

The Global Financial Crisis and Economic Recession: Global and Philippines Perspectives

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PDF WG on Growth & Investment Climate
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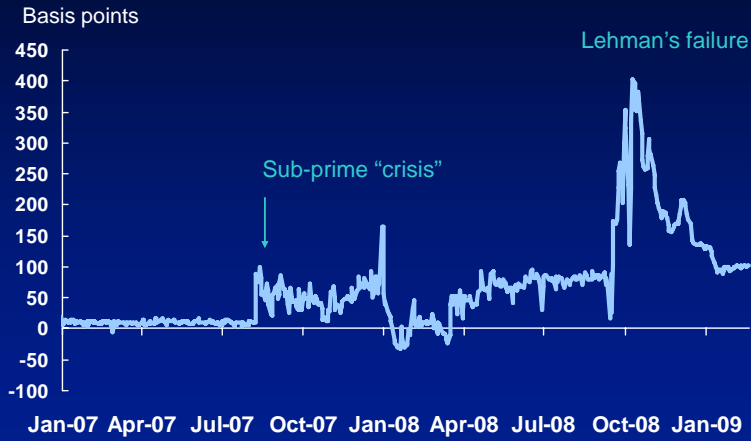
Overview

- Financial crisis suddenly turned into a global recession
- Initial impact was on private sector, but fiscal pressures will quickly intensify, as revenues fall, borrowing costs are up and spending needs increase.
- Risk of balance-of-payment crises are substantial and adjustments could be harsher than during previous crises.
- Impact on the Philippines
 - Overall impact
 - Specific areas of concerns



Financial Crisis: Sudden Spikes in Interbank Rates

Spread between 3-month U.S. Libor and fed fund rate



Source: Datastream.



Developing country spreads are up sharply – dramatically increasing borrowing costs

Emerging-market bond spreads; basis points



Source: JPMorgan



Deleveraging and bubbles burst lead most stock markets to decline 40+ %

Stock market valuations, USD,



Source: World Bank.



Global Connections: Export Revenues Collapse

World exports (US \$ million)

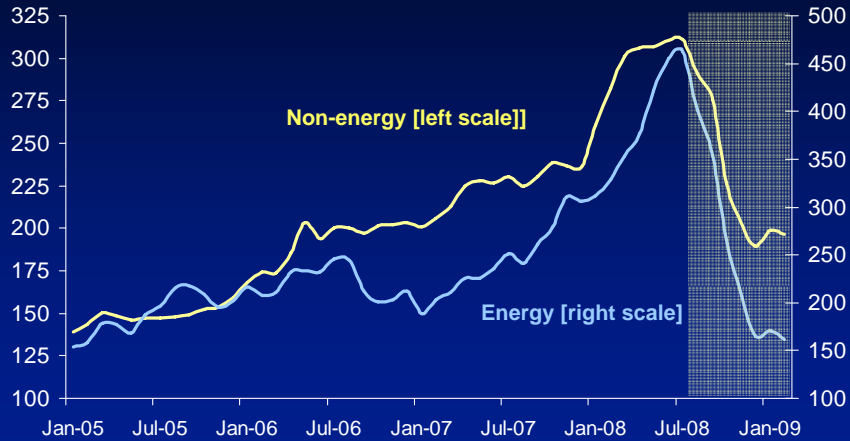


Source: World Bank, DEC Prospects Group.



Commodity prices fall sharply through early 2009

Commodity price indices, current U.S. dollars, 2000=100.

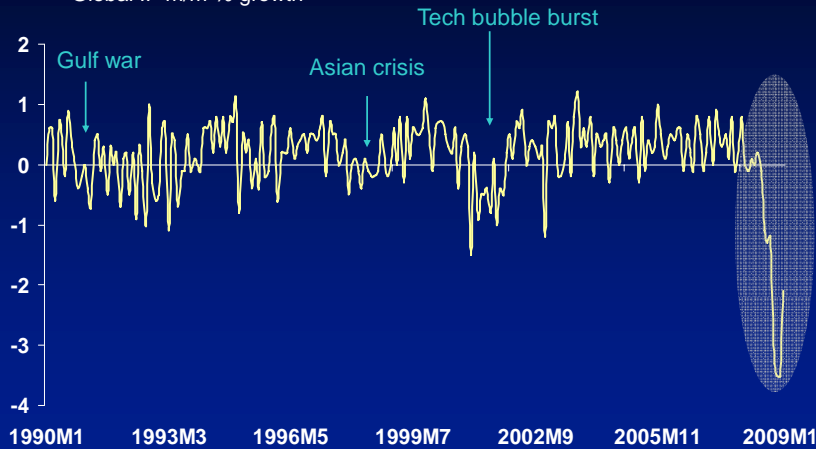


Source: World Bank data.



