



3 Clouds on the Philippine Economic Horizon:

Concerns over the Philippine Economic Momentum

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Flow of presentation

- The Philippine Economy in 2007
 - Sources of strong growth momentum
- 3 major clouds in the short-/medium-term
 - Sub-prime credit crisis
 - Oil price levels
 - Peso appreciation
- Some areas for improvement on the medium-term and long-term
- IDEA forecasts

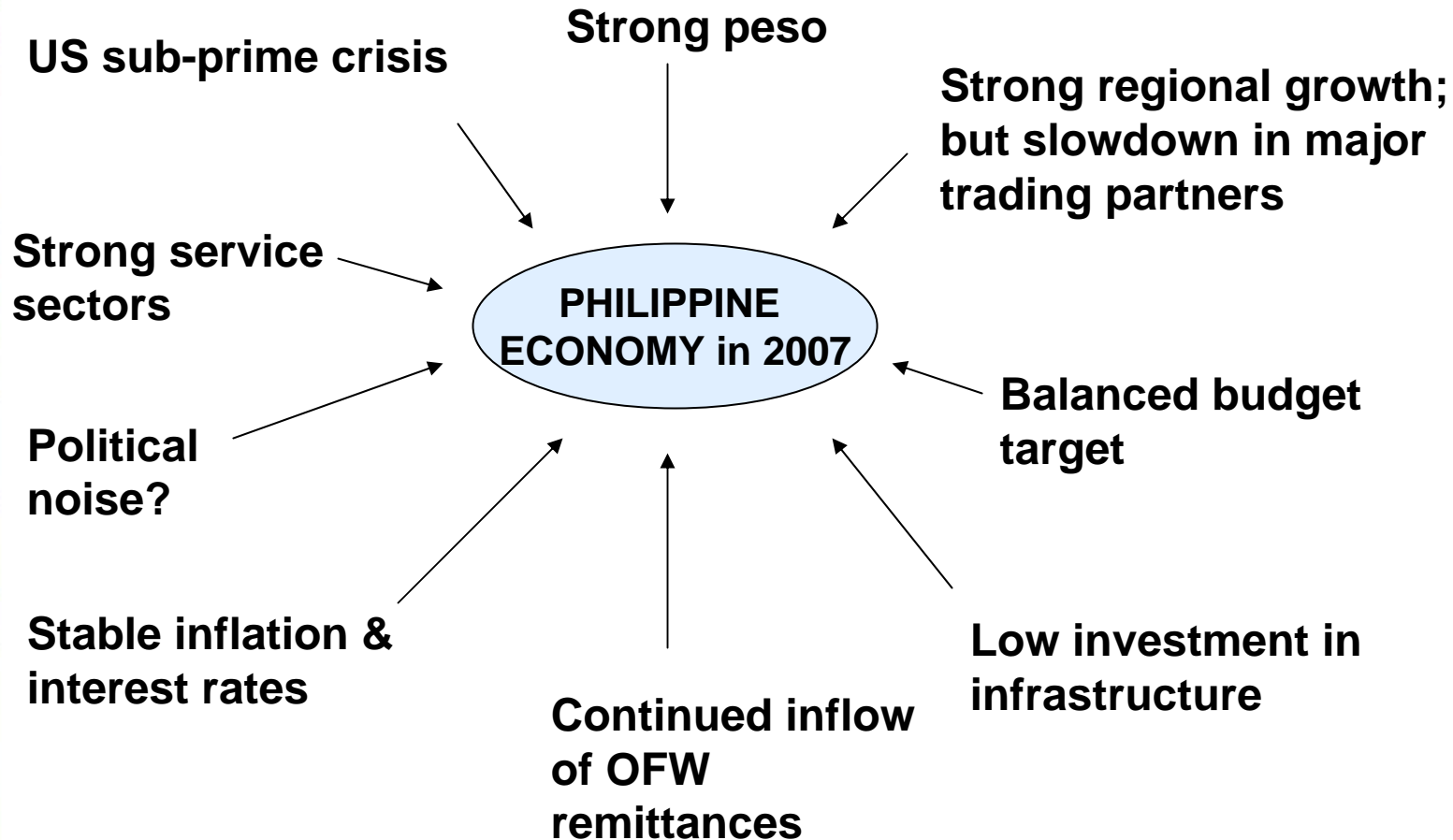


The Philippine Economy in 2007



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The Economy in 2007



On a Growth Momentum

- Government revised full-year growth forecast for 2007 from 6.1%-6.7% to 6.9%-7.3%.
- IDEA: Expected full-year 2007 GDP growth of 6.6% compared to 5.4% in 2006.

Where did the growth come from?

Services: Main growth driver

	Growth rates		% Contribution to GDP growth
	2006	2007/f	
Service Sector	6.7	8.1	3.9
Transport., Comm., Stor.	6.3	8.9	0.8
Trade	6.1	8.3	1.4
Finance	11.4	10.5	0.6
O. Dwellings & R. Estate	5.7	6.2	0.3
Private Services	6.9	8.8	0.7
Government Services	4.7	2.9	0.1

Source: NIA, IDEA

FINANCE: Driven by strong growth of banks, lower interest rates resulting in higher lending; rebound of insurance activities

TCS: Growth in the air transport sector, as well as tourism activities

PRIVATE SERVICES: Driven primarily by the BPO sector due to continued expansion of outsourcing services

TRADE: Sustained growth in consumer spending drove; driven by higher sales of appliances and the opening of new malls

Where did the growth come from?

Mining & Quarrying pushes Industry

	Growth rates		% Contribution to GDP growth
	2006	2007/f	
Industry Sector	4.5	6.2	2.0
Mining & Quarrying	-6.1	18.5	0.3
Manufacturing	4.6	3.8	0.9
Construction	7.3	17.4	0.7
Utilities	6.4	5.7	0.2

Source: NIA, IDEA

MINING: High coal demand from China and India; demand for nickel for the fabrication of steel products, for crude oil and natural gas for power generation

CONSTRUCTION: Recovery of private construction and higher infrastructure investments by the government; public construction growth of 20.2% vs. private construction growth of 13.1% during the same period

Where did the growth come from?

