MACROECONOMICS BRIEFER
CPBD Comments on the NEDA Report on the Philippine Economic Performance in the First Quarter of 2007
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The NEDA reported last May 31, 2007 the performance of the Philippine economy in the first quarter (Q1) of 2007. In its report on the National Income Accounts, gross domestic product posted a hefty growth of 6.9% from 5.7% in the previous year. This is the highest GDP growth registered since the first quarter of 1990. However, the CPBD would like to point out that key factors affecting GDP growth cast doubts on whether this growth rate can be sustained for the remainder of the year. There may also be a need to reassess the record-high GDP growth registered in the first quarter of 2007.

1. ***Anemic Investments.*** The missing link in the favorable showing of the economy in the first quarter is direct investments particularly investments in durable equipment. While investments in capital formation improved by 2.7% from 2.4% last year, with the surge of public and private construction, which grew by 16.9% and 2.0%, respectively, investments in durable equipment continued to drop to 0.4% from 0.7% a year ago. The downtrend has been going on since first quarter of 2005. Further, approved foreign direct investments plummeted by 71.9% to P17.9 billion in the first quarter from P63.5 billion last year.

2. ***Mismatch in Manufacturing Sector Data.*** The 4.6% growth of the manufacturing sector in the first quarter of 2007 does not match with the results of the Monthly Integrated Survey of Selected Industries (MISSI). The value of production (VaPI) and the volume of production (VoPI) have dropped on an average by 6.5% and 7.4% in the first quarter of 2007. Meanwhile, doubts have been raised on the sustainability the manufacturing sector's growth considering the following factors: *(1)* Loans extended to the manufacturing sector according to the BSP (as of December 2006), went down by 8.3% to P394.1 billion from P430 billion in December 2005; and *(2)* Investment in manufacturing-related durable equipment dropped substantially, which includes sawmill and logging machineries (down by 22.5%), sugarmill machineries (down by 91.4%), pulp and paper machineries (down by 4.5%), other electrical machinery and apparatus (down by 44.4%), among others.

3. ***Digital Fatigue.*** As commonly perceived by analysts, the slowdown of the communications sector in the past may be due to "digital fatigue". This is brought about by the stiff competition in the wireless technology market especially mobile phone business with the launching of various products and services. The CPBD reckons that it is hard for an industry experiencing a "fatigue" or a maturity of the market to achieve a double-digit growth, except when there is a shift from the use of traditional technology (text messaging) to a more advanced wireless communication services. The fact that usage of broadband wireless communication services is less than half a million (NTC estimate) may not be sufficient to drive a 10.1% growth of the communications sector. On another note, provided that the sector has grown 10.1% on the back of strong spending on telecommunication products and services during the elections, the greater challenge is whether the sector's growth can be sustained for the rest of the year and over the long term.

4. ***Narrow Finance Growth.*** The finance sector, which is another major contributor to the growth of the services sector, is spurred by the performances of banks and insurance, which grew by 8.1% and 33.9%, respectively. However, the gains of the banking subsector has been limited to a few sectors only. A large share of the

outstanding loans of the banking system went to interbank loans (31.3%), real estate (12.0%), and trade (11.1%). Loans extended to activities, which have far-reaching effects to poor Filipinos constitute a meager share of the total loans portfolio of the banking system – agricultural activities (5.5%), education (0.6%), and health and social work (0.4%).

5. ***Weak Trade Performance.*** The 2.5% contraction of imports is also worrisome, attributed mainly to the decline in the country's top merchandise imports, which include:

   - Mineral fuels, lubricants and related materials dropped by 21%;
   - Base metals went down by 13.2%;
   - Electrical machinery, apparatus and appliances went down by 13.4%;
   - Cereals and cereal products plummeted by 67.2%

   The decline in imports signals a seemingly sluggish export sector for the rest of the year, as bulk of the country's exports are electronics and semiconductor products, which are high on import content. The decline would also adversely affect manufacturing activities for the rest of the year.

6. ***Poor Tax Collection Effort.*** It is worth mentioning that the rapid growth of the economy, as shown in the 6.9% GDP growth, did not translate to an improved tax collection output by the government in the first quarter. The major tax collection agencies actual collection amounted to P237.3 billion in the first quarter, an P18.5 shortfall from its target of P255.8 billion. The Bureau of Internal Revenue (BIR) and the Bureau of Customs (BoC) missed its collection target for the first quarter by P12.1 billion and P6.7 billion, respectively. Tax effort or the ratio between the government's tax and duty collection vis-à-vis the GDP dropped to 12.2% in the first three months of 2007, from 13% in the same period last year. This raises doubts on the government's target of achieving 15.2% tax effort for the end of the year. Furthermore, tax buoyancy – which measures how responsive is the tax collection effort of the government with respect to GDP growth, weakened substantially to 0.36 in the first quarter of 2007 from 2.08 in the same period last year. Tax buoyancy is the ratio between the growth of tax revenues to the growth of GDP.

The first quarter GDP growth of 6.9% makes the Philippine economy one of the best performers in the region, next to China and Vietnam, which posted economic gains of 11.1% and 7.7%, respectively. However, it has been customary that the National Statistics Coordination Board (NSCB) revises (upward or downward) the economic figures every after two quarters to reflect additional NIA data. Hence, the challenge for the rest of the year and over the medium term is to advance social and economic reforms, to sustain the economic growth momentum. Addressing investment concerns especially putting up necessary infrastructures, improving our education system, combating graft and corruption, and honoring contracts with the private investors, should be on top of the government's investments promotion strategy. On the whole, the government must strive to achieve and sustain economic development that is job-generating, and at the same time, significantly reduce poverty and improve the lives of many Filipinos.