kpmg.com.ph





© 2016 R.G. Manabat & Co., a Philippine partnership and a member firm of the KPMG network of independent firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. KPMG International provides no client services. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member firm. All rights reserved

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice and after thoroughly considering the circumstances of a particular situation. The views and opinions expressed herein are those of the authors and interviewees and do not necessarily represent the views and opinions of R.G. Manabat & Co., KPMG International or KPMG member firms.

**2017 Investment Guide** by KPMG in the Philippines

KPMG

R.G. Manabat & Co.

Philippine

Report

#### In this issue:

Changing Consumption and Economic Landscape in the Philippines

Demographics and Urbanization

The Philippines: Asia's New Investment Hub





## R.G. Manabat & Co.

The articles do not purport to give advice on any particular issue or situation but are meant to be a general guide to the reader who should seek the advice herein of qualified professionals on issues specific to his or her situation. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future.

© 2017 R.G. Manabat & Co., a Philippine partnership and a member firm of the KPMG network of independent firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. KPMG International provides no client services. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member firm. All rights reserved.

# Philippine Consumer Market Report

2017 Investment Guide by KPMG in the Philippines

# Contents

Foreword	4
Contributors	6
Developments in Value Added Tax	70
Glossary	73
About the Philippines	74
About KPMG	75
Directory of Partners and Principals	76
Editorial Team	79

## Asia's Rising Star: Taking Stock and Looking Forward 8



## Demographics, Urbanization and the Changing Consumption and Economic Landscape in the Philippines 40



## Consumption Spending andEconomic Growth29



### The Philippines: Asia's New Investment Hub



57



**Roberto G. Manabat** Chairman and CEO KPMG R.G. Manabat & Co.

Foreword

The Philippines has entered a new phase of its narrative with the arrival of its new president. At the start of his term, the new president was quick to present his 10-point economic agenda with a focus on the reduction of government bureaucracy, infrastructure development and human capital investments, while undertaking a careful review of the current tax system and introducing a tax reform program. With these, most Filipinos have remained hopeful and positive about the country's economic growth.

In recent years, the country has grown into one of the strongest economies in Asia. The World Bank indicated that the Philippine economy will continue to lead growth in East Asia economies because of robust domestic consumption, government spending and its improved transparency of building regulations.<sup>1</sup>

With domestic consumption on the rise and Filipino consumer confidence among the highest in emerging markets of the Southeast Asian region according to Nielsen's Q1 2016 Global Consumer Confidence report, the consumer markets sector is considered to be a positive growth story in the Philippines today. The report likewise named the country as one of the four strong member states in the Asia Pacific region along with India, Indonesia and Vietnam, which have seen "increased foreign direct investment combined with strong domestic demand."

On KPMG R.G. Manabat & Co.'s 10th anniversary, we share with you our insights into one of the country's exciting sector - the consumer markets. Fuelled by optimism for its potential high growth, we partnered with the **Institute for Development and Econometric Analysis, Inc.** to explore the Philippines as Asia's rising star in this area. We also look at the demographics, urbanization and the changing consumption landscape affecting the industry. We hope that this guide will provide you with an overview of the consumer markets industry in the country with insightful knowledge for businessmen and investors looking to do business in the Philippines.

<sup>&</sup>lt;sup>1</sup> Doing Business 2017: Equal Opportunity for All. October 2016.



#### About the Institute for Development and Econometric Analysis

The Institute for Development and Econometric Analysis, Inc. (IDEA), based in the UP School of Economics, is a non-stock, non-profit, and non-partisan organization dedicated to high quality economic research, instruction, and communication. It is committed to pursuing independent inquiry into the workings of the economy, propagating the techniques for doing such work, and communicating results of analytic studies to the public. IDEA counts among its network of researchers and fellows the country's top economists, statisticians, allied social scientists, and business practitioners with a proven record of quality economic and statistical analyses; objectivity; and receptivity.

IDEA brings together highly respected people from the government, the academe, the media, and the business community to sit in its Board.

IDEA is also in partnership with various government and private institutions to provide products and services that are timely and useful to the business sector. These institutions include ISI Emerging Markets and the Philippine Statistics Authority. IDEA prides itself with its comprehensive analyses of industry and economic trends, and specialized research projects. Backed by highly competent staff and an up-to-date and extensive database of various economic and financial indicators, IDEA offers and provides products and services to a wide range of clients from the Philippine business scene.



# Contributors



Sharon G. Dayoan



Hadassah May R. Cordero

#### Asia's Rising Star: Taking Stock and Looking Forward

**Sharon G. Dayoan** is the Vice Chairman and Head of Audit of KPMG R.G. Manabat & Co. She has extensive experience in financial audits and handled the audit of several conglomerates in the country, specifically in the sectors of consumer markets, shared services and business process organizations, technology, media and telecommunications. She is a member of the Philippine Institute of Certified Public Accountants (PICPA) and the Philippine Interpretations Committee (PIC). Sharon is also a founding member of the Filipina CEO Circle (FCC), an organization comprised of dynamic and successful Filipina executive directors, top managers and powerhouses based in the Philippines who are committed to inspire and support future women leaders to achieve their career aspirations.