Turnaround in Agriculture

	Growth rates		% Contribution to GDP growth
	2006	2007/f	
Agriculture, Fishery and Forestry	3.8	3.4	0.6

Source: NIA, IDEA

AGRICULTURE: Contributed 1-percentage point to GDP in Q3 of 2007; However, performance of agriculture sector has always been volatile

Where did the growth come from?

The Demand Side

	Growth rates		% Contribution to GDP growth
	2006	2007/f	
Demand Side			
Personal Consumption Expenditure	5.5	5.9	4.6
Government Consumption	6.1	9.8	0.5
Capital Formation	2.7	6.8	0.8
Exports	11.2	1.3	
Imports	1.9	-5.0	

Source: NIA, IDEA

PERSONAL CONSUMPTION: Continued growth in OFW remittances and stable consumer prices; still with the biggest share to GDP from the demand side with 70% share to total

CAPITAL FORMATION: Increased government expenditures on public works' projects and higher investments in durable equipment

Sources of Strong Growth Momentum

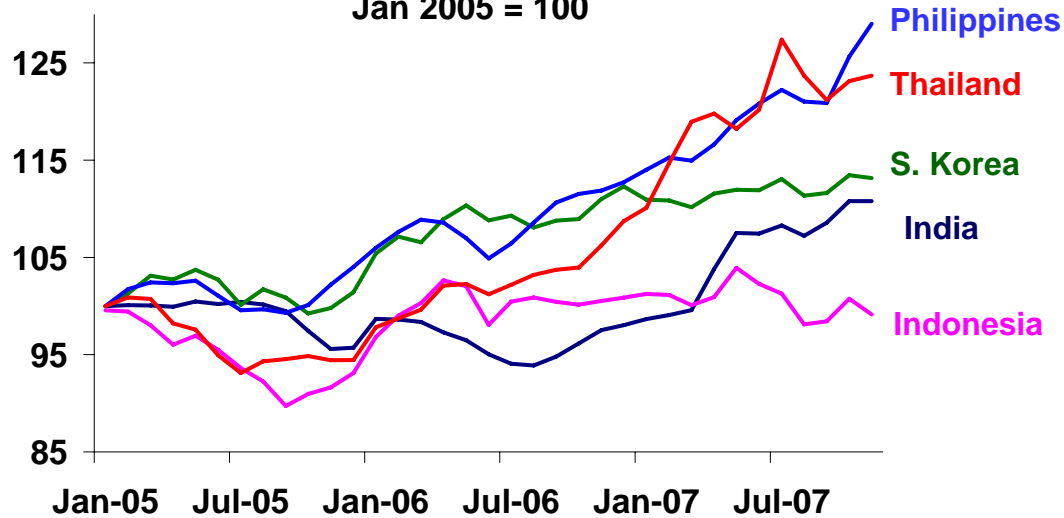
- Strong Asian growth
- Low inflation, low interest rates
- Strong OFW remittances

Strong Asian growth in 2008

- Emerging East Asia: Expectation of robust growth of more than 8% in 2008
 - But concerns remain
- Favorable external & domestic environments supported recent growth
 - Strong equity markets
 - Appreciation of a number of Asian currencies
 - General weakening of the USD
 - Strong dollar inflows (e.g. remittances, capital)
 - Narrowing interest rate differentials
 - Low funding costs for borrowers → credit expansion & growth in private investments



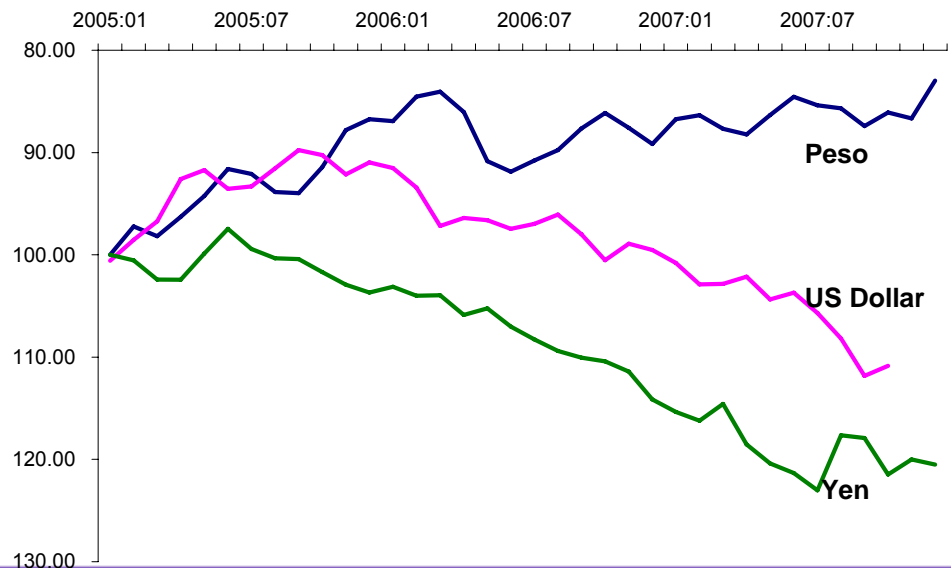
**Exchange Rate Index:
US Dollar rates of selected Asian currencies
Jan 2005 = 100**



Appreciation of their currencies have put pressure in the export competitiveness of some Asian countries

