



Q3 2005 Economic Report: Can Remittances Perk up the Economy?

Based on the third quarter National Income Accounts, growth in the domestic economy is slowing down. The only upward trend is remittances with a substantial growth of 38.7 percent. There have been debates whether remittances can indeed help boost the economy.

With continued oil price hikes, weather disturbances and political instability, the Philippine economy grew slower than expected. The gross domestic product (GDP) decelerated to 4.1 percent in the third quarter of 2005 from 6.2 percent during the same quarter a year ago. This was perked up, however, by an unexpected growth in net factor income from abroad which grew by a hefty 38.7 percent from a negative growth a year ago. This brought gross national product (GNP) to a high of 6.5 percent growth in the third quarter of 2005.

Table 1. Gross Domestic Product and Gross National Product (growth rate, in percent)

Particulars	Q3 2004	Q3 2005	Q1 to Q3 2005
Gross Domestic Product	6.2	4.1	4.6
Net Factor Income from Abroad	(0.9)	38.7	15.2
Gross National Product	5.7	6.5	5.4

Source: NSCB

Production Side

The services sector continued to be the main driver of economic growth on the supply side, but growing at a slower pace in Q3 by 5.1 percent. This is followed by the industry sector which grew at a faster pace of 3.9 percent in the third quarter of this year compared to the 3.6 percent growth during the same period of last year.

Table 2. Gross Value Added, by Industrial Origin (growth rate, in percent)

Industry	Q3 2004	Q3 2005	Q3 2005 Contribution to Growth
Agriculture, Fishery and Forestry	7.3	1.8	0.3
Industry	3.6	3.9	1.4
Services	7.8	5.1	2.4

Source: NSCB

Meager growth in the agriculture sector. The growth of the Agriculture, Fisheries and Forestry (AFF) sector was pulled down by palay, sugarcane, and livestock. Initially, the Bureau of Agricultural Statistics (BAS) forecasted for the third quarter a growth in volume of production for palay and corn of 1.5 percent and 13.4 percent, respectively. However, rice failed to grow and contracted by 7.1 percent while corn grew a little beyond projections at 13.6 percent. The meager growth of the entire AFF sector was explained by NSCB and NEDA as effects of an unexpected tail-end of the dry spell and typhoons. Initially, NEDA forecasted a growth of at least 5 percent for AFF underpinned by expectations of favorable weather conditions in the period July to September. (NEDA presentations, October 2005)

Table 3. Gross Value Added in Agriculture, Fishery and Forestry (growth rate, in percent)

INDUSTRY GROUP	Q3 2004	Q3 2005	Q1 to Q3 2005
1. AGRICULTURE INDUSTRY	7.3	2.1	1.3
a. AGRICULTURE	7.9	1.1	0.2
Palay	17.9	(7.1)	(2.3)
Corn	34.3	13.6	(2.3)
Coconut including copra	1.8	3.3	3.8
Sugarcane	(16.2)	(14.1)	(10.4)
Banana	6.2	13.1	9.8
Other crops	1.2	0.6	0.1
Livestock	(2.5)	3.9	1.9
Poultry	5.8	(4.1)	1.8
Agricultural activities & services	6.9	2.8	2.2
b. FISHERY	5.1	5.7	5.2
2. FORESTRY	7.4	(34.4)	(28.8)
GROSS VALUE ADDED IN AGRICULTURE, FISHERY AND FORESTRY	7.3	1.8	1.1

Source: NSCB

Industry also showed a lackluster performance as the expected growth drivers such as mining grew by only 3.2 percent and construction posted a negative growth of 3.0 percent.

