CHAPTER 18
PHILIPPINES

Introduction. After growing at 4% in the year 2000, the Philippine economy has begun to slow down.

- GDP grew at a slower rate of 3.2% in the first half of 2001. Growth is largely due to solid domestic demand.
- That said, the level of Philippine growth remains disappointing in a Philippine context. Why? It starts from a low baseline.
- The Philippines needs close to double-digit growth to make much of a dent in the persistent poverty in the region.
- Without strong growth and more vigorous outreach, the discontent that supports terrorism and insurgency will continue.

External Shocks. Unfortunately, little can be done for protection from the external winds.

- Corporations are facing weak foreign demand for electronics and other exports.
- The biggest blow has been dealt to the manufacturing sector, where first-quarter growth decelerated to 2.4% year-on-year from 4.4% in the fourth quarter.

Weak Exports. But with the Philippines' two main export markets (the United States and Japan) suffering their own economic problems, Philippine exports are falling.

- In August 2001, exports fell 26% from a year earlier, the biggest drop in 21 years. That same month overseas sales of Philippine semiconductor and other electronic components—which make up 50% of all Philippine exports—dropped 40%. Similarly, August 2001 shipments of electronics, garments, and farm products slipped 26% from a year earlier.
- Weak export figures portend continued anemic growth—or even recession.

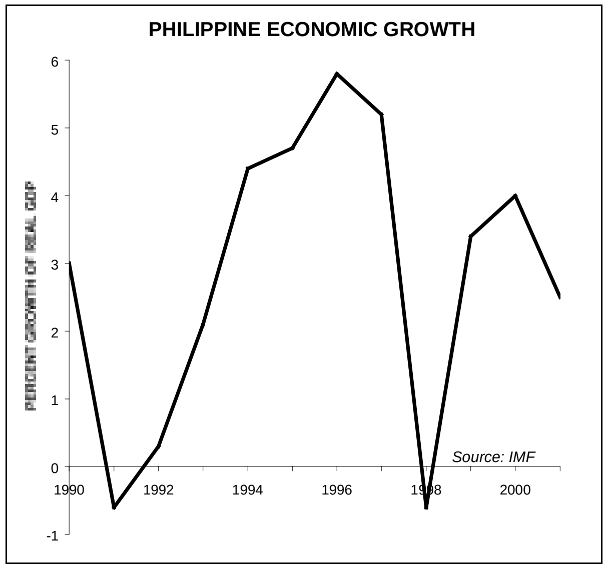
Falling Stock Market. Export fears drove down the stock market. Manila stocks ended at a 10-month low on 31 August. The terrorist attacks on 11 September only worsened the trend. By October, the stock market had hit a ten-year low.

Figure 18-A. Selected Historical Data

$ Billions (or %)	'97	'98	'99	'00
Gross National Income	88.4	78.9	78.0	75.2
Purchasing Power	270.0	266.0	292.9	302.6
Real Growth (%)	5.2	-0.6	3.4	4.0
Inflation (%)	5.9	9.7	6.6	4.3
Exports	25.2	29.5	35.0	38.1
To U.S.	10.8	12.3	12.7	14.2
Imports	38.6	31.5	32.6	33.8
From U.S.	7.4	6.7	7.2	8.7
FDI from U.S.	3.4	3.2	3.1	2.9
In U.S.	0.1	0.1	0.1	0
Cur Account /GDP %	-5.3	2.4	10.0	12.5
Fiscal Balance /GDP %	0.1	-1.8	-3.7	-4.1
External Debt /GDP %	55.7	73.0	71.2	69.8

Sources: IMF, ADB, World Bank, and U.S. Commerce

Figure 18-B



Economic Legacies

Estrada's Mismanagement. In January 2001, President Arroyo inherited an economic mess from Estrada, so putting the precarious economy back on track is no easy task.

- The 31-month presidency of Mr. Estrada left President Arroyo with a negative legacy of mega-corruption, poor economics, and a weaker international standing.
- The deteriorating fiscal, economic, and political picture in 2000 caused Standard & Poor's to downgrade the Philippines' outlook from stable to negative.