Source: ADB

**Exchange Rate Index: Euro Rates of Selected Currencies
2005-2007 (Jan 2005 = 100)**



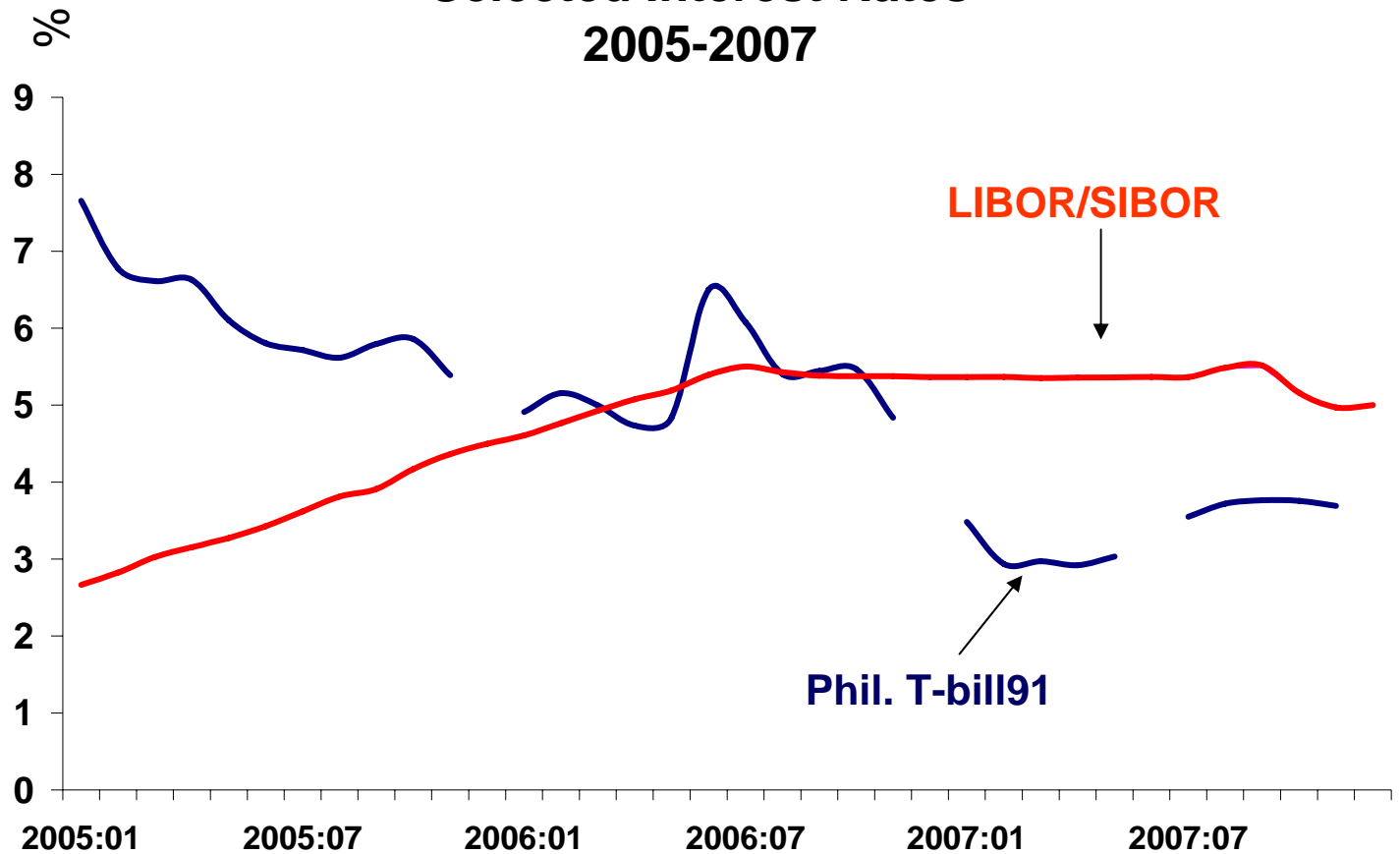
Comparison of the rates per euro shows that a significant part of the peso's appreciation is due to the weakening of the US dollar.

Source: BSP

Sources of strong growth

Low interest rates

Selected Interest Rates
2005-2007



- Movements in interest rates reflect expectation of currency appreciation/depreciation.