The growth of manufacturing by 5.5 percent helped to prop up industry's growth for Q3. The

Table 4. Gross Value Added in Manufacturing Sector (growth rate, in percent)

INDUSTRY GROUP	Q3 2004	Q3 2005	Q1 to Q3 2005
Food manufactures	11.0	9.3	5.2
Beverage industries	9.3	(8.3)	0.8
Tobacco manufactures	(18.2)	(1.9)	(8.5)
Textile manufactures	5.8	15.9	14.9
Footwear wearing apparel	(10.4)	(25.4)	(16.9)
Wood and cork products	(11.4)	(45.9)	(36.6)
Furniture and fixtures	14.1	24.0	42.5
Paper and paper products	6.0	(2.5)	0.7
Publishing and printing	22.0	(10.8)	0.3
Leather and leather products	(65.0)	(7.8)	(14.8)
Rubber products	36.5	0.7	4.1
Chemical & chemical prod.	4.7	28.9	14.7
Products of petroleum & coal	(7.7)	14.4	27.2
Non-metallic mineral prod.	15.9	(10.1)	(9.5)
Basic metal industries	(1.3)	(3.0)	(3.8)
Metal industries	5.0	22.9	1.7
Machinery except electrical	(12.4)	(30.3)	(38.4)
Electrical machinery	9.7	3.9	1.4
Transport equipment	14.6	2.1	18.1
Miscellaneous manufactures	(0.4)	6.9	7.2
GROSS VALUE ADDED IN MANUFACTURING	4.2	5.5	5.4

Source: NSCB

growth of manufacturing was supported by expansion of food manufactures, textile manufactures, furniture and fixtures, chemical products, petroleum products, and metal manufactures. These were consistent with consumption and exports growth at the expenditure side.

Continued growth in the service sector.

Finance led the expansion of the services sector accelerating from the second quarter's growth of 11.9 percent to 15.6 percent in Q3. This was largely due to the overwhelming growth of banks, which accounts for 73 percent of the finance sector's total value-added. The net operating incomes of universal and commercial banks which account for 90% of the banking system, improved by 14 percent. Non-banks which include pawnshops and lending companies pitched in a substantial 14.7 percent growth.

Table 5. Profitability Indicators, Universal and Commercial Banks (as of September 2005)

Indicator	Growth
Total Operating Income	9.5
Net Interest Income	18.1
Non-interest Income	(7.1)
Operating Expenses	8.3
Net Operating Income	14.0
Net Income After Tax (NIAT)	10.3

Source: BSP

Transportation, communication and storage grew at a healthy pace of 5.2 percent boosted mainly by growth of communication of 9.7 percent. However, the growth of the communication sector in Q3 is its lowest since 2003. It grew less than the double-digit growth it posted in the past 10 quarters, signaling a slowdown in the sector.

However, the lukewarm growth of consumption has affected the growth of the trade sector, which posted a 4.9 percent growth in Q3 of this year compared to a higher growth of 7.8 percent a year ago. Like communications, this is also its lowest since 2003. In Q3, wholesale and retail trade both grew at a slower rate of 3.3 percent and 5.4 percent, respectively, from a high growth of 10.7 percent and 6.8 percent, the same period a year ago.

Government service contracted 1.1 percent in real terms on account of the government's tighter spending in Q3.

Expenditure Side

On the expenditure side, Q3 GDP growth was only supported by personal consumption expenditure (PCE) which grew at a slower rate of 4.8 percent from a 5.5 percent growth during the same period a year ago. Government consumption, fixed capital formation and net exports decimated the growth.

Table 6. Gross Value Added, by Expenditure Shares (growth rate, in percent)

Particulars	Q3 2004	Q3 2005	Q1 to Q3 2005
PCE	5.5	4.8	4.8
Gov't Consumption	(7.2)	(2.1)	5.0
Capital Formation	10.4	(2.9)	(5.4)
Exports	17.1	3.9	3.1
Imports	6.6	7.5	1.9

Source: NSCB

PCE decelerated. PCE growth was buoyed by a 12.9-percent upsurge in the spending for transportation and communication-related products, a 5.2-percent growth of consumption on food, and a 4.9-percent increase in tobacco products expenditures. Contractions in consumer spending for beverages, clothing and footwear, and household furnishings were seen in the third quarter. Personal consumption expenditure accounts for roughly 73 percent of GDP. This shows that people are spending more on necessities which is the result of continued rise in inflation and expectations of higher prices due to expanded value-added tax (EVAT.)

