

# **The Philippine Economy: Policies for the 21st Century, Recent Performances, and Prospects**

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*Speech delivered at the First Economic Forum sponsored by the Economics Society, held at the Ateneo de Davao University on 21 August 2002.*

**I**t is my pleasure to be invited to speak before the distinguished teachers and students of the Ateneo de Davao University on its first Economic Forum sponsored by the Economics Society.

Today, I will discuss the economic policy choices of the Macapagal-Arroyo administration, what these policies have yielded in terms of the recent performance of the economy, and prospects for this year and next.

When the Administration took over in January 2001, it inherited several fundamental weaknesses.

Following the political shocks brought about by the involvement of former President Estrada in the illegal numbers game *jueteng*, business and consumer confidence deteriorated, resulting in high interest and inflation rates, and severe weakening of the peso against the US dollar.

The immediate challenge was to restore macroeconomic stability and convince investors that the government was committed to long-term policies for growth with equity.

## **The Policies of President Gloria Macapagal-Arroyo**

Under the leadership of President Macapagal-Arroyo, a deficit-reduction program was put in place aimed at reducing interest and inflation rates, and stabilizing the peso-dollar exchange rate.

In addition, long delayed structural reforms were pursued. This resulted in the enactment of the Electric Power Industry Reform Act and the Anti-Money Laundering Law.

In her first State of the Nation Address, the President laid down her vision: eliminate poverty within the decade.

This calls for a comprehensive set of economic and social policies that are now spelled out in the Medium-Term Philippine Development Plan for 2001-2004.

The Plan has four key elements:

1. Macroeconomic stability with equitable growth based on free enterprise;
2. Agriculture and fisheries modernization with social equity;
3. Comprehensive human development and protecting the vulnerable; and
4. Good governance and the rule of law.

In only 19 months in office, the administration has laid down the foundation for creating prosperity within reach of every Filipino. Our countrymen, imbued with hard work and ingenuity, are responding positively to the policies of the Administration.

### Recent Economic Performance

I will now present a report on the performance of the economy in 2001 until the first quarter of 2002. I will also describe the prospects for the rest of 2002 until next year. An update on the on-going projects here in Region XI will cap my presentation.

The year 2001 is one that many countries all over the world would want to forget. Far too many shocks with unwanted consequences occurred: (1) the retrenchment of the high-technology sector; and (2) the terrorist attacks in the US on 11 September 2001.

Fortuitously, the Philippine economy managed to overcome these shocks.

Overall, the Philippine economy is healthy and strong. Last year, it posted one of the highest output growth rates in the region.

### Aggregate Performance 2001-2002

After a mild slowdown in 2001 following the severe slump in the technology sector and the delayed recovery of the US economy due to the September 11 attack, the economy strengthened in the first quarter of 2002, with gross domestic product (GDP) adjusted for inflation expanding by 3.8 percent from last year's 2.9 percent.

Gross national product (GNP), which takes into account net factor incomes from abroad like the overseas workers' income remittance, rose 4.9 percent as the country paid less in property expense due to lower interest on foreign debt (see fig. 1).

