Economic slump in the Philippines to continue as momentum fades

Weakness across all sectors to weigh on growth momentum in the Philippines as Covid-19 infections rise and restrictions remain in place

Two women wearing face masks in Manila

Authorities forecast a quick recovery in 2021 but trends suggest otherwise

The Philippine economy is mired in a recession with elevated levels of Covid-19 infections forcing an ongoing 9-month long partial lockdown in the capital and surrounding provinces. With the bulk of the economy under mobility restrictions, GDP fell by 10% Year-on-Year for the first nine months of the year with substantial contractions experienced by the main driver of economic growth, household consumption.

Authorities have recently acknowledged the certainty that GDP will contract on a YoY basis in 2020 but government officials continue to bet on a quick recovery in 2021 (6.5 to 7.5%) and 2022 (6.0%) touting the economy's "solid fundamentals".

ING, however, maintains that growth will likely enter a lower trajectory as current trends point to a very different scenario as the Philippine economy will be lacking contributions from almost every sector of the economy. The slowdown in momentum is manifested in worrisome trends across the economy which will not be solved even as lockdown restrictions are relaxed.

Remittances still on a downward trend, and will weigh on consumption

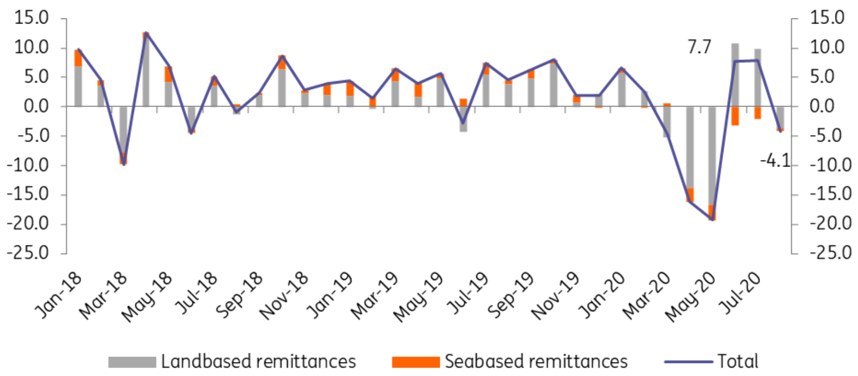
Household consumption delivers the lion's share in terms of economic output for the Philippines, providing roughly 73% of total GDP in 2019. Consumption momentum will be hampered by elevated unemployment (10%) and concerns about the virus but fading remittances complicate the recovery process even further.

A key support for households are remittance flows from overseas Filipinos (OFs), augmenting domestic incomes to bolster consumption. On average, remittance households receive Php59,295 annually, roughly 19% of the average income in the country.

The bulk of remittances are sent by land-based workers with the balance sent home by seafarers (23%) aboard freighters and cruise ships. The pandemic hit sea-based remittances particularly hard (down 5.3% for the year) and prospects for this sector are not positive with global trade expected to be subdued while cruise liners are not expected to sail anytime soon. On the other hand, land-based remittances managed a surprise gain of 7.7% in June and July as lockdowns were eased in the summer but we expect this trend to reverse from hereon in as respective governments reinstate lockdowns around the globe. Meanwhile, authorities estimate that up to 300,000 Filipinos will be repatriated after job losses due to the pandemic which will deplete the stock of 2.2 million Filipino contract workers based abroad.

We continue to forecast a 5-10% drop in remittances this year despite the central bank, Bangko Sentral ng Pilipinas (BSP), recently upgrading their forecast to -2.0% from -5.0%. Renewed lockdowns and negative prospects for maritime traffic will result in a remittances drop of up to $3.1 bn in 2020 and 2021 with consumption missing the integral boost from these inflows.