Sources of strong growth Low and Stable Inflation

Benign inflation outlook

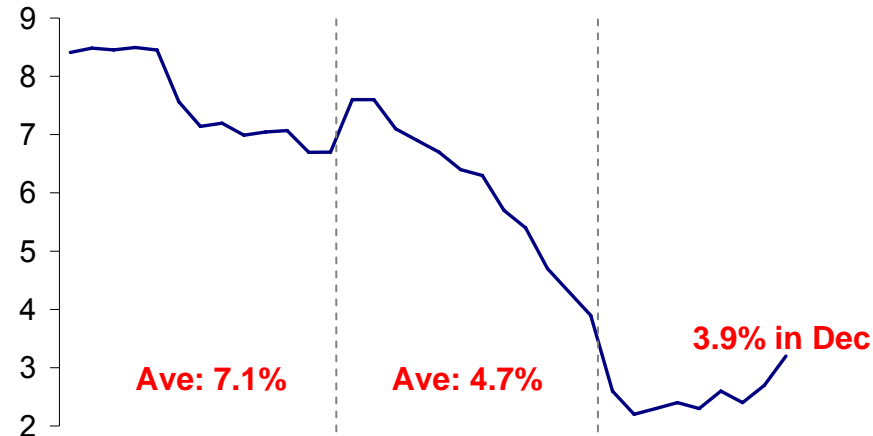
Target for 2007: 4%-5%

2007 Average : 2.8%

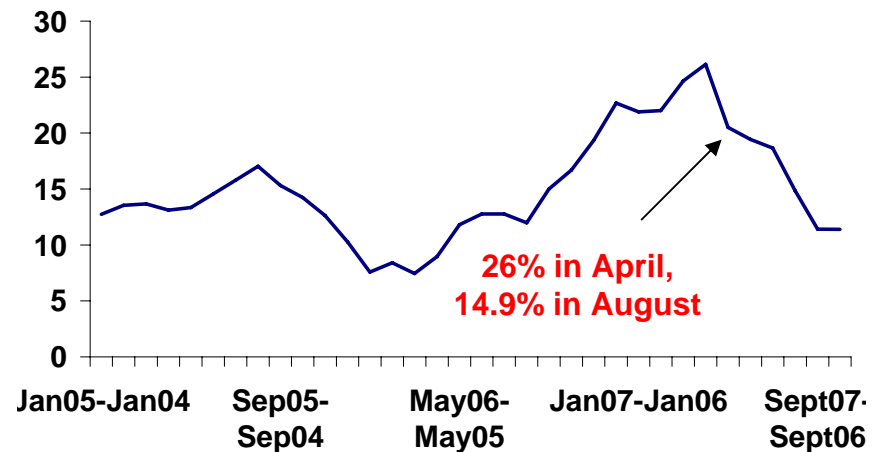
Easing growth in money supply, expanding below 20% since Dec 2006

