 7.2 percent year-on-year from Php13.4 trillion at end-2015 to Php14.4 trillion at end-2016.

Manufacturing activities expanded in November but the growth momentum may have started to moderate. The Volume of Production Index (VoPI) for manufacturing grew 14.6 percent year-on-year in November compared to 4.4 percent in November 2015, driven by the production of petroleum and food commodities and transport equipment. Food manufacturing grew strongly in November by 24.6 percent year-on-year, despite the impact of typhoon Haima on agriculture. The Nikkei ASEAN Manufacturing Purchasing Manager's Index for the Philippines slowed for December to 55.7 from 56.3 for November. This is the third consecutive month of index decline, indicating a weakening growth momentum. The continued increase in the average capacity utilization rate, which inched further up in November to 83.8 from 83.7 in October (and 83.5 a year ago). The need of investment to sustain medium-term output growth appears to be addressed, as signaled by the strong import growth of capital goods.

Exports contracted following two months of consecutive growth while imports retained their strong expansion. Goods exports declined in November by 7.5 percent year-on-year after registering strong growth in October (3.7 percent) and September (5.1 percent). This contraction was led by a decrease in manufactured goods exports by 10.6 percent year-on-year, a sharp reversal from the 1.9 percent growth in the previous month. In particular, electronics products, the country's largest export commodity, contracted in November by 7.9 year-on-year. Meanwhile, import growth accelerated by 19.7 percent year-on-year in November, led by the strong growth in both capital goods and consumer goods imports. A sign of buoyant domestic demand, capital goods imports increased by 29.7 percent year-on-year, while consumer goods imports increased by 32.6 percent year-on-year in November.

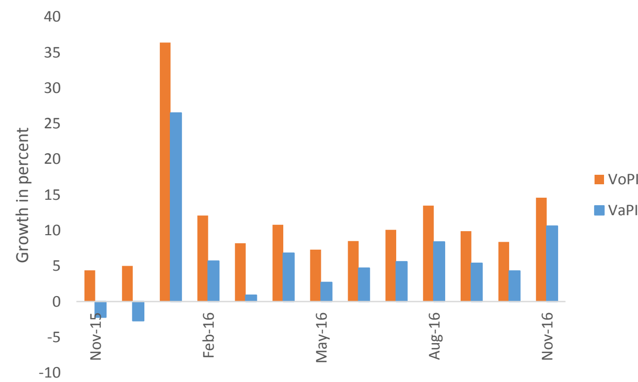
A large net outflow of funds pulled the November year-to-date Balance of Payments from surplus to a US$0.2 billion deficit. The Balance of Payments registered a US$1.7 billion deficit in November, more than ten times bigger than the US$141 million deficit recorded in November last year. This wiped out the US$1.5 billion year-to-date October surplus, and reversed the US$ 2.1 billion year-to-date November surplus in 2015. This sizable net funds outflow may be attributed to the sell-off of portfolio stocks and sustained weakness of net goods exports in November. The outflow took a toll on the peso exchange rate and the gross international reserves (GIR). The peso depreciated by 5.5 percent year-on-year in November, but marginally appreciated to Php/US$49.81 by end-December. Meanwhile, Gross International Reserves were revised to US$81.5 billion in November, reflecting a US$3.6 billion decline from October and dropped further to US$81.0 billion in December. Meanwhile, net Foreign Direct Investment inflows in the first ten months of the year reached US$6.2 billion, increasing by 22.2 percent year-on-year from the same period last year. The sectors which benefitted the most from the infusion of equity capital were the financial and insurance activities industry, manufacturing, real estate activities, and the construction sector.