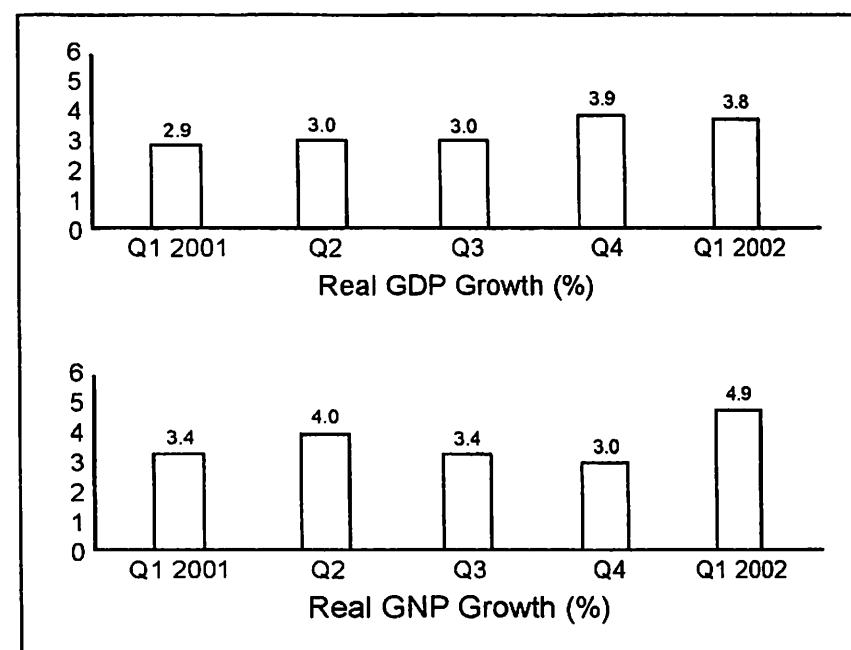


Fig. 1. Aggregate performance 2001-2002.

### Sectoral Performance 2001-Q12002

The recovery was broad-based, with growth accelerating across all sectors. Services led all sectors from a year ago, on account of the robust performance of telecommunications, trade, and private services. Agriculture expanded by 4.4 percent as favorable weather and the government support for Agriculture and Fisheries Modernization Act boosted production in crops, fishery, livestock, and poultry. Industry also recovered, led by rising production in consumer-durable sectors and the rebound in exports (see fig. 2).

### Domestic and Foreign Demand

Growth was domestically driven, as personal consumption spending remained healthy while private construction accelerated. Strong domestic demand offset the decline in net exports arising from the lingering impact of the slump in the technology sector. In the second quarter, however, the indicators so far show a rebound in net exports (see fig 3).

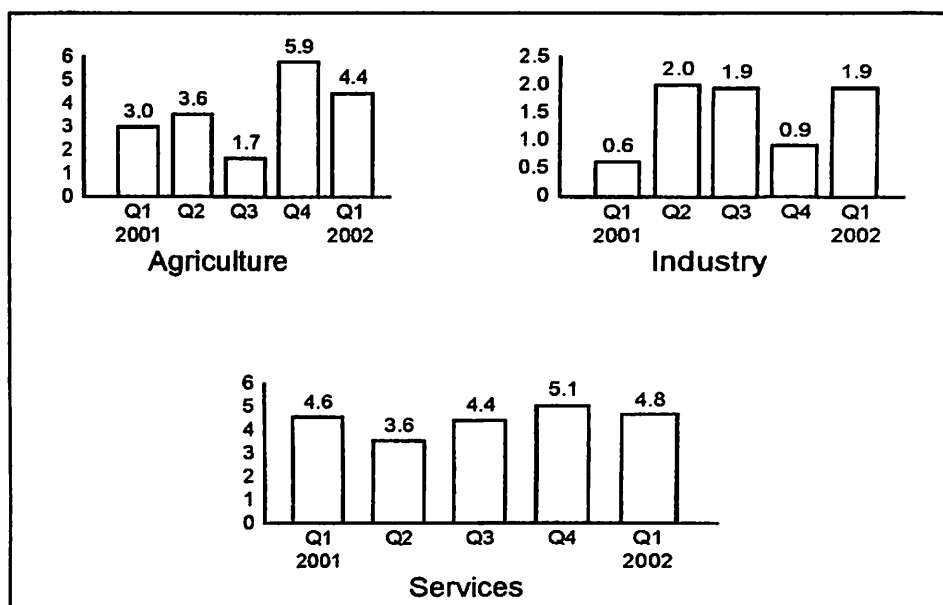


Fig. 2. Sectoral performance 2001-Q1 2002. Real growth rate (%).

