Senate Economic Planning Office

Economic Report

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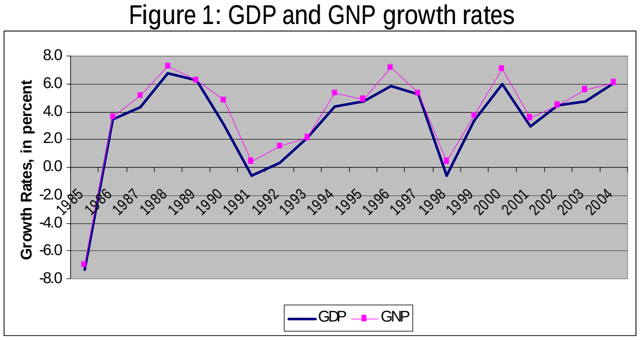
Services sector leads 2004 growth

Amidst hikes in the US Fed rates, high oil prices, and struggles in passing the needed fiscal reforms, the domestic economy expanded by 6.1 percent in 2004, the fastest pace since 1989. The growth was higher than the national government target of 4.9 to 5.8 percent (MTPDP). All sectors of the economy registered impressive growth rates led by the services sector. On the expenditure side, consumption, exports and capital formation were drivers of the 2004 economic growth.

Figure 1: GDP and GNP growth rates



Source: NSCB

Sources of Growth

On the Production Side:

On the production side, services contributed 3.4 percentage points to the overall growth of the domestic economy. In particular, the trade sub-sector contributed 1.13 percentage points, and transportation, communication and storage

Table 1. 2004 Growth Rates and Contribution to GDP, by Industry of Origin

	Growth Rate (%)	Contribution to GDP Growth (%age pts.)
BY INDUSTRY		
A. TOTAL AGRI, FISHERY AND FORESTRY	4.90	0.97
1. TOTAL AGRICULTURE	4.80	0.94
a. AGRICULTURE	3.80	0.59
Palay	7.40	0.25
Corn	17.30	0.18
Coconut including copra	0.40	0.00
Sugarcane	7.90	0.04
Banana	5.00	0.02
Other crops	(0.70)	(0.03)
Livestock	(0.40)	(0.01)
Poultry	4.20	0.09
Agricultural activities & services	4.90	0.04
b. FISHERY	8.50	0.35
c. FORESTRY	29.80	0.02
B. TOTAL INDUSTRY	5.30	1.78
a. Mining & Quarrying	4.30	0.07
b. Manufacturing	5.00	1.21
c. Construction	8.90	0.37
d. Electricity, Gas & Water	3.90	0.13
C. TOTAL SERVICE	7.30	3.40
a. Transportation, Communication & Storage	12.20	0.99
b. Trade	6.80	1.13
c. Finance	8.40	0.41
d. Ownership of Dwellings & Real Estate	6.00	0.28
e. Private Services	6.80	0.52
f. Government Services	1.60	0.08
GROSS DOMESTIC PRODUCT (GDP)	6.1	6.1
GROSS NATIONAL PRODUCT (GNP)	6.1	n.a.

Source: NSCB, SEPO computations

(TCS) contributed a full percentage point. Albeit its slower growth of 5.3 percent, the manufacturing sub-sector accounted for a large part of GDP growth, with a contribution of 1.21 percentage points, representing 68 percent of the industrial sector's contribution to growth. The whole agriculture sector, on the other hand, contributed a smaller 0.97 percentage point.

A dynamic services sector. The 7.3-percent growth of the services sector was supported by the growth of TCS by 12 percent, finance by 8.4 percent, and trade and private services by 6.8 percent.

Among the TCS sub-sectors, it is worthy to note that communication grew by 17 percent. Mobile phone service provider expansions, election-related activities in May and an increased subscription base boosted TCS growth. As of the first half of 2004, major wireless communications players Globe and Smart expanded by 18.8 percent in revenue and 46.6 percent in subscription, compared to the same period last year.

Table 2. Selected Indicators of Wireless Communications Providers, 1st semester 2003 vs. 2004

	Revenues		Subscribers	
	2003	2004	2003	2004
Globe	23,785	27,616	7.3	10.5
Smart	46,219	55,597	8.1	12.1
Total	70,004	83,213	15.4	22.6
Growth Rates		18.9		46.8

Note: Revenue figures in million pesos, subscriber figures in millions
Sources: Globe, PLDT disclosures to the PSE

Financial services grew at 8.4 percent supported by the growth of non-banks by 9.6 percent, banks by 8.3 percent, and insurance by 7.9 percent. Wholesale and retail trade pitched in substantial gains of 6.3 percent and 6.9 percent, respectively. Ownership of dwellings and real estate grew at 6 percent. This growth is attributed to the 20-percent jump in gross value added of real estate and the modest 2.9-percent increase of ownership of dwellings.