Table 7. Personal Consumption Expenditure, by Purpose (growth rate, in percent)

INDUSTRY GROUP	Q3 2004	Q3 2005
Food	5.5	5.2
Beverages	4.1	(2.6)
Tobacco	1.0	4.9
Clothing and footwear	3.1	(1.1)
Fuel, light and water	2.2	0.3
Household furnishings	2.7	(3.3)
Household operations	3.0	2.9
Transportation/communication	13.8	12.9
Miscellaneous	5.9	5.0

Source: NSCB

Government spending tightened. Government consumption slumped from a 15.7-percent growth in Q2 to a contraction of 2.1 percent in Q3. This is

explained by the government's continued effort to keep the deficit target in check for the full year. This is consistent with the Cash Operations Report, where expenditures only grew by 4.8 percent in Q3, which is less than the inflation rate.

Capital formation continues to contract.

Capital formation continued its contraction although at a slower pace of 2.9 percent from Q1 and Q2 contractions of 7.4 and 5.4 percent. Last year, capital formation expenditures grew impressively, averaging 9.6 percent.

These contractions were due to lower business confidence, as a result of political instability, lower demand for exports and slowing down of consumption.

Exports underperformed. Net exports (exports less imports) contributed negatively to growth as exports grew at a slower pace of 3.9 percent while the country's import bill grew by a larger 7.5 percent. Exports growth was pulled down by lower international demand for electronic products. Based on the National Statistics Office (NSO), exports of this sector grew only by 4.2 percent in Q3 and 1.6 percent from January to September of this year, way below the full year target of 10 percent. Exports of non-factor services, which include business processing outsourcing, accelerated its growth from 2.2 percent in Q2 to 10.3 percent in Q3; however, it only accounts for 13.4 percent of total exports.

Imports grew due to higher importation of mineral fuels, lubricants and related products, which rose by 6.1 percent, machineries by 13.2 percent, cereal products by 25.8 percent, transport equipment by 25.9 percent, and textile yarns by 19.1 percent.

Outlook for the rest of the year

The continued political noise, high inflation and implementation of the EVAT do not augur well for the domestic economy. There are indications that consumption is restrained as people feel the crunch of higher prices. The holiday season, though, may lift demand in the fourth quarter.

Business confidence is, likewise, adversely affected as indicated by the contraction in

investments. Capital formation has contracted in the last three quarters. The export sector is performing poorly, growing by only 3.2 percent as of October 2005 as against the full-year growth target of 6 percent.

Table 8. Projections of GDP for Full Year 2005

	Q1 - Q3 Actual Growth	Annual Target	Needed to Achieve the Annual Target*
GDP	4.6	5.3	7.3
AFF	1.1	3.0	8.4
Industry	4.6	4.6	4.7
Services	6.1	6.6	8.1

Source: NEDA
* SEPO computations

These signal that the domestic economy will not achieve its projected growth of 5.3 percent for 2005. To do so, it will need to grow by 7.3 percent in the fourth quarter, which is unlikely. Other multilateral institutions have, in fact, already downgraded their forecasts for the full year GDP.

Table 9. GDP Forecasts, by Selected Institutions

Institutions	GDP Growth
NEDA/DBCC	5.1 – 5.3
Asian Development Bank	4.7
International Monetary Fund	4.7
World Bank	4.8
Economic Intelligence Unit	5.1

The Role of Remittances in the Philippine Economy

The steady inflow of income from abroad has buoyed the country's GNP in the third quarter. Net factor income from abroad grew by 38.7 percent, the biggest growth since Q2 of 2003. This was supported by a 19.7 percent growth of compensation inflow and a 19.7 percent growth of property income inflow, while outflows contracted by 6.2 percent.