From Financial to Real World: World production collapses

Global IP m/m % growth

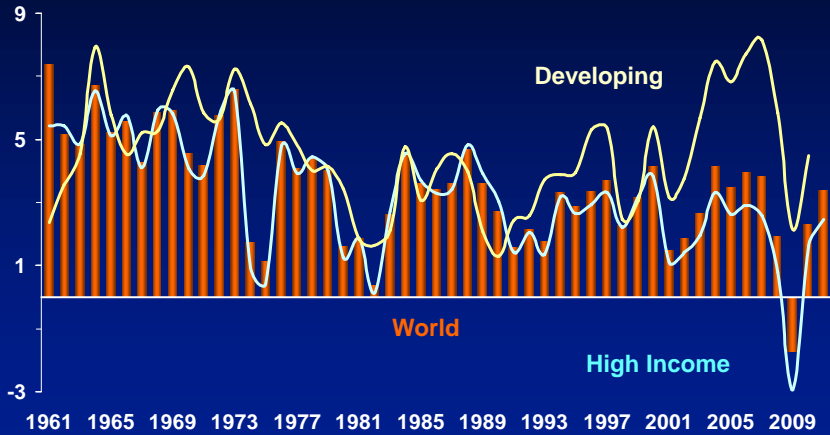


Source: World Bank, DEC Prospects Group.



World Economy Contracting for the First Time on Record

Growth of real GDP, percent

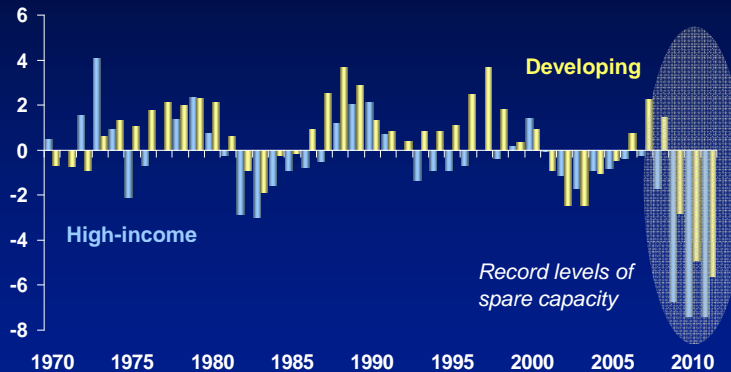


Source: World Bank data and projections.



Even if growth turns positive again, the level of GDP will remain well below potential and economic distress acute

Output gap : Difference between actual GDP and GDP at full employment, as a percent of potential



Source: World Bank, DEC Prospects Group.



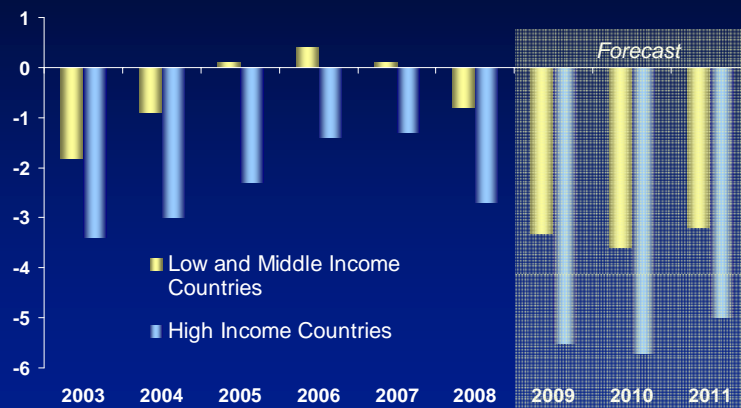
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General Government Balance