- Partially due to BSP's SDA

Inflation Rates,
2005 - 2007 Nov



Growth in Money Supply,
2006 - 2007 Sept

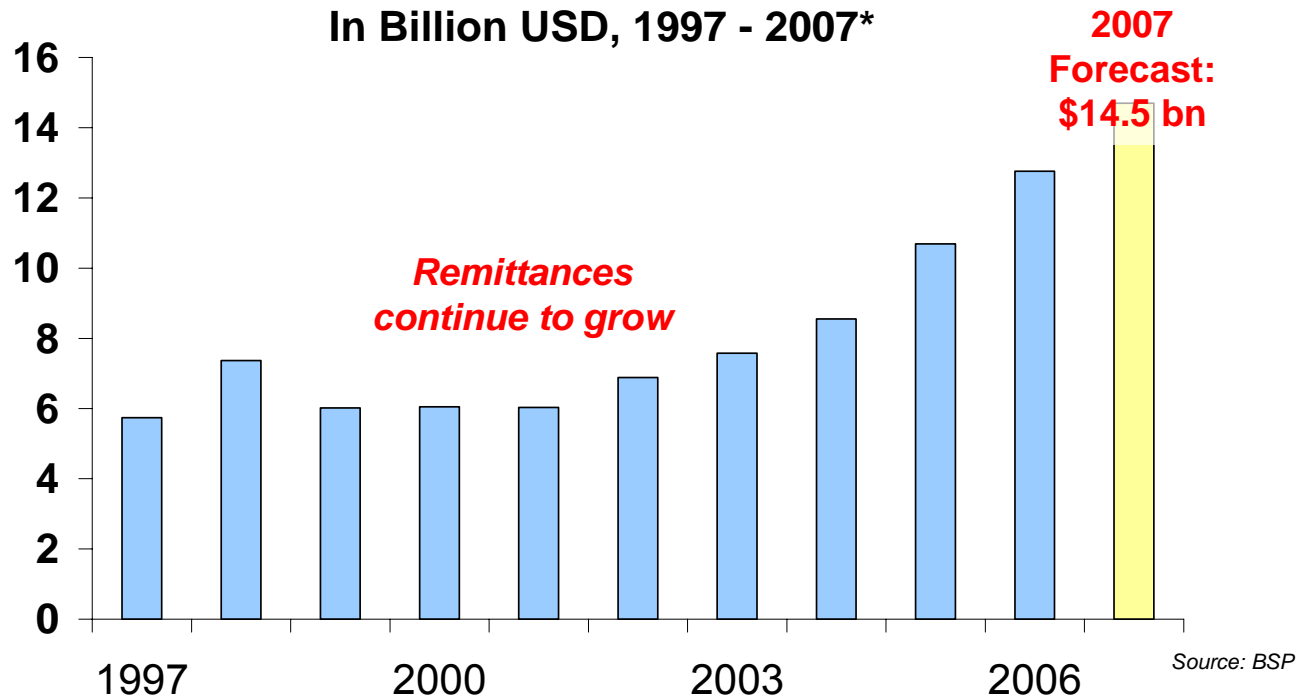


Source: BSP, NSO

Sources of strong growth

Strong OFW remittances

Level of OFW remittances,
In Billion USD, 1997 - 2007*

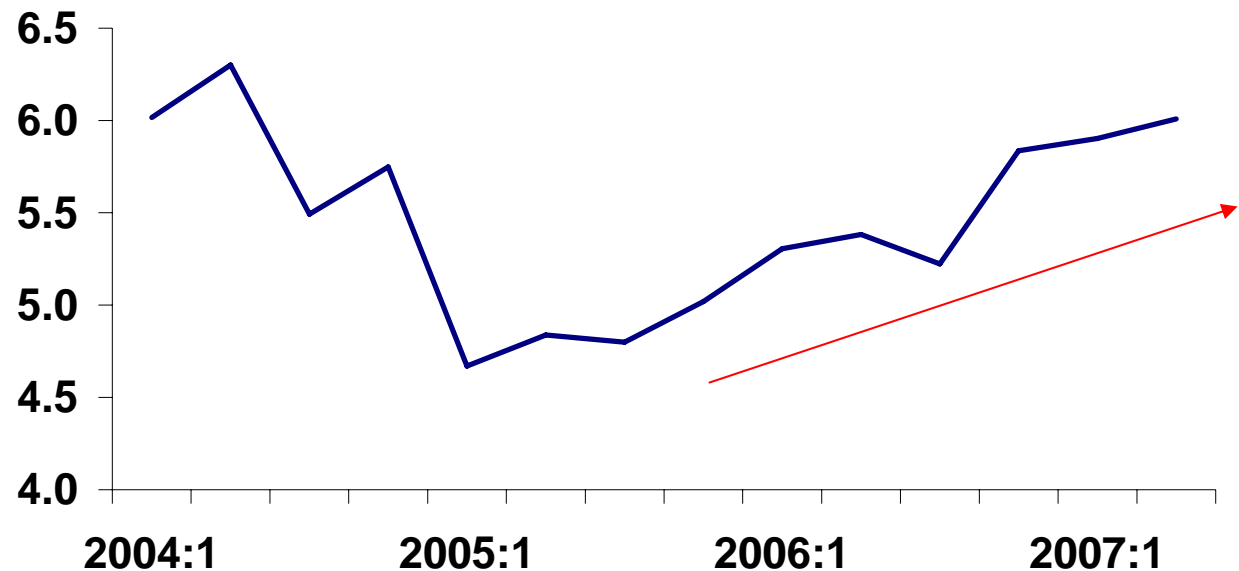


- Remittances higher than other capital inflows (e.g loans, FDI, portfolio investments)
- (Estimated) Average *monthly* remittances for 2007 = \$ 1.21 billion
- How will forex flows affect: liquidity? consumer prices?

Sources of strong growth

Remittances push spending

Growth of Personal Consumption
Expenditure,
2004 - 2007



Source: NIA

- Consumer spending remains as the biggest driver of growth from the demand side, due to
 - Stable inflation rates & lower interest rates
 - Sustained inflows of OFW remittances



3 Major Clouds

- Subprime Credit Crisis
- High Oil Prices
- Peso appreciation

1st Cloud: Sub-prime Credit Crisis

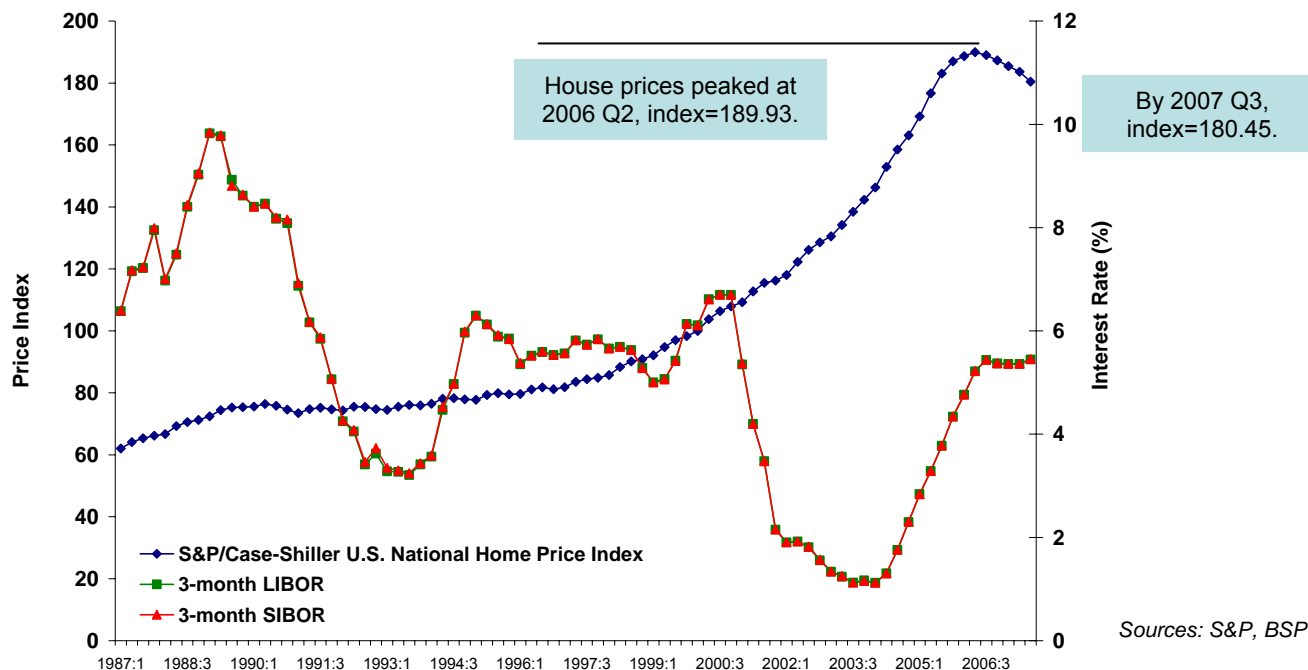
- Roots of crisis
 - Started with long period of low interest and excess liquidity in US
 - Lax credit policies
- Timeline
 - Late 1990s (Dot-com bubble): annual increase in housing prices exceed 10%
 - 2001: Federal funds rate ↓ 11 times, from 6.5% to 1.75%
 - 2002 to 2005: further increase in housing prices
 - 2005 to 2007: Market correction (bubble bursting)
 - July 2007: Subprime mortgage crash started

1st Cloud: Sub-prime Credit Crisis

- Impact of credit expansion

- Increase in asset values (housing and stock prices)

S&P/Case-Shiller US National Home Price Index
vs. Selected interest rates



- Increase in investments (e.g. inflows to emerging economies)
- Market expansion (including imports from emerging economies)