Philippine remittances per source



Source: Bangko Sentral ng Pilipinas and ING estimates

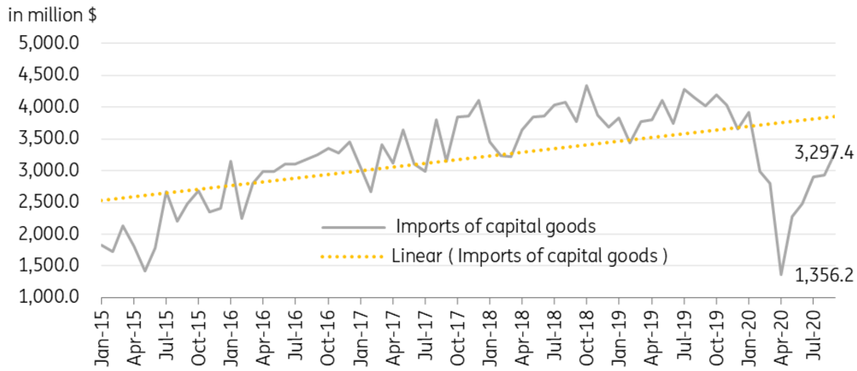
Investment momentum stalls, potential output fades

Capital formation was an integral part of the recent GDP growth surge, delivering roughly 3.1 percentage points of the 6.5% average growth from 2015 to 2019. A pickup in capital formation was driven by a real estate construction boom and a build-up in capital machinery, helping bolster productive capacity and potential output. The administration's hallmark infrastructure programme also helped drive a capital formation surge but the current economic environment points to stalling momentum for this sector.

The acceleration in capital formation was reflected in import trends during that period with capital machinery and durable goods rising steadily in that time period. Capital and durable goods include power generation machinery, telecommunication equipment, aircraft, construction vehicles and consumer road vehicles which grew significantly (cumulative 85%) over the past four years prior to the pandemic.

Capital goods imports have steadily inched up from the lows during the strictest lockdown period in April but latest levels remain below the 5-year average of $3.5 bn per month. We expect the recent downturn in capital goods to weigh on potential output in the near term as corporates are likely to put off large scale investments given the recession to protect cash reserves and weather the downturn. Meanwhile, we also expect households to defer investment plans given the challenging job market, reflected in a steep fall in road vehicle sales, which are down 44.6% for the year.

Philippine imports of capital goods



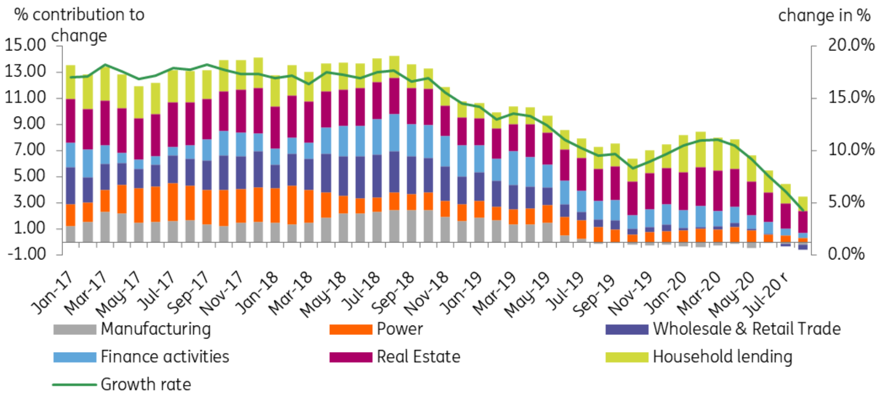
Source: PSA and ING estimates

Bank lending grinding lower

Meanwhile, declining investment momentum is mirrored in trends for commercial bank lending, which has been decelerating for 4 months through September. Loan growth had been on a downtrend since 2018 and the pandemic has forced new disbursements to slow even further with the latest report showing a 2.8% increase in September. Loan disbursements to retail trade and manufacturing have turned negative with manufacturing activity now in contraction (October PMI: 48.5) while the retail trade sector has been hit hard as vacancies in retail mall space have hit 14%, the highest level reported since the Asian financial crisis.

Loans to the real estate sector managed to rise 8.4% YoY although they're decelerating for a second month. However, prospects for a pickup in lending to real estate are not particularly upbeat with office space vacancy rising to 8.3% as offshore gaming operators close shop and head back to China. With loan demand softening after BSP slashed policy rates by 175 bps, banks' net interest margins have compressed with financial players relying heavily on trading gains to support the rest of the business.

