Economics@ANZ

The Philippines

Briefing paper

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The Philippines

Nominal GDP: US$95.4 bn (market exchange rate)
US$409.4 bn (purchasing power parity)

Ranking: 45th largest MER basis; 24th largest PPP basis

Population: 88 mn (July 2005)

Age structure: 0-14 yrs 35.4%
15-64 years 60.6%
65+ years 4%

Median age: 22.3 years

Life expectancy at birth: 69.9 years

Languages: Filipino (based on Tagalog)
English
8 major dialects

Literacy: 92.6%

Land size: 0.3 mn sq kilometres

Capital: Manila

Administrative divisions: 79 provinces; 117 chartered cities

Independence: 12 June 1898 (from Spain)

Chief of State and Head of Government: President Gloria MACAPAGAL-ARROYO (since 20 January 2001);

Elections: President elected by popular vote for six-year terms; election last held 10 May 2004 (next to be held in May 2010)

National Legislature: The Congress of the Philippines consists of the Senate (24 members) and the House of Representatives (212 directly elected members and 24 members selected by party list). Senators are elected for six-year terms and representatives for three-year terms

Elections: Senate - last held 10 May 2004 (next to be held in May 2007); House of Representatives - elections last held 10 May 2004 (next to be held in May 2007)

The structure of the Philippines' economy

In recent years the contribution to GDP of the manufacturing sector has been around 23-24%, that of the agriculture, forestry & fishing around 19% and the services sector of close to 50%. The agriculture sector is vulnerable to drought and storms. In particular, the sector was badly affected by the 1998 *El Nino*. The manufacturing sector is largely concentrated on electronics (eg. computers and semiconductors) and consumer durables. The Philippines' large English-speaking workforce has also attracted multinationals to move services-related operations (eg. call centres) to the country. On an expenditure basis, household consumption's share of GDP has risen steadily and accounts for three-quarters of GDP. Remittance inflows from Filipinos working abroad have been a major contributor to the resilience of the domestic economy. Remittances were over US$8 bn in 2004 and are expected to stay strong.

The Philippines' macroeconomic stability, however, has been weakened by high fiscal deficits over a number of years – largely due to a very narrow tax base and low revenues – and large foreign currency debt burden. This has led to successive sovereign credit ratings downgrades. However, there has been encouraging progress on fiscal reform and the fiscal deficit is expected to come in at under 2% of GDP in 2007 from over 5% of GDP in 2002. This, in turn, should help to improve the debt profile of the Philippines over the coming years, reducing inflation pressures and improving macroeconomic stability.

Composition of GDP – output (% of total)				
	1980	**1990**	**2000**	**2004**
Agriculture, forestry & fishing	23.1	21.9	19.4	19.3
Mining, Manufacturing & Utilities	29.9	28.4	27.7	27.7
Construction & Services	47.0	49.7	52.9	53.0

Source: UN Statistics Division

Composition of GDP – expenditure (% of total)				
	1980	**1990**	**2000**	**2004**
Household consumption	62.9	71.2	74.6	75.8
Government consumption	10.5	10.1	10.5	9.6
Gross fixed capital formation	24.9	23.1	24.9	21.8
Exports of goods & services	23.1	27.5	41.7	39.5
Imports of goods & services	26.2	33.3	45.0	46.1

Source: UN Statistics Division

Politics

President Arroyo's second term of office has been eventful. She has withstood calls for her resignation in 2005, which were triggered by allegations that she had rigged her May 2004 election victory. A subsequent opposition bid to impeach the president was defeated, effectively diminishing the prospect of her removal from office. In late February 2006, President Arroyo declared a State of Emergency following threats of a coup. Several arrests of soldiers and civilians have since been made. While there have been growing calls for President Arroyo to step down, she still enjoys majority support from both Congress and the military and the lack of a serious presidential contender has helped to consolidate her position.

Political noise will remain high in the coming months as Congress debates a constitutional amendment that would start the process by which the Philippines would move to a parliamentary system of government. Nonetheless, this is still likely to remain just noise. Assuming that Arroyo remains in office at least for the next few years – her term expires in 2010 – the unpredictable political environment is unlikely to significantly undermine economic or financial markets.