**Hadassah May R. Cordero** is the Research Operations Manager of IDEA. She has previously served as a statistician in a market research company and has since then been involved in industry-related studies commissioned by both government and private corporations. She is one of the authors of the National Youth Assessment Study 2015, a project which was undertaken by IDEA and the National Youth Commission. She graduated from the BS Statistics program of the School of Statistics, UP Diliman and is currently pursuing an MS in Industrial Engineering in the same university.



Darwin P. Virocel



Jose Fernando S. Morales

#### Consumption Spending and Economic Growth

**Darwin P. Virocel** has over 18 years of experience in financial statement audit, risk management, design of internal control system and due diligence reviews of various companies in diverse industries such as mining, energy, oil and gas, manufacturing, service, retail and consumer, technology and business process outsourcing. He is currently the consumer markets sector lead of KPMG R.G. Manabat & Co. He has a broad knowledge and experience in both IFRS and US GAAP audit and review engagements and in the resolution of complex financial reporting and audit issues. He is also an experienced trainer on PFRS/IFRS.

**Jose Fernando S. Morales** is a Research Associate of IDEA. He has an MA in Economics from the School of Economics, UP Diliman. His Master's thesis focused on the intertemporal effects of electricity price changes on manufacturing production in the Philippines. While serving as a teaching fellow for an introductory Economics course in the School of Economics, he also worked part-time as a research assistant under the Energy Policy and Development Program (EPDP), a project supported by USAID.



Michael Arcatomy H. Guarin



Paul Michael M. Paraguya

## Demographics, Urbanization and the Changing Consumption and Economic Landscape in the Philippines

**Michael Arcatomy H. Guarin** is the Head of Deal Advisory group of KPMG R.G. Manabat & Co. Mike has over 14 years of experience in the areas of due diligence (buy side and sell side), mergers and acquisitions (M&A), valuation and audit. He regularly conducts financial due diligence work for potential investors in the areas of logistics, healthcare, BPO and consumer markets. Mike is an accredited KPMG valuations professional with extensive financial due diligence, model review and impaired loan advisory experience. He is also active in M&A and project advisory transactions.

**Paul Michael M. Paraguya** is the Executive Director of IDEA. He served as a Research Assistant of the late Dr. Cayetano W. Paderanga, Jr. from 2013 to 2016 and as a teaching fellow at the School of Economics, UP Diliman from 2013 to 2015. He graduated from the Cebu Institute of Technology with a Bachelor of Science degree in Electronics and Communications Engineering after having finished a vocational degree from the Center for Industrial Technology and Enterprise (CITE Technical Institute). He is currently pursuing his Master's Degree in Economics at the School of Economics, UP Diliman.



Emmanuel P. Bonoan



Bernadette P. Destura

#### The Philippines: Asia's New Investment Hub

**Emmanuel P. Bonoan** is the Vice Chairman and Chief Operating Officer of KPMG R.G. Manabat & Co., the Philippine member firm of KPMG International. He is a former Undersecretary of the Philippine Department of Finance and exercised oversight functions over the Bureau of Internal Revenue and the customs authority. His key accomplishments in government include introducing anti-corruption and anti-tax evasion programs that, to this day, are recognized as effective deterrence mechanisms. For his work, he was awarded in 2004 the prestigious Ten Outstanding Young Men (TOYM) in the category of Public Service. He is a Tax principal who advises both multinational and large domestic companies on various tax issues.

**Bernadette P. Destura** is the statistician of IDEA. She has served as an Administrative Assistant to the technical department of the New Port Project. She is also one of the authors of the National Youth Assessment Study 2015, a project undertaken by IDEA and the National Youth Commission. She graduated with a Bachelor of Science degree in Statistics from the School of Statistics, UP Diliman and is currently pursuing her Master's Degree in Communications.



Sharon G. Dayoan Vice Chairman and Head of Audit KPMG R.G. Manabat & Co.



#### Hadassah May R. Cordero

Research Operations Manager Institute for Development and Econometric Analysis, Inc. (IDEA)

# Asia's Rising Star: Taking Stock and Looking Forward

The Philippines' sustained economic growth in the past five years is a testament to the country's resilience amid challenges in the global economy. The World Bank's country director has dubbed the Philippines as Asia's rising tiger<sup>1</sup> – on her way to becoming at par with the tiger economies of South Korea, Taiwan, Hong Kong, and Singapore.

The employment situation in the country has been improving with the expanding economy. Better employment figures and steady inflow of remittances, as well as low and stable inflation, have supported sustained growth in household consumption. As a result, consumption spending has been the main driver of economic expansion. The past six years also saw renewed investor confidence and the recovery of the manufacturing sector. These have more than offset the headwinds posed by weak trade and a generally challenging external economic environment.