Percent share of GDP

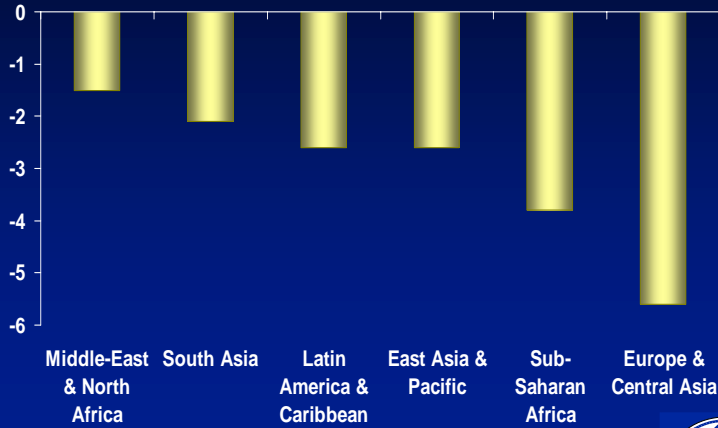


Source: World Bank, DEC Prospects Group



Weaker revenues will soon cause fiscal deficits to deteriorate sharply

Projected deterioration in fiscal balance, percent of GDP

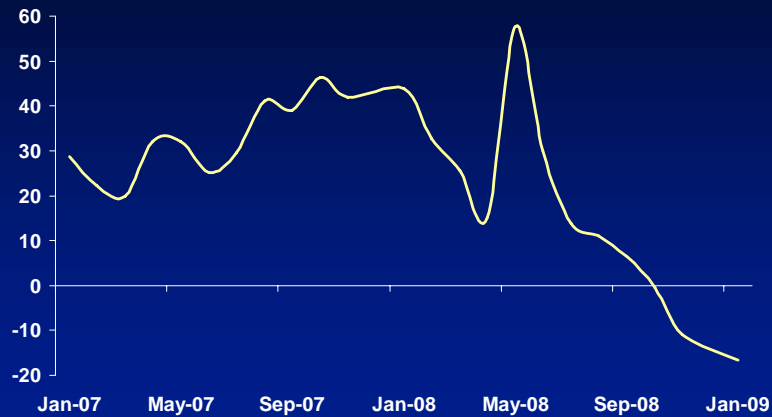


Source: World Bank, DEC Prospects Group.



China's monthly tax revenues

Annual percent change



Source: World Bank, DEC Prospects Group.



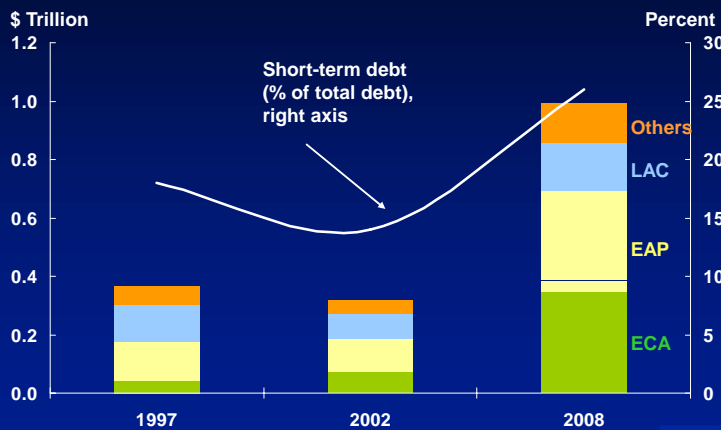
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Developing countries' short-term external debt is at record-high levels

Developing countries' external short-term debt*



*Debt with an original maturity of one year or less
*Source: World Bank, DEC Prospects Group.



Emerging markets have already drawn reserves

Total reserves of developing countries excl. China, \$ trillion



Source: World Bank, DEC Prospects Group.