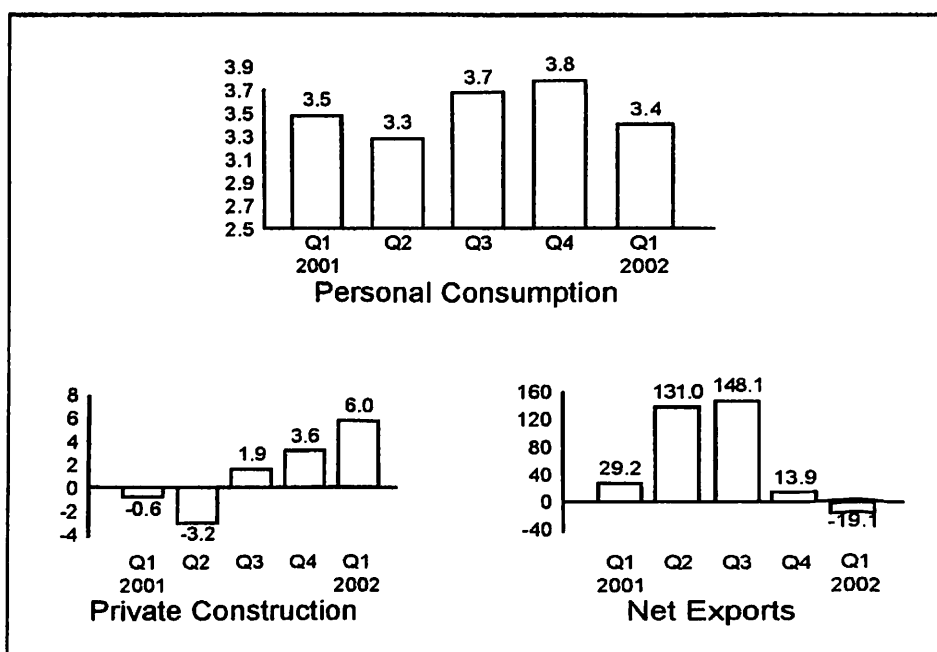


Fig. 3. Domestic and foreign demand. Real growth rate (%).

### Gross Domestic Product: Annual Percent Change

Growth so far compares well with our neighbor in the region. As of the first quarter of 2002, the Philippine economic performance was ahead of Malaysia and Indonesia but slightly lower than Thailand (see Table 1).

### Employment

About 1.3 million jobs were created as of April 2002. The bulk of the new jobs generated were in services and agriculture as shown in fig. 4.

### GDP-Region XI. 2001-2002

The healthy pace of economic expansion in the country a year ago is also seen in the modest improvement of Region XI's economy. In 2001, the Davao region (Region XI) grew 2.1 percent.

Davao Region is one of the country's most progressive regions. It ranks 1st among Mindanao regions, accounting for 34.2 percent of Mindanao output, and 6th nationwide, accounting for a 5.6 percent share in the Gross Domestic Product (see fig. 5).

### Gross Value Added by Sector

The services sector accounts for the largest share of the region's GRDP (44%), with its trading activities contributing about nearly one-half of the sector's output (44.1%).

Table 1. Economic Performance of Selected Asian Countries.

Country	Q1 2001	Q1 2002
Philippines	2.9	3.8
Malaysia	3.1	1.1
Indonesia	4.0	2.2
Thailand	1.7	3.9
Hongkong	2.2	-0.5
South Korea	3.7	5.7
China	8.1	7.6
Singapore	5.0	1.2

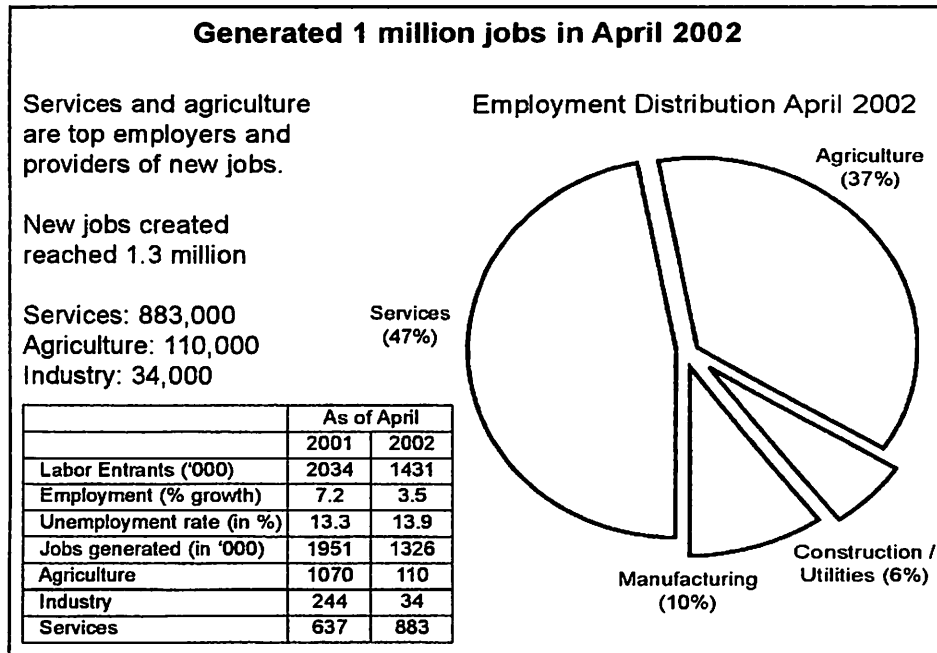


Fig. 4. Employment distribution, April 2002.