Relations with Australia

Australia's total trade with the Philippines has declined in recent years. The Philippines ranked as the 25th largest export market for Australia and 33rd most important source of imports. Australia's trade surplus with the Philippines has been weakened in recent years and was recorded at A$169 mn in FY2004/05 (year ending June 2005) compared with A$988 mn in FY2000/01. In terms of services trade, total trade between Australia and the Philippines amounted to A$412 mn in FY2004/05 acounting for 0.6% of total services trade with the Philippines ranked as the 25th most important partner.

According to the Australian Bureau of Statistics, Australia's stock of investment in the Philippines was A$0.9 bn as at December 2004.

Australia's Merchandise Trade with the Philippines

FY2004/05	A$ bn	% share of total	Rank	5-year trend growth
Exports to the Philippines	0.87	0.7	25	-9.7
Imports from the Philippines	0.70	0.5	33	10.9
Total Trade	1.57	0.6	29	
Trade Balance	0.17			

Source: DFAT,Composition of Trade Australia

Australia's Trade with the Philippines

Main Australian Exports*	A$ mn (% of total)	Main Australian Imports*	A$ mn (% of total)
Milk & Cream	144.9(16.7%)	Crude Petroleum	116.0 (16.6%)
Medicaments	99.2 (11.4%)	Computers	107.9 (15.4%)
Copper	47.2 (5.4%)	Telecom. Eqpt.	55.2 (7.9%)
Coal	38.6 (4.4%)	Integrated circuits	40.0 (5.7%)
Copper ores	32.2 (3.7%)	Radio receivers	34.6 (4.9%)

**: includes confidential items which accounted for 8.9% of exports and 4.7% of imports*
Source: DFAT,Composition of Trade Australia

Forecasts

Real GDP growth for 2005 was 5.1%, lifted by a robust fourth quarter outcome of 6.1% YOY. 2006 is expected to see a slightly slower, albeit healthy, pace of economic expansion, supported by investment and strong remittance inflows, which will help underpin private consumption.

The fiscal deficit for 2005 was down 22% from 2004 and was 18.6% lower than the target, bringing it to 2.9% of GDP. The Supreme Court lifted the freeze on the implementation of the Expanded Value Added Tax (EVAT) in October 2005, paving the way for the government to continue with fiscal reform. This is a significant step towards reducing borrowing needs and the debt service burden. A further narrowing of the fiscal shortfall is expected for 2006 to around 2.1% of GDP. President Arroyo aims to bring the budget to balance by 2008, two years ahead of plan.

Inflation is expected to edge up, reflecting in part the impact of the expansion of the VAT to incorporate a wider range of products and services and an increase in the VAT rate to 12% from 10% from 1 February. High oil prices will also continue to add upward price pressures. Inflation is forecast to average 8% in 2006 from 7.7% in 2005 – well above of the target of 4-5%.

The central bank has been vigilant in its watch over inflation risks, having raised policy interest rates three times in 2005. The overnight borrowing rate is currently at 7.5%.

Key economic indicators				
	2004	**2005e**	**2006f**	**2007f**
Real GDP growth (%)	6.0	5.1	4.8	4.3
Nominal GDP (US$ bn)	86.1	98	110	122
CPI (%, year average)	5.9	7.7	8	6
Fiscal balance (% GDP)	-3.9	-2.9	-2.1	-1.5
Current account (% GDP)	2.6	2.0	2.0	1.8
Foreign exchange reserves (US$ bn)	13.1	16	17.5	18.5
USD/PHP, eop	56.2	53.1	50.7	50.0
AUD/PHP, eop	43.9	38.9	35.5	35.0
Policy Rate (% pa)	6.75	7.5	7.75	7.25

Source: Economics@ANZ

Issues in the economy

- Growing competition for trade and investment will continue to pose a serious challenge to growth in the manufacturing and services sectors. The electronics sector may lose ground to China and call centres and back-office services to India.
- Exports are heavily dependent on electronics goods and are thus vulnerable to global weakness in this sector.
- While the Philippines economy and investment environment has coped well with leadership challenges and policy uncertainty, the unpredictable political environment is likely to cloud prospects for a ratings upgrade and impede large-scale investment flows.

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