Industry accelerated growth from 3.8 percent in 2003 to 5.3 percent in 2004. Internal demand for manufactured goods has been strong. Personal consumption of food rose by 5.7 percent and beverages by 4.8 percent. Exports growth of 13.8 percent also stimulated the manufacturing sector. Construction also picked up with a growth of 8.9 percent compared to its 2.6-percent contraction in 2003.

Agriculture registered modest gains. In the first quarter of 2004, the agriculture, fisheries and forestry (AFF) sector grew at a historic pace of 8.1 percent. However, bad weather conditions have slowed the sector's growth in subsequent quarters. Nonetheless, the sector's annual growth of 4.9-percent growth was the highest since 1999. The sub-sectors of palay, corn and aquaculture posted substantial gains at 7.4, 17.3 and 17.9 percent, respectively. Livestock, however, contracted by 0.4 percent from its 2003 levels. Meanwhile, the average farm gate prices surged by 12.7 percent partly explaining the rise in value of production (BAS).

On the Expenditure Side:

On the expenditure side, personal consumption expenditure (PCE) contributed a huge 2.9 percentage points to the 6.1-percent GDP growth, while capital formation contributed 1.57 percentage points.

Consistent to being a consumption-driven economy, PCE expanded by 5.8 percent in 2004. Huge increases in spending were posted for transportation and communication of 14.2 percent, food of 5.7 percent, clothing of 5 percent and beverage of 5.7 percent, bolstering personal consumption.

More importantly, capital formation was robust in 2004. From a stagnant 0.1 percent real growth in 2003, it grew 12.7 percent last year.

Table 3. 2004 Growth Rates and Contribution to GDP, by Type of Expenditure

BY EXPENDITURE	Growth Rate (%)	Contribution to GDP Growth (%age pts.)
A. PERSONAL CONSUMPTION EXPENDITURE	5.80	2.90
B. GOVERNMENT CONSUMPTION	(0.80)	(0.03)
C. CAPITAL FORMATION	12.70	1.57
1. Fixed Capital	5.10	0.65
a. Construction	6.20	0.33
b. Durable Equipment	4.40	0.28
c. Breeding Stock & Orchard Dev't	3.70	0.04
D. EXPORTS	14.00	3.81
1. Merchandise Exports	13.80	3.28
2. Non-Factor Services	15.60	0.53
E. Less: IMPORTS	6.30	(2.14)
1. Merchandise Imports	6.30	(2.04)
2. Non-Factor Services	5.50	(0.11)
GROSS DOMESTIC PRODUCT (GDP)	6.1	6.1
GROSS NATIONAL PRODUCT (GNP)	6.1	n.a.

Source: NSCB, SEPO computations

This was supported by increased investments in fixed capital of 5.1 percent, and a reversal in 2003's change in stocks of negative PhP 7.2 billion to a positive PhP 8.4 billion in 2004.

As the growth of the world economy accelerated last year, the Philippine exports followed suit. Exports increased by 14 percent, with merchandise and non-factor services exports expanding by 13.8 percent and 15.6 percent, respectively (See Table 4). Imports, on the other hand, decelerated from 10.2 percent in 2003 to 6.3 percent in 2004. The higher increase in exports resulted in a current account surplus of US$2.91 billion in the period of January to September 2004 from US$ 1.85 billion recorded in the same period of 2003 or a 57.1 percent increase (BSP). The faster growth of exports also supported domestic growth with net trade (exports less imports) contributing 1.67 percentage points to GDP.

Table 4. Export of Goods and Services, 2004 growth rates

ITEMS	Growth Rates
TOTAL MERCHANDISE EXPORTS	13.8
A. MONETIZATION OF GOLD*	93.1
B. MERCHANDISE EXPORTS**	12.1
Principal Merchandise Exports	6.5
1. Garments	(1.0)
2. Semiconductors and electronic microcircuits	13.5
3. Finished elect'l machy	20.2
4. Other Prods. Manufactured	(2.5)
5. Ignition wiring sets	37.4
6. Crude coconut oil	(1.8)
7. Bars, rods of copper	38.2
8. Shrimps and prawns	(11.4)
9. Gold from copper ores	(63.5)
10. Banana and plantains	(2.8)
11. Transmission Apparatus	132.1
12. Copper concentrates	25.1
13. Canned pineapple	7.8
14. Dessicated coconut	3.0
15. Centrifugal sugar	37.0
16. Liquefied petrol.gas	(41.6)
17. Petroleum Naphtha	(43.3)
18. Baskets, basketwares	8.9
19. Prepared tuna	(10.0)
20. Iron agglomerates	8.8
21. Copra oil, cake & meal	(27.1)
22. Tennis, gym & sports shoes	(9.0)
OTHERS	16.9
EXPORTS OF NON-FACTOR SERVICES	15.6
1. Other transportation and comm.	5.5
2. Insurance	30.4
3. Travel	31.7
4. Government	(96.4)
5. Miscellaneous services	5.3

Source: NSCB

Outlook for 2005

Slower growth. The global economy is projected to slow down this year and the country is expected to grow at a slower pace of 5 percent.