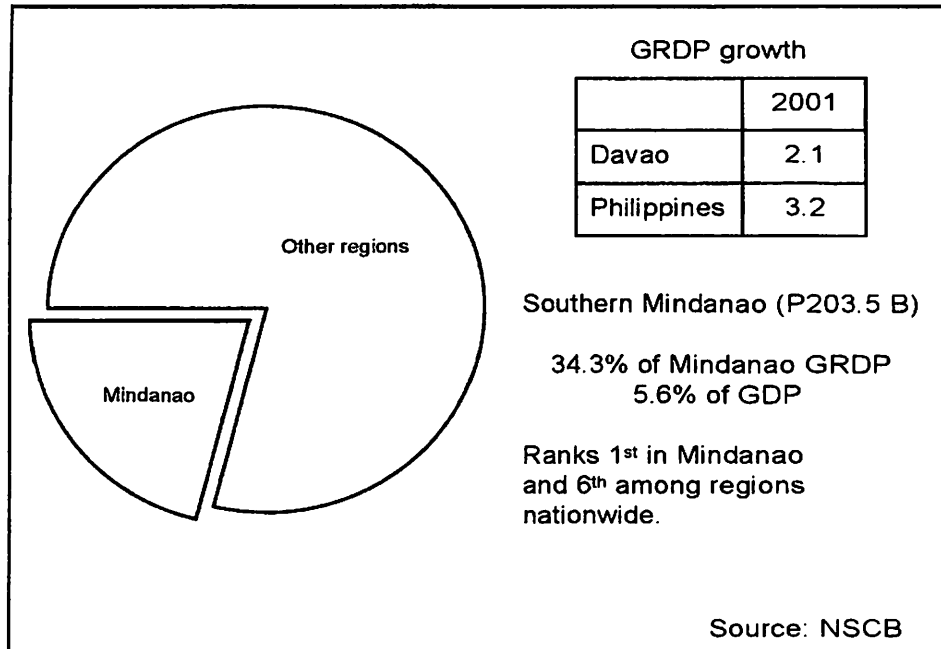


Fig. 5. GDP Region XI, 2000-2001.

Thirty percent (30%) of the region's output comes from agriculture. It is the second largest contributor to agricultural production in the country, next to Region IV. It also has the 6th largest output in both services and industry sectors among all regions in the country (see fig. 6).

**The Region's Major Exports**

Davao Region is noted for its high quality agricultural products which are among the region's major exports. Banana is the top export of the region followed by pineapple, oil cake and other residue, yellowfin tuna, mixture of fruit preserves and natural rubber.

Among the region's top 10 exports are non-agricultural products such as activated carbon and Portland cement.

Japan, China and the USA are the region's major export markets. New and promising markets include Palau for Portland cement and New Zealand for its fruit preserves (see table 2).

