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# ECONOMIC AND MARKET UPDATE DECEMBER 2011

**December inflation hits 11-month low at 4.2%.** December inflation eased to 4.2% from 4.8% in November, the lowest level in 11 months due to lower prices of selected food items such as rice, vegetables and sugar as domestic supply remained sufficient. The general downward adjustments in the prices of gasoline and diesel nationwide also contributed to the slowdown in December inflation. This brings the annual average inflation rate for 2011 to 4.8% (based on 2006 prices) or 4.4% (based on 2000 prices). Both averages are well within the government's target of 3-5% for the year. Likewise, core inflation declined to 3.4% in December from 3.7% in November, bringing the 2011 average core inflation to 3.6%.

**BSP might consider cutting key policy rates or reserve requirement ratios in 2012.** The BSP decided to keep its key policy rates and reserve requirement ratios unchanged for the fifth straight Monetary Board meeting held last December 1 due to slower-than-expected third quarter GDP growth. And given that the county's annual inflation eased in December to its lowest level in 11 months, the BSP is expected to do some adjustments in either key policy rates or reserve requirements by the first quarter of 2012 to foster economic growth amid doubts over the pace of the global economic recovery. Further, some analysts believe that the BSP will deliver a 25-basis-point cut on its first Monetary Board meeting on January 19, 2012.

**Investors swamp the 25-year bond auction.** In an auction held last December 06, investors swamped the 25-year Treasury bonds as investors sought to park their funds in long term government papers amid improving inflation outlook as well as the monetary authorities' decision to keep rates steady. The 25-year T-bonds fetched an average rate of 6.656%, 47.5 bps lower than the 7.131% accepted at the previous auction. Total tenders amounted to P32.57 billion, more than thrice the planned debt sale of $9 billion. The government sold as planned.

**Domestic liquidity growth accelerates faster in November to $4.4 trillion.** Domestic liquidity or M3 grew at a faster pace of 7.2% in November to P4.4 trillion from 6.9% in October driven by steady foreign exchange inflows from overseas remittances and portfolio investments. On a monthly basis, seasonally-adjusted M3 increased by 0.9% from a contraction of 0.7% in the previous month. The steady growth in domestic liquidity indicates that liquidity in the financial system remains sufficient and supportive of economic growth.

**Different agencies cut growth outlook; NEDA remains optimistic.** Given the slow global trade and the weaker-than expected third quarter growth, different agencies slashed their growth forecasts in the country. The Asian Development Bank (ADB) reduced its growth forecast to 3.7% from 4.7% this year. Whereas, the Union Bank of Switzerland (UBS) lowered its growth forecast to 3.6% from 4.3% and to 3.3% from 4.0% for 2011 and 2012, respectively. The International Monetary Fund (IMF) is now seeing the country's GDP growing by 3.7% instead of 4.7% this year and by 4.2% instead of 4.9% next year. The World Bank (WB) lowered its growth forecast to 3.7% and 4.2% for 2011 and 2012, respectively, from the 4.5% and 5% forecast made last October. HSBC, for its part, sees the economy growing by just 3.6% this year and next year, down from the 4.3% and 4.8%, respectively, announced in October. Also, Singapore-based DBS Bank Ltd. slashed its projected GDP growth for the Philippines to 3.6% from 4.6% and 4.2% from 5.2% for 2011 and 2012, respectively. However, NEDA stands firm that the Philippine economy could grow by atleast 4% in 2011 and more than 5% in 2012. The government expects the improvement in export growth, increased government spending and the start of public-private partnership infrastructure to boost the economy in the last quarter of 2011.

**BOP surplus rises to $9.7 billion in the first three quarters.** In the 3rd quarter of 2011, the balance of payments (BOP) surplus reached $4.7 billion, up by 42.3% from the $3.3 billion it posted during the same quarter in 2010, due mainly to higher net inflows in the capital and financial account. Activity in the Asian region including the Philippines remained solid despite the prevailing uncertainties in the global market particularly in the US and Eurozone. Further, the BOP position yielded a surplus of $9.7 billion in the first three quarters of 2011, increasing by more than 50% compared to the surplus of $6.4 billion in the same period a year ago.

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**October imports growth slows to 2.3%.** Data from NSO showed that the country's merchandise imports for the month of October improved as compared from the same period last year but grew at a slower pace. It rose by 2.3% year-on-year to $5.019 billion from the $4.904 billion in the same month last year, the weakest growth rate since May 2010. However, on a monthly basis, imports dropped by 1.1% from the $5.076 billion registered in September. The main driver for the decline was the 19.9% drop in electronic products to $1.235 billion, which made up about 25% of the total. Meanwhile, balance of trade in goods registered a deficit of $932 million, 703% higher than last year's deficit of $116 million. This brought the 10-month deficit to $9.23 billion.