Table 5. Consensus Forecast

	GDP Forecast
National Economic Dev't Authority	5.8
Asian Development Bank	5.5
International Monetary Fund	4.2
World Bank	4.5
Economic Intelligence Unit (The Economist)	4.8
Average	5.0

Sources: NEDA MTPDP, ADO, IMF World Economic Outlook, WB East Asia Update, and The Economist Country Forecast

External developments that will slow domestic growth are the increase in world oil and commodity prices, higher interest rates, monetary and fiscal tightening in developed economies, and efforts to slowdown the Chinese economy.

Still services-led. Sectoral forecasts for 2005 show that services will continue to lead the growth. However, for 2006-2009, the National Economic and Development Authority (NEDA) forecasts an industry-led growth. Industry is expected to expand by 8.1 percent, outpacing services' 7.4 percent growth for the period 2006 to 2009, according to NEDA. The Economist's Economic Intelligence Unit (EIU), on the other hand, sees services sustaining domestic growth as it grows by 5.8 percent versus industry's 4.5 percent average rise in the same period.

Table 6. Selected GDP Forecasts

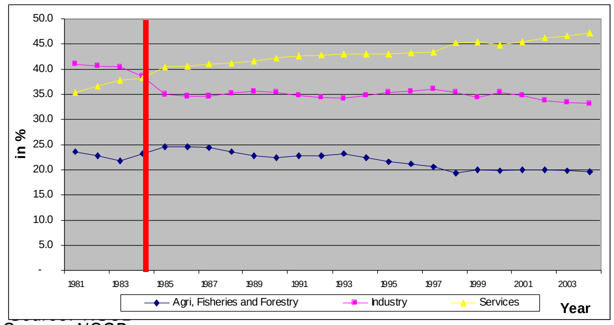
	2005		2006-2009	
BY INDUSTRY	NEDA	EIC	NEDA	EIC
1. Agriculture	4.7	3.8	4.6	3.5
2. Industry	5.9	4.8	8.1	4.5
3. Services	6.2	5.2	7.4	5.8
BY EXPENDITURE				
1. PCE	5.0	4.8	5.8	5.0
2. Government Exp.	3.7	0.0	4.2	2.1
3. Capital Formation	6.7	5.5	13.4	6.5
GDP	5.8	4.8	6.7	4.9

Source: Recomputed NEDA, EIU data

The limits of a service-led growth

The services sector has been providing the most stable source of growth since 1985 when it began to overtake industry in terms of contribution to GDP. In 1985, the share of services to GDP grew to 40 percent from 35 percent in 1981, while industry's share fell from 41 percent to 35 percent in the said period. In the last two decades, services has grown twice the pace of industry, growing by an average of 3.76 percent every year, as compared to industry's 1.86 percent, with the TCS sub-sector taking much of the lead.

Figure 2. Sectoral Distribution of Growth by Industrial Origin, 1981-2004

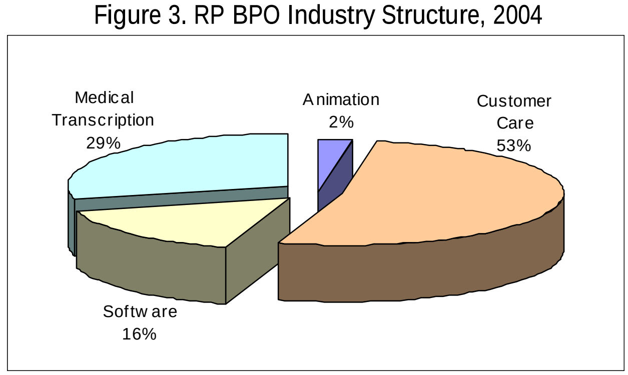


Source: NSCB

The strong growth in communications accounted for much of the growth of the TCS subsector. This paved the way for the boom of business process outsourcing (BPOs) activities. According to the Department of Trade and Industry (DTI), BPOs grew at an annual average of about 160 percent between 2001 to 2004 and amounted to about US$1.655 billion in 2004. The biggest sub-sector is customer care or call centers (US$864M), followed by medical transcription (US$483M), software development (US$268M) and animation (US$40M)(Rodolfo). The Philippines is considered to be one of the top call center destinations in the world, and is seen to even top India this year. BPO's growth, both globally and locally, is expected to continue and is estimated to generate 96,000 more jobs in 2005 as foreign investors expand their businesses in the country (DTI).