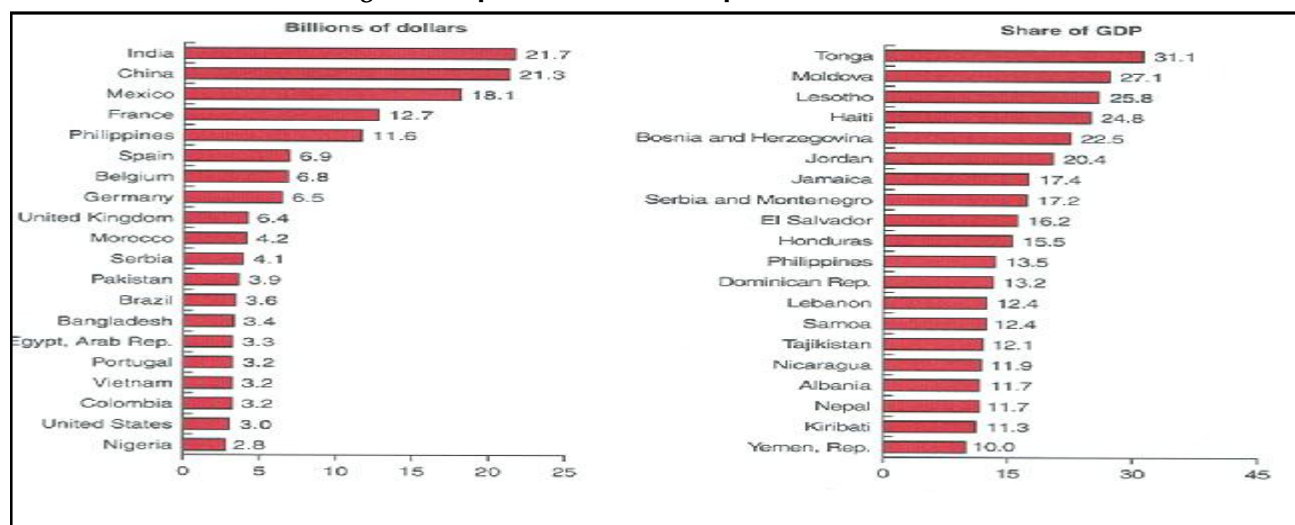
Table 10. Historical Growth Rates of Net Factor Income from Abroad

Period	NFIA Growth
2002 Q1	10.2
Q2	(18.5)
Q3	(6.2)
Q4	44.4
2003 Q1	3.0
Q2	40.9
Q3	32.3
Q4	2.8
2004 Q1	7.0
Q2	18.7
Q3	(0.9)
Q4	8.7
2005 Q1	7.6
Q2	2.3
Q3	38.7

Source: NSCB

The role of remittances in propping up GNP has always been substantial. However, has this translated to the improvement in the domestic economy? Does this increase investment in the

Figure 1. Top 20 Remittance-recipient Countries, 2004



Source: World Bank

country? Or does it simply induce consumption? This section of the economic report intends to provide a quick insightful look at the role of Overseas Filipino Workers (OFWs) remittances in the Philippine economy.

Global and Local Trends

The World Bank (WB) estimates that remittance flows are set to increase as 14.2 million additional migrants from developing countries are expected to move into developed countries from 2001 to 2025. This year alone, USD167 billion will be sent home by migrant workers to their home countries. The Philippines, in particular, is the fifth biggest recipient of remittances. (See Figure 1)

Table 11. Stock Estimate of Overseas Filipinos (as of end 2004)

REGION	PERMANENT	TEMPORARY	IRREGULAR	TOTAL
WORLD TOTAL	3,187,586	3,599,257	1,296,972	8,083,815
Africa	318	58,369	17,141	75,828
Asia, East & South	91,901	1,005,609	443,343	1,540,853
Asia, West	2,312	1,449,031	112,750	1,564,093
Europe	174,387	506,997	143,035	824,419
Americas / Trust Territories	2,689,722	292,892	549,725	3,532,339
OCEANIA	228,946	57,357	30,978	317,281
SEABASED WORKERS		229,002		229,002