**Exports decline for 6th straight month in October. Exporters remain optimistic for 2012 recovery.** The country's export earnings fell for the sixth consecutive month in October, plummeted by 14.6% to $4.09 billion from $4.78 billion recorded in the same period last year as electronic demand remains lackluster. Likewise, year-to-date exports dropped by 4.3% to $41.29 billion compared to $43.15 billion in the same period a year ago. On a monthly basis, however, exports recovered to a 4.9% growth from a 5.5% contraction in September. While export receipts continue to plunge in 2011, exporters remain optimistic for 2012 recovery, citing seven reasons for their optimism. These seven reasons are the success of the campaign to make exporters aware and use existing trade agreements, infrastructure developments through the public-private partnership (PPP) scheme, the launch of the new export-development plan, efforts to address competitiveness issues like red tape, the various capacity-enhancement programs for the sector, global demand for renewable natural materials, and sustained domestic consumer demand.

**OFW remittances reach $16.53 billion in ten months**. Remittances from overseas Filipino workers grew by 6.2% in October to $1.777 billion attributed to the continued strong demand for Filipino workers abroad, particularly skilled manpower. For the first ten months of the year, cumulative remittances rose by 7% to $16.53 billion compared to the $15.46 billion posted in the same period last year. OFW remittances are projected to grow by as much as 8% in 2011 to $20.3 billion from $18.8 billion last year, as global demand for Filipino workers remained strong despite economic problems in labor markets in the West. Further, BSP Deputy Governor Diwa Guinigundo sees remittances picking up in late 2011 as OFWs abroad are likely to send more money to their loved ones for Christmas season and especially those affected by typhoon Sendong that claimed the lives of more than 1,000 Filipinos and rendered thousands of families in Mindanao homeless. In line with this, the World Bank sees remittances to hit $23 billion in 2011, higher than the government's own forecast of $20.1 billion, which represents a 7% growth from $18.8 billion in 2010. With the World Bank's projection, the Philippines would likely remain as the fourth-largest remittance recipient country following India (seen to get $58 billion), China ($57 billion), and Mexico ($24 billion).

**October unemployment rate drops to 6.4%.** According to the NSO, the country's unemployment rate hit a four-year low of 6.4% in October from 7.1% in the same month last year. Further, data from the NSO showed that 38.5 million Filipinos were employed as of October 2011. The services sector accounted for 52.1%, agriculture 33.4% and industry 14.5%. Meanwhile, the number of underemployed was estimated at 7.4 million in October or an underemployment rate of 19.1%. Most of the underemployed were working in the agriculture sector at 41.9% and services sector at 41.7%.

**End-2011 GIR level stands at $75.1 billion.** The country's gross international reserves (GIR) stood at $75.1 billion as of end-December 2011, higher by $12.7 billion compared to the end-December 2010 GIR of $62.4 billion. This was due mainly to sustained foreign exchange inflows from overseas Filipinos' remittances, business process outsourcing (BPO) services receipts, and direct and portfolio investments. The current level of GIR was sufficient to cover 11.1 months worth of imports of goods, payments of services, income and corresponds to 10.5 times the country's short-term external debt based on original maturity and 6.8 times based on residual maturity. However, the end-December 2011 GIR was lower by $1.1 billion than the previous month's level of $76.2 billion on account of the negative revaluation on the BSP's gold and foreign currency-denominated reserves and debt service payments by the National Government (NG).

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**Government posts P22 billion budget deficit in November.** The government incurred a budget deficit of P22 billion in November, bringing the shortfall in the first 11 months of the year to just 32% of the full year target. Deficit from January-November amounted to P96.25 billion, 64% lower than the deficit of P267.328 billion recorded last year. The pace of spending is significantly slow as fiscal consolidation measures to increase efficiency have slowed it down considerably. However, according to Budget Secretary Florencio B. Abad, the Budget department was still working to release as much funding in December to boost the deficit as well as the economy. Further, economists expect the pace to pick up in 2012, as the government tries to boost domestic demand with its delayed PPP projects.

**FDI inflows down by 24.7% in 10 months.** For the month of October, foreign direct investment (FDI) inflows reached $58 million, in contrast to the $32 million net outflows posted in the same month a year ago. However, cumulative net FDI inflows for the tenth-month period totaled $729 million, lower by 24.7% than the $968 million net inflows recorded in the same period in 2010. The decline was due to the fears over the prevailing uncertainties in the global economic environment and greater risk aversion amid intensified financial strains in the Euro Zone and the continuing weak U.S. economic performance

**"Hot Money" inflows yield net inflows in November.** Foreign portfolio investments, also known as "hot money" for the month of November yielded net inflows of $490 million, 106.6% higher than the $237 million level posted in October but 70.7% lower than the $1.7 billion in 2010. Further, for the period January to November 2011, net inflows were recorded at $3.9 billion, 5.8% lower than the $4.2 billion level a year ago amid global risk aversion due to fears of a Eurozone break up. At the start of 2011, emerging markets had attracted hot money investments, however, saw these funds exit after investors, worried by the turn of events at the Eurozone, chose to repatriate their investments.

**Peso closed at 43.84, 0.46% weaker than previous month.** For the last month of the year, the local currency closed at 43.84 against the greenback, or 0.46% higher than the previous month's close of 43.64. Philippine peso breached the P44 to $1 level, the weakest level in 10 months, on the back of growing fears of mass downgrades by credit rating agencies for European Union economies led to more risk aversion among investors. The peso has remained near the P44.00 level on continued US dollar strength. This level is favorable to exporters, overseas Filipinos sending money to the Philippines and BPO companies. Still, throughout 2011, the local currency had been one of the most stable






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