

## MEMORANDUM

**FOR** : **The Honorable House Members**

**SUBJECT** : **CPBD Comments on the Second Quarter Performance of the Philippine Economy**

**DATE** : **September 6, 2007**

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The 7.5% growth in gross domestic product (GDP) in the second quarter of 2007, as reported by NSCB, is the highest quarter-on-quarter growth recorded since 1986. It surpassed the 5.8% average forecasts of firms surveyed by Bloomberg<sup>1</sup>. The 7.5% GDP growth recorded in the second quarter, though lower than that of China (11.6%) and Singapore (8.6%), exceeded the second quarter economic growth of Hong Kong (6.9%), Indonesia (6.3%), Malaysia (5.7%), Taiwan (5.1%), and South Korea (4.9%).

The GDP growth in the second quarter drew much from the following sectors:

- *On the supply side*, the services sector, which make up 49.8% of total GDP, contributed the most with 4.1 percentage points of the 7.5% GDP growth. The services sector grew by 8.4% in the second quarter from 5.7% last year. Key areas of growth in the services sector include finance (up by 11.8%), transportation, communication and storage (up by 9.8%), private services (up by 8.6%), and trade (up by 8.4%). In the industry sector, the construction, as well as, the mining and quarrying subsectors surged by 33.3% and 21.0% respectively, but had smaller contribution to the total growth since they represent only a combined 7.5% of GDP.
- *On the demand side*, Personal Consumption Expenditure, which account for roughly 63.2% of GDP, improved by 6.0% from 5.4% last year. Investments in Fixed Capital Formation rebounded by 10% from a 1% drop in the previous year due mainly to an upsurge in public construction (which included continuing infrastructure projects not covered by the election ban) by 46.7% from 18.1% last year. Strong government spending during the elections, up by 13.5% from 3.3% in the same quarter in 2006, also buoyed GDP growth.

Nonetheless, while the GDP growth in the second quarter is remarkable, other key drivers of growth – agriculture and manufacturing where substantial gains in employment and value-added come from, slowed down.

- ***Slowdown in Agriculture.*** Coming from a 6.7% expansion last year, the agriculture sector slowed down to 3.9% in the second quarter of 2007. Despite the fact that the second quarter is usually a harvest period for major crops, palay production slowed down to 4.4% from 10.3% growth last year, and corn output even dropped by 2.5% compared to a 49.2% expansion in the same period last year. This may be due to the mild El Niño phenomenon experienced during the second quarter of 2007.

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<sup>1</sup> Bloomberg is a financial information services company. The Bloomberg surveyed investment companies, which include among others Development Bank of Singapore, Standard Chartered Bank, UBS securities, etc., on their quarterly economic growth forecast of economies in Asia.

- **Weak Manufacturing Performance.** Manufacturing, which comprised 67% of the industry output, decelerated by 3.7% in the second quarter this year compared to the 4.2% gain last year. The weak manufacturing output could also be explained by the results of the Monthly Integrated Survey of Selected Industries (MISSI) conducted by the National Statistics Office (NSO), where the value of production (VaPI) and the volume of production (VoPI) continuously dropped since the start of the year. The VaPI and VoPI declined on the average by 3.1% and 5.0% in the second quarter. The decline in investments in manufacturing-related durable equipment which include among others sugarmill machineries (down by 76.7%), textile machineries (down by 28.9%), and sawmill and logging machineries (down 15.9%), could further weaken manufacturing over the long term.
- **Fragile Exports.** The exports sector substantially weakened as it registered a meager 4.2% growth compared to its 21.2% increase in the previous year. The strong Peso partially explains the sluggish performance of the exports sector. Worse, merchandise exports that have huge local content – or those products where most of its raw materials are sourced domestically, plummeted during the period. These include among others: garments (down by 15.1%), crude coconut oil (down by 26.1%), centrifugal sugar (down by 100%), cathodes and section of cathodes, of refined copper (down by 31%).

It is imperative that the country sustains the growth momentum over the medium term to ensure that this redounds to the benefit of the Filipino people. This means building on the gains of past reforms and addressing structural weaknesses and bottlenecks in the economy. In particular, there is a need to address the low level of agricultural performance and competitiveness by addressing problems of inadequate rural infrastructure, absence of an effective agriculture credit system, poor maintenance of irrigation facilities, lack of research and development and the absence of agriculture extension services. There may a need to allocate funds for watershed reforestation and water impounding systems that could provide for irrigation water even during a dry spell. It is also important to provide sufficient funds to new programs on high-value crops in order to increase farm incomes. Diversification of the rural economy should also be encouraged by way of providing alternative livelihood to people in agricultural areas other than farming.

In order to improve the investment climate in the country, issues relating to high power cost, freight transport cost, and policy stability should be addressed adequately. The government's role to provide the basic infrastructure requirements in the countryside should not only improve the delivery of social services, but will also facilitate more private sector investments. Furthermore, efforts to reduce the cost of doing business in the country by limiting venues for corruption and red tape should likewise be intensified.