Sources: CFO, DFA, POEA

Table 12. Sources of Remittances by Region, Full Year 2004, (in million USD)

REGION	REMITTANCES
WORLD TOTAL	8,550.4
AFRICA	3.4
ASIA	918.3
MIDDLE EAST	1,232.1
EUROPE	1,286.1
AMERICAS	5,023.8
OCEANIA	42.6
OTHERS	44.0

Source: BSP

As a major exporter of labor, the Philippines has 8.1 million workers in the whole world, comprising 23 percent of the domestic labor force as of 2004. (Table 11) The growing number of overseas workers point to the fact that domestic employment has not kept pace with population growth (Burgess and Haksar, 2005). Given the wide wage differentials with advanced economies and the strong educational background of most Filipinos, the outward movement of the population to find better employment opportunities seems natural.

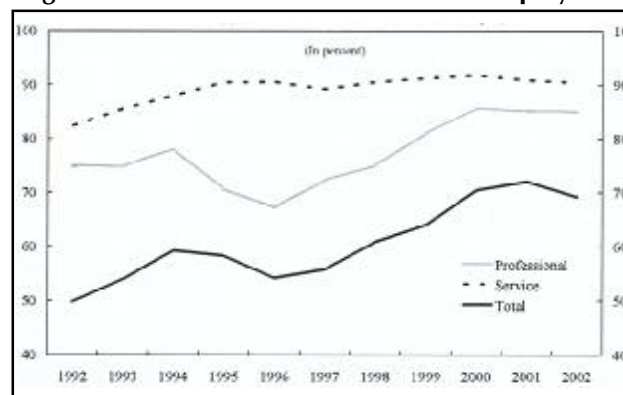
Figure 2. Filipino Overseas Workers, by type



Source: IMF

In recent years, it is notable that the proportion of higher skilled workers among migrants is increasing, a clear indication of the “brain drain” phenomenon. Also, the migrant workers are more and more composed of women, which have a social effect on the families.

Figure 3. Share of Women in Overseas Employment



Source: IMF

Developmental Impact of Remittances

The increasing flow of migrant workers from developing countries to developed countries is a recent economic phenomenon being investigated by economists because of its economic impact on countries of migrant labor. The phenomenon is of great interest because the huge inflows of remittances in recent years are even larger than private capital flows and official development assistance in some countries. Studies by the WB and International Monetary Fund (IMF) show that the inflow of remittances has great impact on the economy of a recipient country. On the macro economic level, remittances provide a significant source of foreign currency that help finance imports and contribute to the balance of payments

(BOP). It also increases national income as the Philippine economy experienced this third quarter. The improvement in the BOP positions also helps improve the country's credit worthiness, thus, enhancing access to international capital markets. Moreover, if inflows are remitted through the formal market channels, it opens up opportunities for greater savings mobilization. If invested on productive activities, this helps to improve the domestic economy.

Aside from efficiency factors, remittances were also found to have an impact on welfare. Majority of OFWs come from underprivileged families. Remittances increase income and their families consume more, again stimulating the domestic economy. When remittances are spent on education and health expenditures, this develops the country's human capital, benefiting the economy in the long run. As a result, remittances improve per capita income levels and reduce poverty. Based on an IMF study, on average, 2.5 percentage point increase in the remittances/GDP ratio is associated with less than a 0.5 percentage point decrease in the number of people living in poverty. In the Philippines, a study by Yang (WB, 2006) showed that remittances have reduced poverty among migrant households by 0.6 percent.

Likewise, the study revealed that an economic downturn or natural disaster will lead to increases in remittances, just like what happened in 1997 financial crisis. This implies that poor families are better able to cope during difficult times. It also found spillover effects on households without migrant members due to increases in remittance-driven economic activities.