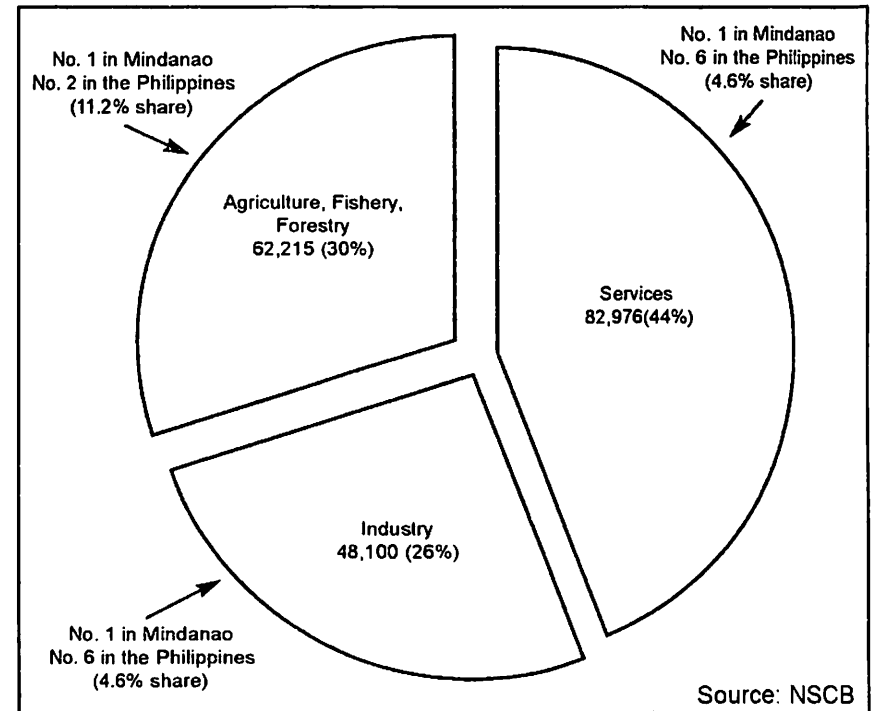


Fig. 6. Gross value added by sector (in billion pesos/percent share, at current prices), 2001, Southern Mindanao.

Table 2. Major export products and markets.

Products	Markets
Bananas	Japan and China
Coconut crude oil	Netherlands & USA
Coconut refined oil	USA & China
Fresh Pineapple	Japan & South Korea
Activated Carbon	Singapore & Japan
Oil cake & other residue	Japan & Taiwan
Yellowfin tuna/fresh	USA & Japan
Mixture of fruit preserves	Hongkong & New Zealand
Portland Cement	Palau & Indonesia
Natural Rubber	China & Malaysia

### Leading Indicators for Second Quarter Growth

The momentum of growth of the country in the first quarter appears to have firmed up in the second quarter, based on the latest indicators. We are expecting the release of official data on national income accounts this last week of August.

The economy has been off to a good start in 2002.

Favorable macroeconomic conditions augur well for a stronger recovery in consumer and investment demand. Inflation has been on the downtrend since January 2001 on account of the adequate supply of agricultural commodities, generally stable world oil prices, and recent change on electricity pricing. The falling inflation rate and the prudent borrowing strategy of the administration has also led to 91-day T-bill rates that are lower than a year-ago levels. Monetary policy, meanwhile, has made price stability its main goal. At the same time, the exchange rate system in place is flexible, allowing the peso to stabilize given the anti-inflationary stance of monetary policy and the fiscal discipline of the Administration.

The low interest rate environment has perked up the housing sector. The number of building permits granted in the first quarter of 2002 rose 16.3 percent, while value increased 56.3 percent. About 70 percent of the building permits issued are for residential purposes.

Our trade sector has also rebounded strongly. Exports remain dominated by electronic equipment and parts. The pick-up in both exports and domestic production has led to rising imports.

With the favorable domestic and external environment, the manufacturing sector has become more upbeat. Based on the results of

the Monthly Integrated Survey of Selected Industries (MISSI) in May 2002, volume of production rose by 10.6 percent.

Notwithstanding the dry weather which precedes the onset of an El Niño, the agriculture sector expanded 2.5 percent in the second quarter leading to a first semester growth of 3.2 percent. The delayed rainfall affected palay production in the second quarter (-4.9%) and corn (-6.1%). However, there was an expansion in high value crops such as onion and cassava, as farmers shifted production to these crops. Livestock (3.1%), poultry (2.0%) and fishery (5.5%) posted strong growths (see table 3).

Other indicators such as Meralco sales and appliance sales also indicate that the economic recovery firmed up in the second quarter.

Business confidence has also improved in Region XI.

From January to July 2002, the total value of projects registered with BOI-Region XI reached P135 million from zero in the same period last year.

The projects registered in this period include the export of banana chips by: (a) Tropical Synergy in Davao City (P45 million); (b) GSL Enterprises in Davao del Sur (P45 million); and (c) Lucas International in Davao City (P45 million).

Moreover, BOI XI has received initial applications in the following investment areas: Landline expansion by Davao Telephone Company (DATELCO) in Tagum City (P200 million) and; Vapor Heat Treatment (VHT) expansion by DOLE-Tropi -Fresh Co, in Panabo City (P267 million). These represent the potential BOI registrants in the region for the second half of the year.