Figure 1: The stock market ended 2016 lower than 2015



Source: Philippine Stock Exchange

Figure 2: Manufacturing activities expanded in November

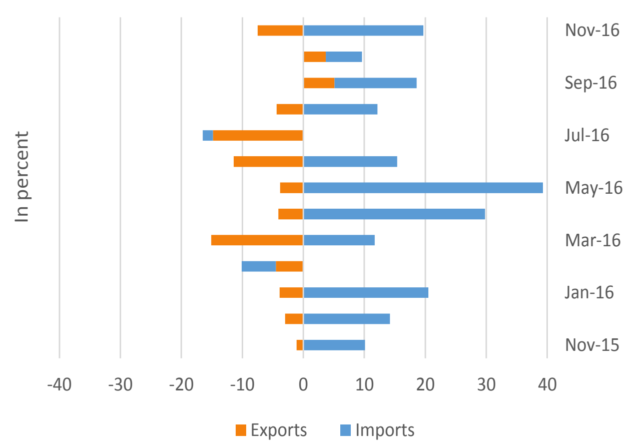


Source: Philippine Statistics Authority (PSA)

Despite rising inflationary pressure, the Central Bank did not change its key policy rates in December. Headline inflation rose in December to 2.6 percent year-on-year from 1.5 percent in the same month last year. As in November, food inflation drove headline inflation, accelerating by 3.6 percent year-on-year. Meanwhile, core inflation also continued to climb, to 2.5 percent year-on-year compared to 2.1 percent in December 2015. The 12-month average Consumer Price Index registered 1.8 percent, while core inflation at 1.9 percent, which remained below the 2-4 percent *Bangko Sentral ng Pilipinas (BSP)* target. Despite the rise in the inflation rates and a recent 25 basis point increase in US interest rate, the monetary authority maintained its policy rates at 3.0 percent during its December 22 board meeting.

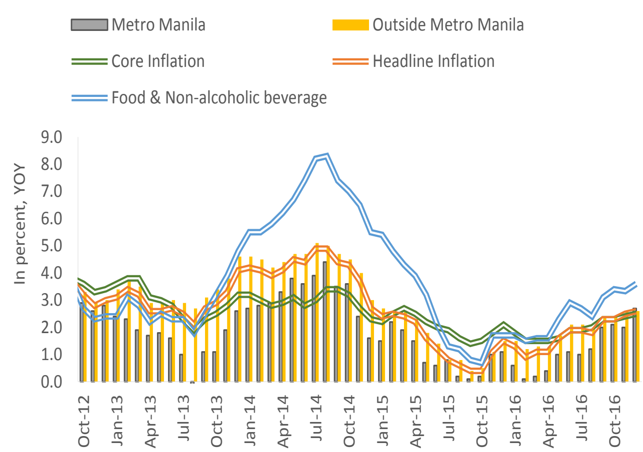
Domestic credit demand remains strong and the market is sufficiently liquid. Domestic liquidity (M3) reached Php9.1 trillion, growing by 12.7 percent year-on-year in November. Credit growth remained the main driver of money growth as the expansion in private sector lending accelerated. In November, commercial bank lending grew at a faster pace of 18.6 percent year-on-year compared to 14.4 percent in November 2015. Household credit increased by 24.5 percent year-on-year (compared to 13.3 percent in November 2015), while firm credit grew by 18.1 percent year-on-year (compared to 14.4 percent in November 2015). Non-performing loans as a share of the total loan portfolio declined to 1.6 percent in September year-on-year from 1.9 percent in September 2015. In December, demand for the *BSP's* one-month deposit facility was weak with 4 out of the 5 auctions undersubscribed.

