2nd Quarter GDP Growth in line with our forecast

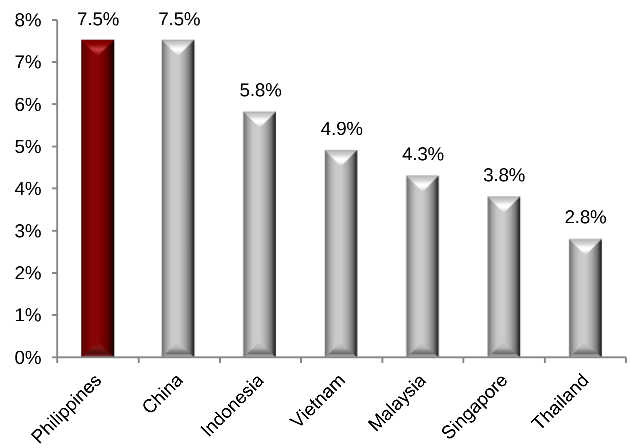
September 3, 2013

2Q2013 GDP in line with forecast. As we projected (see previous report entitled *'2nd Quarter GDP Growth seen at 7.5%'*), the Philippine economy grew by a robust 7.5% year-on-year during 2Q2013, topping the Bloomberg consensus estimate of 7.2%. The result was the highest recorded for the Asia Pacific Region (see figure 1), but slightly lower than the downwardly revised 7.7% growth recorded in 1H2013. The second quarter reading also brought the 1H average growth rate to 7.6% year-on-year. Among the ASEAN region, the Philippines distinguished itself with domestic-led economic growth, while trade-dependent peers continue to suffer from falling export receipts underpinned by weakening global demand for commodities.

Public and private spending propels growth. Private consumption, which accounted for 67% of the economy, accelerated by 6.2% year-on-year (in-house estimate: +6.0%) during the period. Sustained growth in overseas remittance inflows (+5.7% year-on-year for 2Q2013) helped support private spending. After having disbursed more than three quarters of the planned budget for the year, government spending soared by 17% year-on-year, slightly higher than our forecast. On the other hand, investments failed to sustain momentum, posting only +13.2% year-on-year which paled in comparison to the 48% year-on-year growth rate achieved in the 1Q2013. The slowdown was attributable to the deceleration in private sector investment spending. Private spending in construction slowed to 9% year-on-year from 40% year-on-year in 1Q2013, while government infrastructure spending rose by 31%, year-on-year (consistent with the trend during election years). As expected, trade was disappointing with exports declining by 6.5% year-on-year, though this was partially offset by a 3.0% year-on-year slowdown in imports.

On the supply side, growth was driven by services (+7.4% year-on-year) which accounted for more than half of the total GDP. The industry sector likewise posted a 10.3% year-on-year increase while agriculture fell by 0.3% year-on-year.

Figure I: 2Q Economic Growth: Peer Comparison



Source: Bloomberg

Table I. 2Q GDP Breakdown by Expenditure

BY EXPENDITURE	Weight	Growth Rate	Contribution to growth
1. Household Final Consumption Expenditure	**67%**	**6.2%**	**4.2%**
2. Government Final Consumption Expenditure	**13%**	**17.0%**	**2.2%**
3. Capital Formation	**17%**	**13.2%**	**2.3%**
A. Fixed Capital	19%	9.7%	1.8%
1. Construction	9%	15.6%	1.3%
2. Durable Equipment	9%	5.7%	0.5%
3. Breeding Stock & Orchard Development	1%	-1.1%	0.0%
4. Intellectual Property Products	0%	16.2%	0.1%
B. Changes in Inventories	-2%	16.2%	-0.2%
4. Exports	**47%**	**-6.5%**	**-3.1%**
A. Exports of Goods	38%	-8.7%	-3.3%
B. Exports of Services	9%	4.0%	0.4%
5. Less : Imports	**46%**	**-3.0%**	**-1.4%**
A. Imports of Goods	38%	-4.0%	-1.5%
B. Imports of Services	8%	2.4%	0.2%
6. Statistical Discrepancy			0.5%
GROSS DOMESTIC PRODUCT	100%	7.5%	7.5%

Source: National Statistical Coordination Board

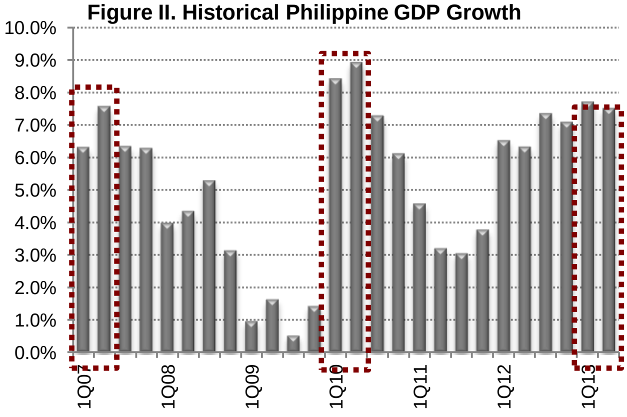
Table II. 2Q2013 GDP Breakdown by Industry Group

INDUSTRY GROUP	Weight	Growth Rate	Contribution to growth
Agriculture, Hunting, Forestry, and Fishing	9%	-0.3%	-0.1%
Industry	33%	10.3%	3.3%
Services	58%	7.4%	4.3%
GDP	**100%**		**7.50%**

Source: National Statistical Coordination Board

Slowdown seen in the second half. While we remain optimistic that the government will meet its growth target of 6.0%-7.0% year-on-year for the year, a slowdown in the second half is imminent. The slow down in GDP expansion is a normal occurrence during election years (see Figure II). The government has front-loaded government expenditure during 1H2013, thereby limiting potential any upward surprises in growth moving forward. The inconsistency of growth contribution from investments during the second quarter is a stark contrast with the previous quarter's figure. This indicates that investments could be unstable as a growth driver going forward. Moreover, adverse developments globally continue to pose as a threat to exports. However, this could be partially offset by a weakening peso. Taking into account this slowdown in the second half, we reiterate our full-year growth forecast of 7.0%.

Figure II. Historical Philippine GDP Growth



Source: National Statistical Coordination Board

Remain defensive. Private consumption has been a consistent growth driver, increasing by over 5.0% for the past two and a half years. Sustained growth in remittances, which is supported by a depreciating local currency, has anchored the uptrend in GDP growth. In turn, consumer (SM and URC) and property (ALI and SMPH) sectors are expected to benefit from the increase in consumers' spending capacity. Nevertheless, we maintain our defensive stock picks (TEL and MER) as uncertainties in the global economy could cause a massive withdrawal of funds from emerging market assets overall.

The Philippines has not completely decoupled from other emerging market Asian countries, however, its strong fundamentals will provide the necessary cushion from the negative investor fallout from 'tapering' neurosis and the deterioration in the current account deficit of neighboring economies.

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