1st Cloud: Sub-prime Credit Crisis

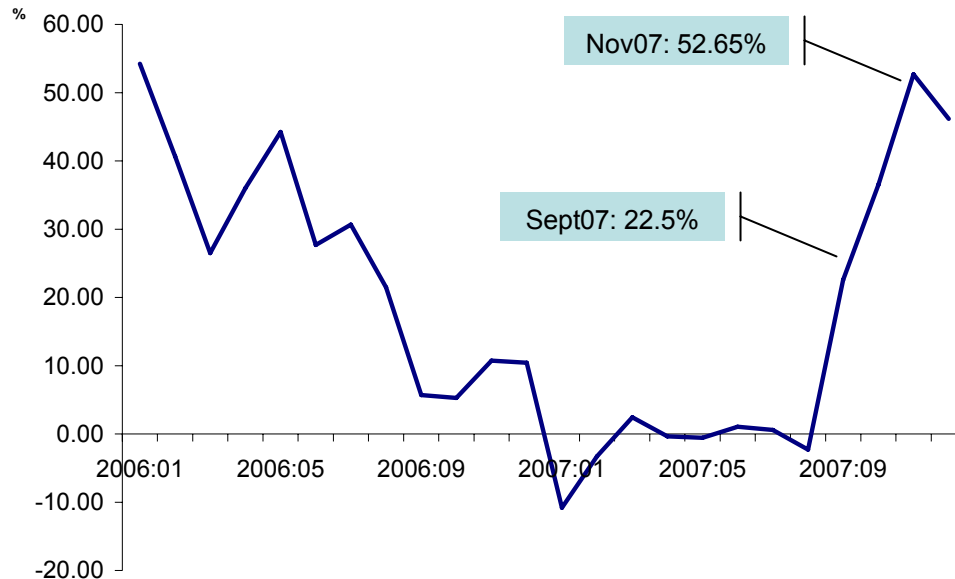
- Impact of reversal: On US
 - Financial markets
 - credit contraction → interest rates rise → inventory build-up → lower asset values
 - Fed response: lower discount rates
 - Investment markets
 - Change in portfolio mix
 - Real trade
 - Dangers brought by a US economy slowdown/recession

1st Cloud: Sub-prime Credit Crisis

- Impact of reversal: On emerging markets
 - Financial markets: exposure to CDOs
 - Investment markets: reversal of investment flows to emerging economies?
 - Export markets: softening of demand for products from emerging economies?
- Bottomline: Slowdown in the US Economy → growth risk to developing countries, e.g. Phils.

2nd Cloud: High Oil Prices

YOY Growth in Dubai Crude Oil Prices
2006-2007



Inflation Rates		
	2006	2007/f
China	1.5	1.8
India	5.5	5.0
Southeast Asia	7.1	4.2
Asia, average	3.4	3.0

Source: ADB; f - forecast

- Oil prices have picked up from lows in early 2007
 - Has reached a record high of \$100/bbl
 - From political risks in oil-producing countries, oil supply constraints and weak US dollar
 - High demand from China and India

Source: BSP

2nd Cloud: High Oil Prices

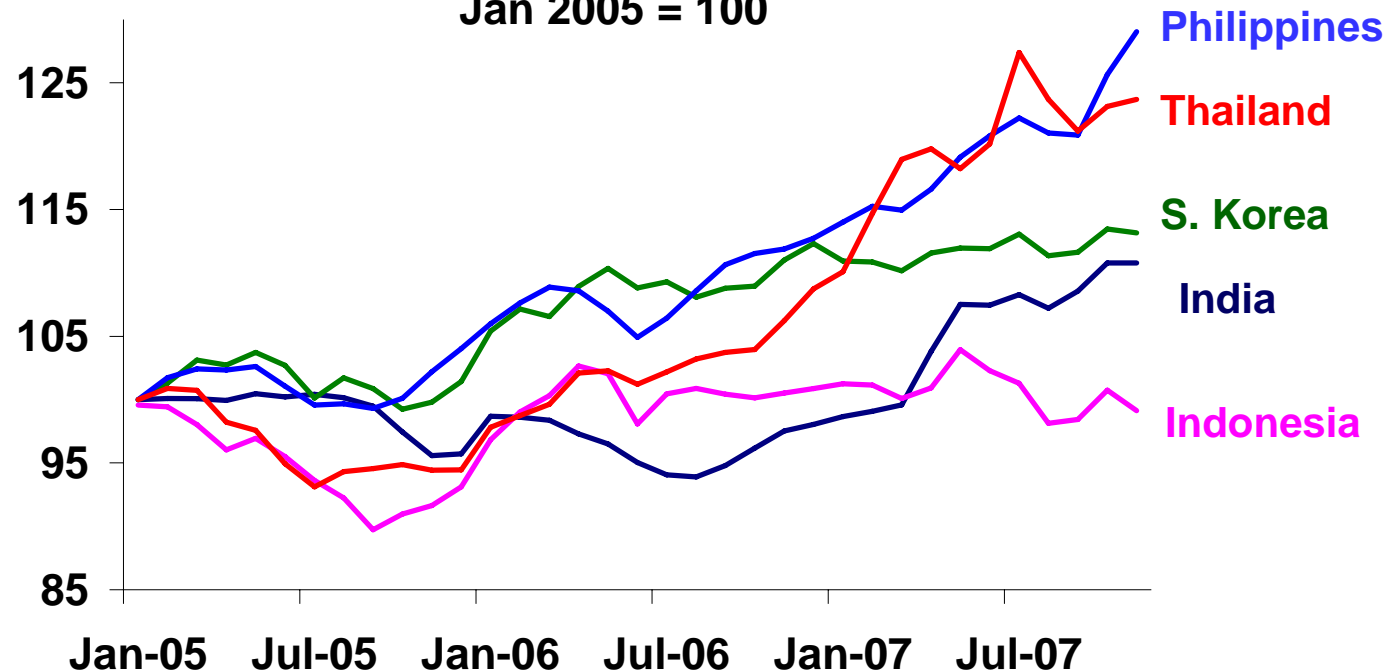
- Funds flows: Recycling problem (OPEC)
- Effects:
 - Slight slowdown in global trading activity
 - Lower demand from major industrial partners (e.g. US, Japan)
 - Déjà vu of 1970s oil crisis?
 - 1970s: Recycling problem → Debt crisis of 1980s → 1980s recession
 - 2007: Recycling problem → ?
 - Real economy effects: Worldwide recession?