Arroyo's Good Start. Initially, President Arroyo made progress stabilizing the economy. Philippine financial markets rallied sharply on her ascension to power. The stock market hit a year high of 1,954 on Mr. Estrada's removal from office. The peso also rallied, at first.

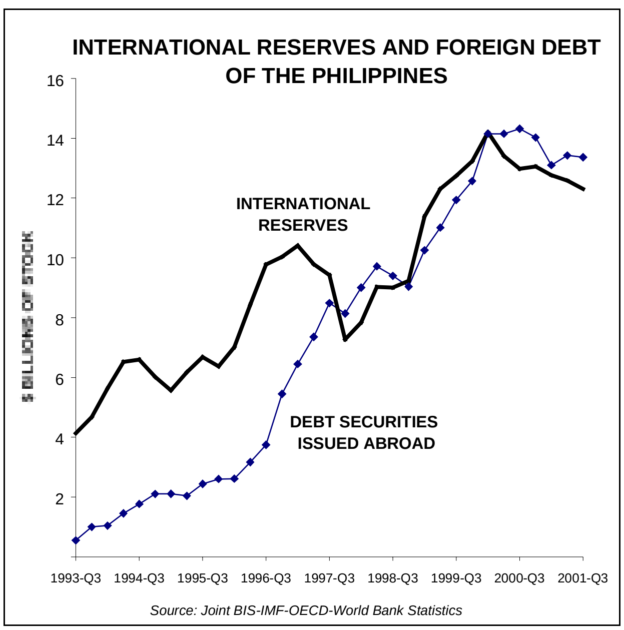
***Protests Hit Markets**.* Then the pro-Estrada forces mounted protests against President Arroyo. For example, on April 30th, Philippine financial markets took a beating—the stock market fell 2.9% and the peso fell to a 15-week low of 51.55 pesos to the dollar.

Weak Foreign Direct Investment (FDI). Foreign investors remained jittery in 2001. Future FDI inflows depend on political stability.

Fiscal Woes. A central issue facing Arroyo is how to control a runaway budget deficit.

- Manila's budget deficit ballooned to 136B pesos ($2.72B) in 2000, more than double the IMF target. IMF is therefore critical of this fiscal irresponsibility.
- This situation may well worsen. In October 2001 President Arroyo said that her government would boost spending to avoid a recession in the face of a severe global economic downturn.

Figure 18-C



Low Foreign Reserves. Servicing its foreign debt is another central problem for Manila.

- Foreign debt is nearly two-thirds of GDP.
- On the surface, foreign reserves look respectable at about $12B, over twice the government's short-term debt of $5.6B. However, foreign debt matches reserves.

Weaker Growth. Given weak U.S. and Japanese demand for exports, GDP growth slowed from 4% in 2000 to only 2.5% in 2001.

- Weaker growth will fan social unrest.
- Budget problems will worsen.

Looking for Good News

An Asian Consumer Economy. Personal consumption accounts for a sizeable 70% of the country's GDP.

***Good Weather, Good Crops**.* When the weather is good—not too much rain, not too little—the agricultural sector does well. With more than a third of the country's workforce involved in farming, agriculture has become the lynchpin of consumer spending. President Arroyo calls it her "engine of growth."

Low Inflation. Fortunately, inflation is still quiescent as food, housing, and fuel prices fall.

Lower Interest Rates. If inflation remains low, the overnight borrowing rate, currently 9%, could be reduced. That should eventually boost growth. Even so, it will take some time before the effect of a rate cut is felt in bank lending and domestic manufacturing. Until this happens, the economy will be continuing to look overseas for good news.

Conclusion

Weak external demand for Philippine exports is dampening growth. Without stronger economic growth and more vigorous outreach, the social and economic discontent driving the terrorism and insurgent movements in the country will continue unabated.

Unfortunately, the grim legacy of President Estrada's economic mismanagement still plagues the country. On the structural side, the budget deficit has ballooned and is now almost twice the IMF target for financial stability. The Philippines is also saddled with a large foreign debt. Its currency reserves are also dangerously low. Such financial quicksand is a weak foundation for stronger long-term economic growth in the Philippines.