Table 3. Agricultural Production 2nd Quarter.

	2nd Quarter	
	2001	2002
Total Agriculture	3.7	2.5
Crops o/w:	4.3	0.9
Palay	6.4	-4.9
Corn	-9.5	-6.1
Livestock	3.1	3.1
Poultry	1.7	2.0
Fishery	3.8	5.5

Source of basic data: Bureau of Agricultural Statistics.

Let me now discuss the prospects for 2002-2003.

Barring a renewed recession or a severe slowdown in the US economy, growth forecast for the rest of the year and 2003 remain cautiously optimistic. GDP growth, adjusted for inflation, is expected to grow 4.0-4.5 percent in 2002 and GNP by 4.5-5.0 percent. Growth is expected to accelerate to 5.0-5.5 percent in 2003 (see table 4).

Agriculture will post a slightly lower growth with El Niño affecting the sector in the last quarter of 2002 to mid 2003.

Services will continue to lead growth, as domestic demand continue to favor telecommunication, trade, and private services. Industry will grow at a faster pace, lifted by the continuing recovery in manufacturing and private construction, assuming that external demand conditions remain favorable to exports.

#### Prospects for 2002-2003: Domestic demand

Private consumer demand is expected to remain firm in 2002 as inflation remains modest. The continued remittance of overseas foreign workers (OFWs) and better labor market conditions will also continue to prop up domestic consumption.

Private construction demand is expected to pick up in 2002, given the low interest rate environment. Private construction is seen expanding robustly in 2003 pulled up by higher demand for housing. Housing is seen to pick up with the implementation of measures in housing finance such as that of the Home Guaranty corporation for low-cost housing. The passage of the Special Purpose Asset Vehicle Act (SPAV) will also increase the resources available for the investment spending (see table 5).

#### Prospects for 2002-2003: Global Environment

A major risk to growth is the threat of a possible double-dip recession in the US in 2002-2003. However, the diversification of Philippine exports to the fast-growing Asian market, including China, increases the resiliency of the Philippine economy against a slowdown in the US economy.

China offers opportunities, evident from the fact that it is now in the top ten destination list of Philippine exports (see table 6).

Table 4. GNP and GDP Growth Projection.

	2001 Actual	2002 Projection	2003 Projection
GNP g.r.	3.4	4.5-5.0	5.1-5.7
GDP g.r.	3.2	4.0-4.5	5.0-5.5
Agriculture	3.7	2.7-3.6	3.0-3.9
Industry	1.3	3.3-3.7	5.3-5.8
Services	4.4	5.0-5.5	5.5-6.0

Table 5. Domestic Demand Forecast.

	Actual		Forecast	
	2001	Q12002	2002	2003
Personal consumption	3.6	3.4	3.5-3.8	3.8-4.3
Investments	1.3	-1.3	2.7-3.2	5.6-6.1
Private construction	0.3	6.0	2.0-2.5	9.0-9.5

Table 6. RP Export Destinations.

	Share to RP's exports as of	GDP Growth Forecasts**	
	1st Sem 2002*	2002	2003
Asia minus Japan	27.8	-	-
China	3.4	7.0	7.4
South Korea	3.8	5.0	5.5
Singapore	7.3	3.2	5.1
Malaysia	4.6	3.0	5.5
Taiwan	7.3	2.3	4.8
Hongkong	5.8	1.5	3.6
US	25.1	2.3	3.4
Japan	15.5	-1.0	0.8
Europe***	12.8	1.2	2.7

\*Source: NSO

\*\*Source: IMF-World Economic Outlook, April 2002

\*\*\*Germany and Netherlands

### Prospects for 2002-2003: Domestic Environment

Macroeconomic stability remains crucial in ensuring strong domestic demand. Keeping a modest deficit relative to GDP is important in moderating domestic interest rates and in tempering inflationary expectations.

Barring extreme shocks to the economy and in line with the shift to inflation targeting, inflation is expected to remain tame in 2003 at 4.5 percent. The forecast is also conditioned on a moderate increase in the peso-dollar exchange rate (from P50-51 in 2002 and P51-52 in 2003); modest increases in global oil prices; and on measures to mitigate the impact of a mild El Niño on food supply (see table 7).