Overview

- Financial crisis suddenly turned into a global recession
- Fiscal pressures will quickly intensify.
- Risk of balance-of-payment crises are substantial.
- Impact on the Philippines
 - Overview
 - Financial / Monetary sector
 - Trade / Balance of Payment sector
 - Real sector
 - Specific areas of concerns
 - Remittances / social and poverty
 - Labor markets / poverty
 - Public finance



Financial sector: Resilience

- Financial system was still cleaning up balance sheet from Asian crisis + regulations introduced after that crisis helped (e.g., real estate concentration)
- Excesses that took place globally did not occur (leverage; financial disintermediation, securitization)
- Nonetheless: high exposure to GS (B/S); pressure on margins going forward (Income)
- Tightening of lending conditions + spreads widening
- Access to finance: issue for SMEs and MSMEs during downturn (→ labor market consequences)



Monetary conditions: Positive overall

- Inflation receding rapidly thanks to global recession (12.5% in August to 6.4% in February)
- Provided room for BSP to cut rates (150 bps since December)
- But real interest rate actually going up as disinflation very sharp (-150-610=+460bps)
- Monetary conditions have been pro-cyclical (real rates decreasing in high growth periods and decreasing during downturns)
- Liquidity in the banking system ample on Peso side; robust money and credit growth



Trade / BoP: Drastic Shocks

- Exports and Imports contracted by 40% YoY
 - X: Electronics, garment, furniture suffered particularly
 - M: energy bill shrank, M for reexport
- Remittances: still holding but weakening
- CA >0 entering into the slowdown. First time in generation. No need for domestic contraction!
- BoP: dwindling but still positive in 2008.
- Outlook: CA remains positive under most scenario. Under strong decrease in remittances, a small deficit is projected.



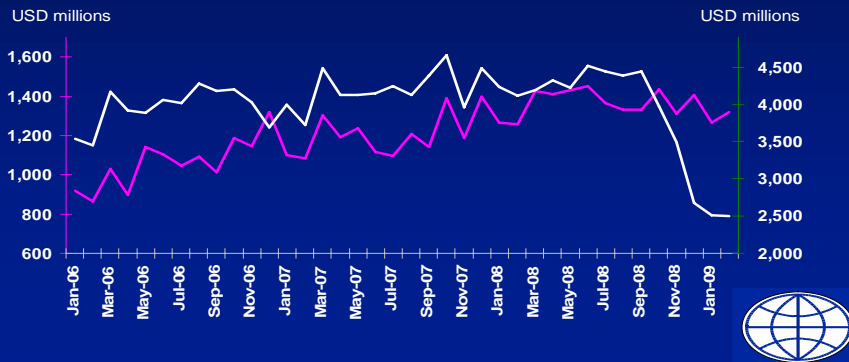
Real Sector: Overall Resilience

- Consumption (77% of GDP) remains robust
 - Reversal of food and fuel price shock (surveys)
 - Remittances still growing in nominal USD (and real Peso)
 - Labor market still holding well overall through end-2008
- Manufacturing performed well (food processing) but (almost all) services and agriculture weakened in 2008
- Export sectors battered by global recession
- BPO: emerging signs of structural gains thanks to the global crisis and push for efficiency gains



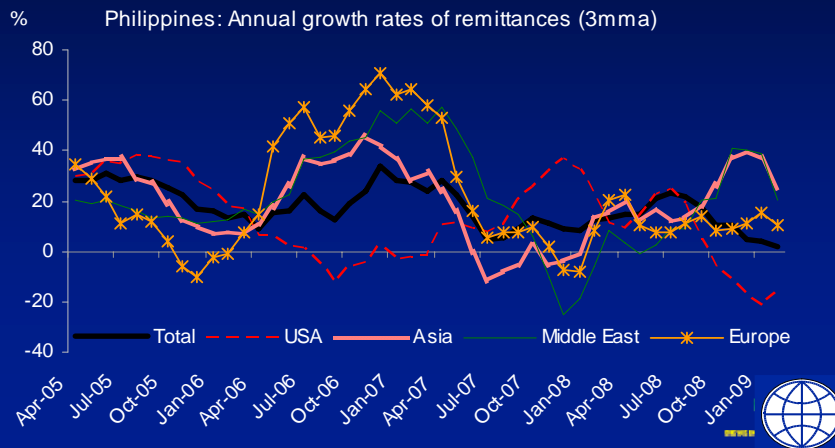
Remittances: Resilient but can it Last?

- Stable at about 10 percent of GDP
- Crucial for BoP, reserves, consumption, deposits, etc.
- Have continued to be a stable source of inflow (e.g., vis-à-vis portfolio, FDI, X)



Remittances: Resilient but can it last?