While these developments are positive, services alone cannot propel higher growth on a sustainable, equitable and employment-creating path.

Figure 3. RP BPO Industry Structure, 2004



Source: Rodrigo, forthcoming.

For one, the development of the formal service sector, such as BPOs, cannot fully cater to growing number of unemployed in the country. While wages are relatively higher in the said sector, they also require higher levels of literacy and skills and cannot directly absorb most of the country's surplus labor. In 2004, for instance, over one million Filipinos entered the labor force, yet, call centers have complained of shortage of qualified applicants to sustain the growth it is experiencing. The industry's hit rate (the percentage of qualified applicants from the total) last year was only around 1.6 to 2 percent, a deterioration from its 5 percent hit rate in 2003 (Rodolfo). This indicates the inadequate skills of the labor force and the need to invest more in education.

Moreover, while telecommunications has been boasting of rapid expansion today, uncertainties over its sustainability abound as it nears its so-called saturation point. The current mobile penetration rate is estimated at 25 percent. Growth is expected to continue in the next four or five years, after which it will reach its peak and eventually taper off (Clavecilla). Further, BPOs are susceptible to developments in its market countries. At present, outsourcing is facing political scrutiny in the US, where nine states are considering an anti-outsourcing legislation.

In addition, BPO units and other-related firms are confined mainly to metropolitan areas such as the National Capital Region, Southern Tagalog, and Central Visayas that meet their infrastructure and manpower requirements. Since employment opportunities are also limited to these areas, people tend to migrate from rural to urban locations. This large migration often results in a host of other social and economic concerns, including the expansion of the informal service sector.

This is not to say though that pursuing reforms to further develop the information and communications technology (ICT) and BPO sectors is an unfavorable growth strategy, given their comparative advantage. The Philippines, while it has a comparative advantage in these sectors, must train the BPOs applicants to be proficient not only in the English language, but also in Math and Science. As mentioned before, the Philippine's biggest stumbling block when it comes to BPOs is the availability of qualified applicants who are proficient not only in the English language, but also in key disciplines such as Math and Science. The latest results of the Trends in International Mathematics and Science Study (TIMSS) ranked the Philippines 41st and 42nd out of 45 countries in Math and Science proficiency, respectively (See Table 6). Investing to improve the quality of education is vital if the country is vying for higher value-added sectors of BPOs like software development and finance.

Table 6. TIMSS Results, 1999 vs. 2003

Country	1999 Math	1999 Science	2003 Math	2003 Science
	Rank out of 38 countries		Rank out of 45 countries	
Philippines	36	36	41	42
Singapore	1	2	1	1
Korea	2	5	2	3
Taiwan	3	1	4	2
Japan	5	4	5	6
Malaysia	16	22	10	20
Russia	12	16	12	17
US	19	18	15	9
RP Score	345	345	378	377
Int'l Ave.	487	488	467	474

Source: Rodrigo, forthcoming.

The inclusion of ICT in the education policy must also be ensured as a 2001 survey of public and private primary and secondary schools concluded that only 14 percent of these have computers. Improving the country's infrastructure, technology, and the overall business environment are equally critical in enhancing the competitiveness of the sector.

The need for a more broad-based growth

The general pattern of growth, goes from the development of a country's agricultural sector, to its industry, and finally, to its services sector. Economists warn that leapfrogging from one stage to another or limiting a country's economic base to only one sector might prove to be risky and untenable. Hence, the big challenge is in effecting a more broad-based growth across all sectors.

Agricultural growth in the country has been dismal, growing at an average 2 percent in the last two decades. Agriculture's weak performance has, in fact, been identified as the foremost reason why poverty levels remain high in the Philippines. About two thirds of the poor can be found in the rural areas and are dependent directly on agriculture-related economic activities for their major livelihood. In the past five years, the AFF sector posted a higher 4.1 percent growth. This needs to be sustained and further boosted. Improving productivity by way of improvements in rural infrastructure, research, and technology diffusion, must then be undertaken to ensure rural development.

Boosting industrial growth, on the other hand, is also necessary as it has important backward and forward linkages with the rest of the economy. Industrial wages are reasonably higher compared to agriculture. With higher incomes, people start to consume more goods and services. A strong domestic manufacturing sector, in particular, provides a large demand base for the country's service sector, making it less vulnerable to overseas conditions, and thus enabling a virtuous cycle of growth.

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This paper was prepared by Mark Emmanuel Canlas and Ma. Christina Rubio-Pardalis of the Macroeconomics Group, under the supervision of the SEPO Director General.