Table 7. Forecast on Inflation and Other Variables.

	2001	2002	Forecast 2003
Inflation Rate (%)	6.1	4.5-5.5	4.0-5.0
91-day T-bill rate (%)	9.9	7.0-8.0	8.0-9.0
P/\$ rate	50.99	50-51	51-52
Dubai Crude Oil, \$/bbl	22.81	23.64	24.64

Sustained growth and stability will also depend on structural reforms that will firm up business confidence and further improve the efficiency of the production sectors.

The cost of doing business is expected to decline with the rationalization of Independent Power Producers (IPP) contracts and with the implementation of the Electricity Power Industry Reform Act (EPIRA) and passage of the Transco bill. The Special Purpose Asset Vehicle (SPAV) bill will pave the way for greater lending to the corporate sector while strengthening the banking sector's balance sheets. Finally, tax reforms that aim to improve the buoyancy of the tax system will enable the government to increase its investments in education, health, housing, agriculture, basic infrastructure, and peace and order. Recent moves such as the filing of charges against 300 VAT tax evaders and the Administration's priority to reduce criminality are seen to boost investor morale.

The government remains committed to the development of Region XI. Thus, the following strategies shall be pursued for the next two and half years:

1. hasten agriculture and fisheries modernization
2. enhance the environment for further access in the global market
3. construct major roads, bridges and farm to market roads, and
4. set up mechanisms to improve, as well as expand the delivery of basic services and upgrade educational and health facilities.

### Major Public Investment Programs and Projects

In support of the region's development objectives, the government is currently implementing official development assistance (ODA) and locally funded programs and projects in the region to address its requirement in terms of infrastructure, human development services, agricultural development and agrarian reform, among others. There are two ongoing ODA projects in the region, namely: Davao International Airport Development Project and Construction and Equipping of the Davao Medical Center.

The Davao International Airport Development Project involves the upgrading of the Davao International Airport to International Civil Aviation Organization Standards at the existing site. This includes the upgrading and extension of existing runway; widening and grading of the landing strip; construction of dual access taxiway; the construction of new passenger terminal, cargo terminal and other airport operations, maintenance and air traffic control facilities. The project costs P4.2 billion and is being implemented by the Department of Trade and Commerce (DOTC), with support from the Asian Development Bank (ADB). The airport project supports the vision to further deepen the participation of Region XI in the national and international markets.

The Construction and Equipping of the Davao Medical Center aims to provide products and services necessary for the construction of the outpatient building; equipment necessary for the execution of the project and services thereof; and other services necessary for the transportation of these products. The project costs P860 million and is being implemented by the Davao City Government, with support from the Japan International Cooperation Agency (JICA).

In addition, there are also on-going ODA infrastructure projects in support of the region's development. These are the following:

Table 8. ODA infrastructure projects.

Project	Implementing Agency/ODA Partner	Project Cost (P M)
1. National Road Improvement Management Program (NRIMP)	DPWH/WB	1,430.07
2. PJFH Mindanao Section Rehabilitation Project, Phase I	DPWH/JBIC	765.80
3. PJFH Mindanao Section Rehabilitation Project Phase II	DPWH/JBIC	1,170.00
4. Rural Road Network Development Project II	DPWH/JBIC	225.50
5. Maritime Safety Improvement Project Phase III	DOTC/Spain	55.20
6. Improvement of the Marine Disaster Response and Environmental Protection System Project	DOTC/JBIC	3390.63
7. President's Bridge Program II	DILG/Austria	210.87

### Continuing Challenges

At this point, let me acknowledge that the Philippines still faces several challenges, including reducing poverty incidence and unemployment rate.

However, a commitment to policies known to be working will be of great help.

These policies enhance the long-run prospects of the economy. Macroeconomic policies to ensure stability. Structural reforms aimed at raising the economy's competitiveness. Good governance and rule of law to improve quality of life and investors' confidence.

I am confident that the economy's performance under the administration of President Gloria Macapagal-Arroyo brings greater hope for the future of the Philippine economy and that of Region XI than two years ago.

The support of all Filipinos, particularly the people of Mindanao and Region XI are key in transforming these policies into actual improvements in the people's lives, especially those of the poor.

Thank you and good day.