Furthermore, there is also evidence that remittances provide working capital for its recipients that lack access to credit market. The steady inflow of remittances makes them more credit worthy. These allow recipients to engage in entrepreneurial activities, hence, creating jobs and boosting economic growth.

On the other hand, the huge inflow of remittances has its downside as it may create adverse conditions that may be harmful to the economy. First, there is the problem of moral

hazard on the recipient families and the government. Because of the expectation that their relatives abroad will continuously send money, the culture of dependence is developed. It also reduces their incentive to work.

On the part of the government, reliance on huge inflow of remittances may lead to complacency in instituting fiscal and trade policy reforms. This dependence on the inflow of foreign exchange strengthens the local currency, hence, making exports less competitive. This will result to concomitant contraction on tradable sectors.

The "brain drain" phenomenon is also a great concern. Statistics show an increasing number of OFWs are high-skilled such as nurses, doctors and engineers. This depletes the country's pool of skilled labor force. One visible effect of this is the impact on the provision of health services as the government is having difficulty hiring medical practitioners. In the long run, it discourages investments since the number and quality of the labor force is declining. Another related issue which still has to be investigated is whether the benefit deploying workers abroad is higher than the cost of education and training spent by the sending country.

Table 13 summarizes the major contributions to the debate.

Table 13: Benefits and costs of remittances from international worker migration

Benefits	Costs
Ease foreign exchange constraints and improve balance of payments	Spent on consumer goods which increases demand, increases inflation and pushes up wage levels.
Permit imports of capital goods and raw materials for industrial development	Result in little or no investment in capital generating activities
Potential source of savings and investment for capital formation and development	High import content of consumer demand increases dependency on imports and exacerbates BOP problems
Net addition to resources	Replace other sources of income, thereby increasing dependency, eroding good work habits and heightening potential negative effects of return migration
Raise the immediate standard of living of recipients	Spent on 'unproductive' or 'personal' investment (e.g. real state, housing)
Improve income distribution (if poorer/less skilled migrate)	Create envy and resentment and induce consumption spending among non-migrants

Source: International Labor Organization

Conclusion

OFWs are hailed as national heroes because of their role in helping the economy through their remittances. In recent years, the huge inflows of OFW remittances have provided a stable source of foreign exchange that eased the payment of the higher cost of the country's oil imports and external debt. It has also boosted consumption that benefited our industries.

While many are wary of the social effects of huge deployment of workers on Filipino families, remittances have played a positive role in ensuring the education of children of poorer families. Likewise, incomes of families of migrant workers increased, allowing them to weather economic downturns and income losses due to natural calamities and other external shocks. Increased incomes also imply that they are better able to cope with their health expenditures. Literature shows that these benefits have a direct impact on the human capital formation of the country.

Nonetheless, there are concerns over the moral hazards created by the huge inflow of remittances. First is the issue of dependency and disincentive to work by recipients of remittances. Likewise, there is concern that only a small portion of the money sent by our OFWs are saved or invested properly. Another is the danger that government may become complacent such that

they postpone necessary macroeconomic reforms to improve the domestic economy. While remittances benefit the economy, it should not be viewed as the solution to the country's economic ills.

To make remittances really work for the country in the long run, measures to address these concerns must be pursued by government. Current programs by the government to educate OFWs and their families on available saving instruments and entrepreneurial activities are in the right direction. Increasing the portion of remittances channeled into savings instruments will help develop our capital market and provide funds for productive endeavors. This should drive the financial sector and the Bangko Sentral to make available financial instruments that are safe and offer better yields. This also provides an opportunity for rural banks and microfinance institutions to cater to the needs of the OFWs since majority of them come from the countryside.

Channelling remittances to productive investments is another challenge for government. Families of OFWs need to be encouraged and trained to engage in small businesses. This will create jobs and help improve the domestic economy. In the long run, OFWs can return and be reintegrated in the country, bringing in better skills and technology.

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