Figure 3: Import growth continued to outpace export growth



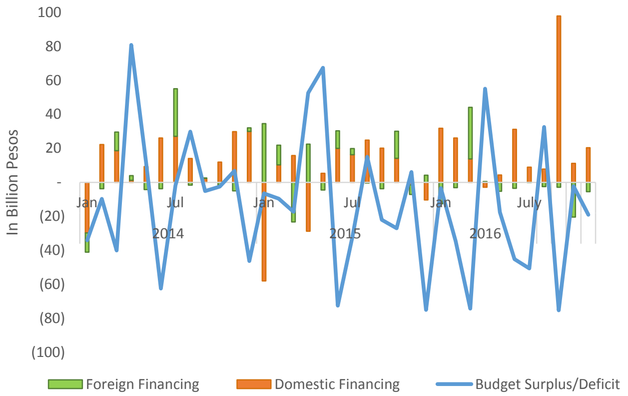
Source: PSA

Figure 4: Headline and core inflation further rose in December



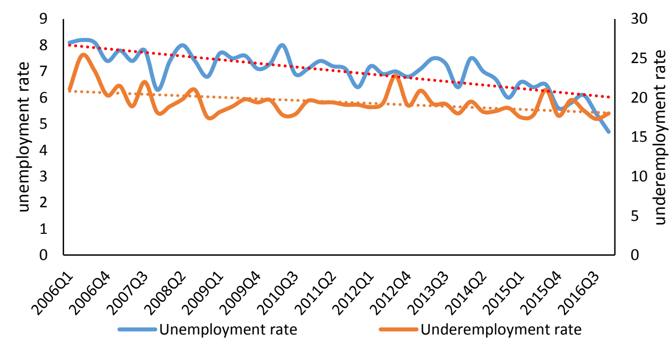
Source: PSA

Figure 5: The fiscal deficit further widened as spending outpaced revenue growth



Source: PSA

Figure 6: Robust economic activity led to gains in employment, but underemployment remained high



Source: PSA

The fiscal deficit widened in January-November as the government accelerated spending outpacing revenue growth. Expenditures increased by 13.7 percent year-on-year from January to November (compared to 13.0 percent in the same period in 2015), totaling Php2.3 trillion. Underspending continued and the *Department of Budget and Management* expects a 4.6 percent shortfall of the programmed amount of Php2.64 trillion. At the same time, revenues increased at a slower rate, rising by 4.4 percent year-on-year in January-November (compared to 12.1 percent in the same period in 2015) to Php2.0 trillion. Revenues were driven by the expansion of tax revenues, which increased by 9.4 percent year-on-year from January to November, compared to 7.2 percent in the same period in 2015. Collections from the *Bureau of Customs* registered the fastest growth of 9.6 percent year-on-year as of end-November (compared to 1.6 percent in January-November 2015), but collections from the *Bureau of Internal Revenues* also grew strongly, increasing over the same period by 9.3 percent compared to 8.8 percent in 2015. This led to a deficit of Php235.2 billion in November, about 61 percent of the full-year target of Php388.9 billion.

National government debt grew at a slower rate in the first eleven months of 2016 compared to the same period in 2015. As of end-November, the government's outstanding debt increased by 2.5 percent from end-2015 level (compared to a 3.8 percent increase over the same period in 2015), reaching Php6.1 trillion. Year-to-date, the government's external debt position expanded by 4.6 percent−compared to 7.4 percent over the same period in 2015−exacerbated by the depreciation of the peso against the US dollar. In particular, direct loans from external sources drove the growth of the country's external debt stock as external loans increased by 7.4 percent from January to November, while external obligations from government securities expanded by 3.1 percent. Meanwhile, in the first eleven months of the year, domestic debt increased by 1.4 percent (compared to 2.0 percent in the same period in 2015) as the government issued securities worth Php54.9 billion. About two-third of the government's obligations are composed of domestic debt, and a third, external.

The 2016 unemployment rate dropped to a decade low as robust economic performance fueled job creation. The unemployment rate fell from 6.3 percent in 2015 to 5.5 percent in 2016, which is the lowest level since the country adopted the *International Labor Organization's* definition of unemployment in the second quarter of 2005. Robust activities in the services and construction sectors drove job creation. In particular, the services sector remained the largest contributor to employment, accounting for 55.6 percent of total jobs in 2016 from 54.6 percent in 2015. Given the strong growth in the construction sector, the employment share of the industry sector increased from 16.2 percent in 2015 to 17.5 percent in 2016. In contrast, the contribution of the agriculture sector to employment contracted from 29.2 percent in 2015 to 26.9 percent in 2016. This reflected the relative poor performance of the agriculture sector, which suffers from low productivity and vulnerability to weather-related events. Despite the overall gains in jobs creation, the underemployment rate remained persistently high at 18.4 percent in 2016 from 18.5 percent in 2015, suggesting that the quality of employment remains a concern.

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