Philippine bank lending per sector



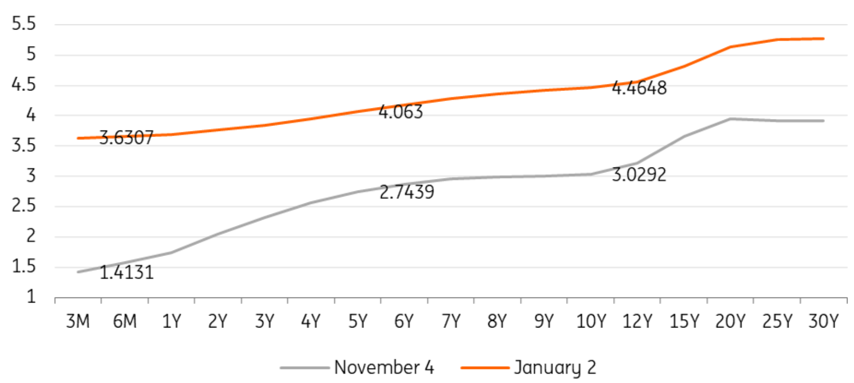
Source: Bangko Sentral ng Pilipinas and ING estimates

The central bank's unconventional moves and low inflation

The BSP's response to the pandemic has been aggressive, slashing rates and flooding market with liquidity. On top of aggressive rate cuts, the central bank has resorted to unconventional measures like quantitative easing and even providing pseudo debt financing to the national government. The net effect of BSP's unconventional moves has been a stark increase in excess liquidity which now totals Php1.4 trillion, roughly 7.2% of GDP and 8.9% of money supply.

With the system flooded by liquidity with BSP cutting rates and purchasing bonds, the yield curve has shifted downward over the past few months and we expect rates to remain floored in the near term. Inflation, now averaging 2.5%, is not expected to accelerate in the next few months given depressed demand conditions and a stronger PHP. Meanwhile, the central bank has indicated it would keep unconventional policies in place for "as long as growth is below target". With inflation forecast to remain well within target in 2021 and 2022 and BSP not expected to exit from unconventional policies anytime soon, we expect the yield curve to remain pressured lower and flatten unless government borrowing picks up substantially next year.

Philippine bond yield curve



Source: PDS

Fiscal response has been modest at best

Trends in government spending also point to a downward trajectory for growth. The fiscal response, however, has been modest with authorities recently passing additional Covid-19 funding worth Php140 bn, to bring the total Covid-19 response spending to roughly Php590 bn or 2.7% of GDP. After seeing an initial surge in spending, we've noted a sharp slowdown, with September expenditures falling 15.5% as authorities clamp down on spending efforts to manage the budget deficit. Government officials have repeatedly thumbed down calls for additional fiscal packages in 2021 and it appears that the economy will not be able to count on government spending to help offset the slowing growth momentum.

Recession to continue as trends point to weakness across key sectors

The Philippines is poised to remain in recession for a couple of more quarters with trends pointing to sustained weakness across key sectors. Government officials remain confident of a quick turnaround in growth prospects but signs of soft consumption, decelerating investment outlays and lacklustre government spending all suggest otherwise. Unless we see a reversal in all three of these trends we believe that the Philippine economy is on pace to enter a lower growth trajectory and fail to return to the pre-pandemic growth average of 6%.

Philippine forecast table

	3Q20	4Q20F	1Q21F	2Q21F	3Q21F	4Q21F
Real GDP (% YoY)	-11.5	-11.9	-7.6	9.4	4.2	3.2
CPI (% YoY)	2.5	2.1	3.0	3.1	2.9	3.1
BSP policy rate (%, eop)	2.25	2.25	2.25	2.25	2.25	2.50
3M rate (%, eop)	1.15	1.29	1.88	2.01	2.33	2.56
10Y govt. bond yield (%, eop)	2.98	3.06	3.11	3.17	3.39	3.69
Budget deficit to GDP (%, eop)	6.3	6.7	5.7	5.8	5.6	5.2
Current account deficit to GDP (%, eop)	1.5	1.7	1.2	0.7	0.8	0.2
PHP per USD (eop)	48	48.45	48.09	47.87	47.51	47.38

Author

Nicholas Mapa
Senior Economist, Philippines
nicholas.antonio.mapa@asia.ing.com