- Remittances from the US have dived (but surprising >0 in Feb)
- Remittances from the Gulf and Asia are slowing down sharply.



Social/Poverty Impact of a Fall in Remittances

- Remittances (from overseas) are regressive (first decile receives 1% of their HH income, while 10th decile receives 16%)
- Remittances flow to regions with highest economic activity
- 10% fall in remittances:
 - Pushes non-poor into poverty; disproportionately increase poverty among the urban population (+1% against +0.4% for rural)
 - Pushes poor further into poverty (+0.3% increase in income gap below the poverty line)



Labor Market: Severe Worsening Projected

- Weak quality of labor market prior to global recession
 - High unemployment (7.4% in 2008), underemployment rate (18.2%); Youth highly affected, even skilled (graduates) youth.
 - High informal sector (mostly agriculture and services)
 - Rigid labor market environment
 - Trend fall in real wages since 2001
- Sharp increase in labor force in 2008-2010. Labor force growth rate projected to +73% compared to 2000-2007 (2.73% to 4.9%)
- Projected slowdown in net OFW deployment due to global recession and sharp rise in global unemployment
- Deterioration in labor market lags economic deterioration



Labor Market: Projected Impact

- Urban workers first affected (high degree of economic activity in sectors affected by global recession and crisis)
- NCR, CALABARZON, Central Luzon most at risk to increased unemployment and underemployment.
- Non-poor are most at risk to unemployment spells
- Poor will be impacted by increase in underemployment and informality
- Over the ST: non-poor most affected; over MT/LT: poor will be most affected (reduction in income can have lasting consequences)



Public Finance: Controlled Fiscal Easing?

- Much improved public finance prior to global recession
- But debt remain elevated
- Fiscal easing appropriate (some fiscal space) to buffer less well off citizens from the crisis and close some of the output gap through growth-increasing measures (infra investment)

Q? How much is appropriate? Can there be too much easing?

A: Fiscal easing has to be controlled; LT debt sustainability not questioned.



14.7 - 18.9 = - 4.2 % of GDP?
= - P335 bn ?

Revised Budget, WB projections, etc

	2006	2007	2008	2009	
	Act	Act	Est.	Budget	WB Proj.
(in percent of GDP unless stated otherwise)					
Revenue and grant	16.1	15.7	15.6	15.9	14.7
Tax revenue	14.3	14.0	14.0	14.3	13.1
Nontax revenue	1.9	1.7	1.6	1.6	1.6
Total expenditure	17.3	17.3	17.2	18.9	17.9
Current Expenditures	15.2	14.6	14.0	15.3	14.8
Capital Outlays and Net Lending	2.1	2.7	3.2	3.6	3.0
Balance (GFS definition)	-1.2	-1.6	-1.5	-3.1	-3.1
Balance (Government definition)	-1.1	-0.2	-0.9	-2.5	-2.6
Memorandum item					
Primary balance (GFS definition)	4.1	2.7	2.3	1.1	1.1
National Government Debt	63.8	55.8	56.3	...	56.5
Nominal GDP (PHP billions)	6,033	6,651	7,498	7,984	7,984



Public Finance: Controlled Fiscal Easing?

- Ambitious expenditure plans (NG, GOCC, SSIs, PPPs)
- Significant increase in the NG deficit (2.5/3.1 % of GDP)
- ERP calls for front-loading of discretionary expenditures. Successful to date.
- Issues: Potential for the fiscal deficit to balloon
 - Revenue is falling far short of budgeted projections. WB projects significant drop in tax-GDP ratio.
 - Fiscal risks: what is not in the budget but will be?
- Options:
 - Deliver on spending plans, let deficit exceed 4%?
 - Control revenue (petroleum excises)?
 - Re-prioritize expenditure in mid-year?



Summary impact of the global financial crisis and recession on the Philippines

- A delayed impact on the Philippines economy given its structure (sizeable domestic consumption share buffered by remittances);
- A significant impact nonetheless (trade sectors already severely affected) 7.2 to 4.6 to 1.9?
- Areas that would deserve particular attention include:
 - Remittances: a moderate decrease expected but downside significant and material
 - Labor markets: expected to be particularly affected over time (H2 2009, 2010)
 - Public finance: is the desired fiscal easing controlled?