2nd Cloud: High Oil Prices

- Effects to Phil. Economy
 - I-O Analysis: Petroleum refineries including LPG
 - Backward linkage : 1.31 (Rank=5)
 - Forward linkage : 8.67 (Rank=2)
 - Out of 240 sectors
 - Sectors most affected by increases in petroleum prices:
 - Petroleum refineries including LPG
 - Manufacture of asphalt, lubricants and miscellaneous products of petroleum and coal
 - Air transport
 - Public utility, cars and taxicab operation
 - Tourist buses and cars
 - Rubber tire and tube manufacturing
 - Jeepney, tricycles (motorized and non-motorized) and other road transport
 - Bus line operation

3rd Cloud: Peso Appreciation

Exchange Rate Index:
US Dollar rates of selected Asian currencies
Jan 2005 = 100



- Regional currencies strengthened against the US\$, but the Peso appreciated more
- In 2007, Philippine peso has gained 19% vs. US\$

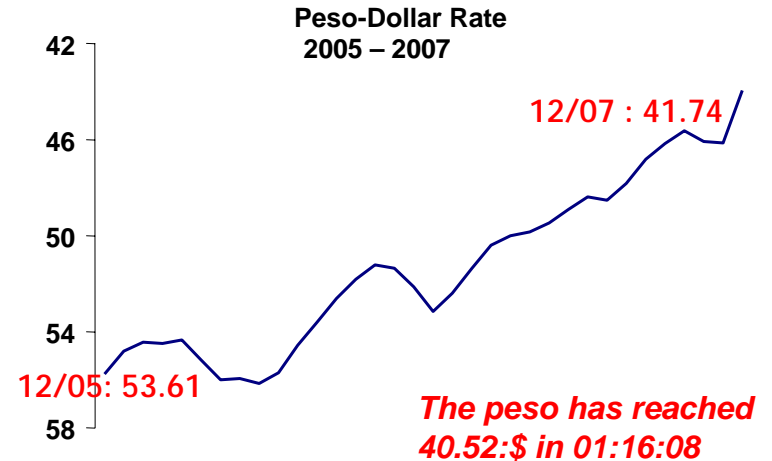
Source: BSP

3rd Cloud: Peso Appreciation

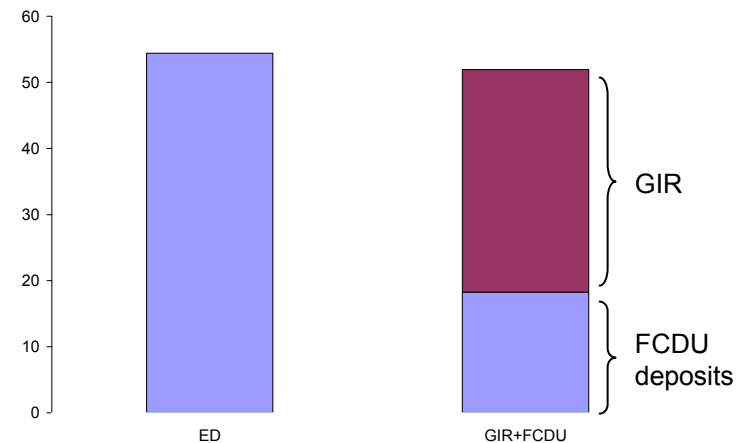
Strong peso aided by:

- Sustained inflow of OFW remittances
- Influx of portfolio investments
- General weakening of the US\$. . .

. . . resulting in a *comfortable level of foreign exchange reserves*



External Debt vs GIR + FCDU Deposits
(In US \$ billion)



Source: BSP

3rd Cloud: Peso Appreciation

Stronger peso:

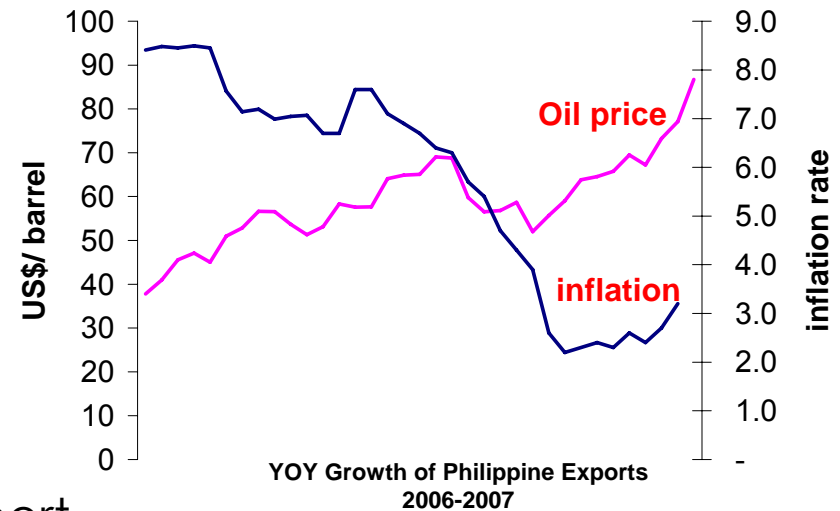
→ lower import costs

Expected to mitigate higher oil prices in the market + global food prices

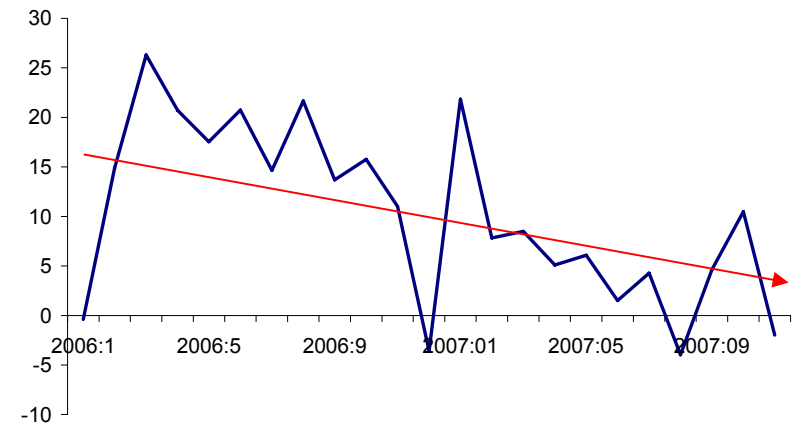
→ but also led to lower export growth

Export forecasts revised from 11% to 6%

Price of Dubai Crude Oil vs. Phil. Inflation



YOY Growth of Philippine Exports 2006-2007



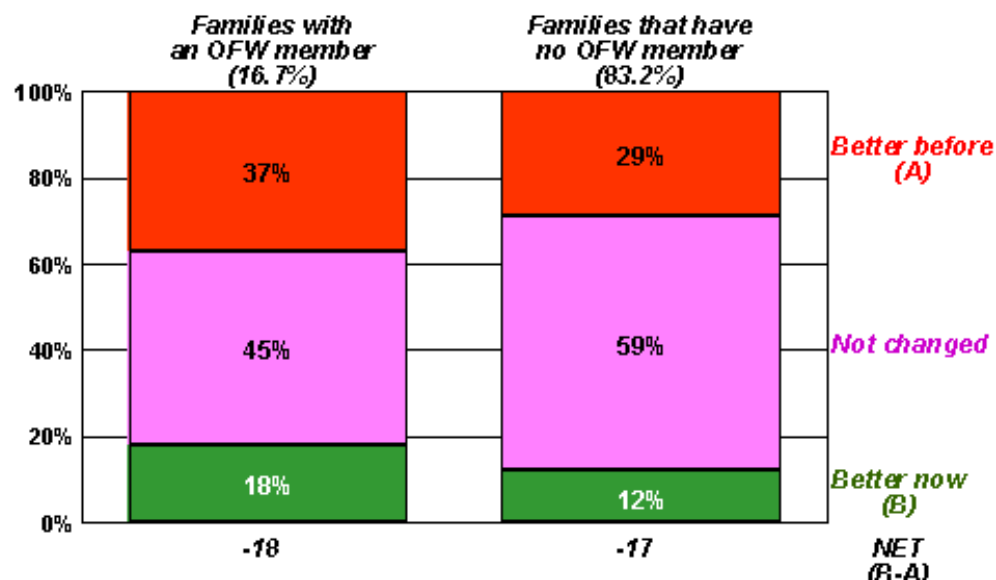
Source: BSP

3rd Cloud: Peso Appreciation

- Sept 2007 SWS survey results: Negative net effect in all areas and classes

	RP	NCR	BAL			ABC	Class	
			Luzon	Visayas	Mindanao		D	E
Better off now	13%	11%	11%	13%	17%	9%	14%	11%
Not changed	57	63	55	61	53	57	57	57
Better off before	30	26	33	26	29	34	28	32
Net	-17	-15	-22	-13	-12	-25	-14	-21

- Effect of strengthening peso against the dollar exchange rate on family well-being, among OFW and Non-OFW families:



Source: Business World

The 3 clouds

Investment flows

- Portfolio effects
- Investment funds
- flight from EMs

US subprime crisis

Peso appreciation

Oil prices

Real trade

- Tradeables sector
- Inter-industry impact
- Outsourcing & Offshoring

Consumption

- OFW remittances
- Inflation

Financial market

- Recycling problem
- Credit/stock market
- flight from EMs

Inflation + weakening of US = ↓ OFW remittances → ↓ Consumer spending

The background of the slide is a collage of financial and business-related images, including a newspaper clipping with a headline 'Share Sell on Top', a bar chart, and a line graph, all rendered in a light blue, semi-transparent style.

Areas for Improvement

- Medium-term
- Long-term



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Areas for improvement

- Medium-term weaknesses
 - Infrastructure investment
 - Quality of education
- Long-term weakness
 - Economic governance
 - Red-tape costs
 - Perception of corruption

The background of the slide is a collage of three panels. The left panel shows a newspaper clipping with a line graph and the headline 'Share Sell on Top'. The middle panel shows a computer monitor displaying a bar chart. The right panel shows a close-up of a document with a line graph. The entire background is overlaid with a semi-transparent blue filter.

iDEA Forecasts



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	Actual		Forecasts	
	2005	2006	2007	2008
1. Agriculture, Fishery and Forestry	2.0	3.8	3.4	3.1
2. Industry Sector	3.8	4.5	6.2	5.4
a. Mining & Quarrying	9.3	-6.1	18.5	15.8
b. Manufacturing	5.3	4.6	3.8	3.5
c. Construction	-5.9	7.3	17.4	12.6
d. Elect, Gas and Water	2.5	6.4	5.7	6.2
3. Service Sector	6.8	6.7	8.1	8.0
a. Transport., Comm., Stor.	7.3	6.3	8.9	10.1
b. Trade	5.6	6.1	8.3	7.9
c. Finance	13.6	11.4	10.5	9.5
d. O. Dwellings & R. Estate	5.3	5.7	6.2	6.0
e. Private Services	7.5	6.9	8.8	8.4
f. Government Services	3.0	4.7	2.9	2.5

iDEA Forecasts

The Bottomline

	Actual		Forecasts	
	2005	2006	2007	2008
GROSS NATIONAL PRODUCT	5.3	6.1	7.7	7.4
Net factor income from abroad	10.8	13.3	18.7	18.7
GROSS DOMESTIC PRODUCT	4.9	5.4	6.6	6.2

- Average GDP growth over the years = 4.5%



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Thank you!




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Present Value of a Fixed-Payment Loan

$$LV = \frac{FP}{1+i} + \frac{FP}{(1+i)^2} + \frac{FP}{(1+i)^3} + \dots + \frac{FP}{(1+i)^n}$$



where

- LV = loan value
- FP = fixed yearly payment
- n = number of years until maturity