The developments in the real economy have benefited the financial sector, which is supported by an improved fiscal position, a strong external position, and sound monetary policy management by the central bank. The country has shown its resiliency amid external shocks and slowdowns in global activity. However, new challenges appear on the horizon. Public spending in infrastructure needs to improve to drive growth in sectors such as tourism, agriculture and industry. More investments along with the proper implementation of sound policies are needed for the agriculture sector to catch up with the overall economic growth and further drive the industry towards structural change in the economy.

Meanwhile, the new administration has expressed on its 10-point socioeconomic agenda that it will continue the macroeconomic policies that the previous administration has put into place. Thus, the country's economic growth story remains intact. Despite the challenges, there is more than enough reason to be optimistic about Asia's next rising star.

<sup>1</sup> World Bank. (2013) Press statement of Motoo Konishi, Co-Chair Philippines Development Forum. Retrieved from http://www.worldbank.org/en/news/speech/2013/02/06/Press-Statement



#### By the numbers: an economic overview

As measured by the gross domestic product (GDP), the Philippine economy has performed remarkably well on a number of fronts. Despite external headwinds, bouts of fiscal underspending, and a series of natural calamities, the country has consistently grown in the last six years (see Figure 1). The country's real GDP grew by an average of 6.2 percent during the period, one of the fastest in the region and in the country's own history.<sup>2</sup>



Figure 1. Philippine Real GDP

Source: Bangko Sentral ng Pilipinas (BSP)

GDP growth took a dip in 2011 as exports declined due to the global economic slowdown and as the administration of then President Benigno S. Aquino III plugged fiscal leakages and instituted more prudent spending. The economy bounced back in 2012 once external trade picked up and government spending normalized. From then on, economic growth has remained robust on the back of strong domestic demand. Private consumption and investment spending have greatly contributed to the economy in recent years, though government spending has remained erratic. While spending under the Aquino administration was generally restrained, the Aquino government introduced reforms aimed at strengthening public finances and accelerating budget execution.

Amid continued weakness and uncertainty in the global economy, investment inflows in the Philippines experienced remarkable growth in the last six years. From around US\$1 billion in 2010, net foreign direct investments (FDI) doubled to US\$2 billion in 2011 and almost doubled again to US\$3.9 billion in 2013. The country's annual FDI inflow increased to US\$5.74 billion in 2014 but declined in 2015 at US\$5.72 billion. This pick-up in foreign investment mirrors the increased contribution of capital formation to GDP growth and the overhaul in the public perception of the Philippines.

This improved perception of the country is not without basis. The Philippines has shown considerable improvement in various measures of competitiveness and ease of doing business. In the Global Competitiveness Index (GCI) released by the World Economic Forum in September 2016, the country ranked 57th out of 138 countries – a significant improvement from its 2010 rank of 85.<sup>3</sup> Among the GCI's 12 components, the Philippines ranked highest in macroeconomic environment (20th) and market size (31st).

<sup>&</sup>lt;sup>2</sup> Philippine Statistics Authority. (2016). 6.3% Gross Domestic Product growth for the Last Quarter of 2015. Retrieved from http://www.gov.ph/report/gdp/

<sup>&</sup>lt;sup>3</sup> World Economic Forum. Competitiveness Rankings. Retrieved from http://reports.weforum.org/global-competitiveness-report-2015-2016/competitiveness-rankings/

Likewise, the country's rank in the Index of Economic Freedom by the Heritage Foundation went up by 45 notches since 2010, reaching 70th in 2015. According to the report, success was observed in the country's monetary freedom and management of public finance, while improvements are needed to be done on the rule of law and labor freedom.

Sound macroeconomic fundamentals, strong external position, and the country's good debt management are among the factors that contributed to the sustained confidence by credit rating agencies and international financial institutions. As of this writing, country's credit ratings from Fitch, Moody's, and Standard & Poor's remain at investment grade with a stable outlook. Meanwhile, both the Asian Development Bank (ADB) and the World Bank (WB) expect the Philippine economy to grow by at least six percent in 2016 and 2017.<sup>4,5</sup>

Sustained growth in the services and industry sectors has led to better employment statistics in the past years (see Figure 2). In 2015, expansion in the services sector generated 490,000 additional jobs, while job increments reached 109,000 in the industry sector. However, the prolonged El Niño phenomenon that affected several regions triggered a loss of 509,000 jobs in the agriculture sector. Meanwhile, underemployment, although decreasing since 2012, remains practically unchanged from 2010 levels.<sup>6</sup>



Figure 2. Employment Statistics (in percent), Philippines

\*Administrative data from POEA is not yet available for 2015 Source: Bangko Sentral ng Pilipinas (BSP)

<sup>5</sup> World Bank. Philippines sustains strong growth amidst difficult global environment. Retrieved from

<sup>&</sup>lt;sup>4</sup> Asian Development Bank. Philippines: Economy. Retrieved from http://www.adb.org/countries/philippines/economy

http://www.worldbank.org/en/news/press-release/2016/04/11/philippines-sustains-strong-growth-amidst-difficult-global-environment

<sup>&</sup>lt;sup>6</sup> BSP Annual Report 2015. Retrieved from http://www.bsp.gov.ph/downloads/publications/2015/annrep2015.pdf

Robust economic activity has also been accompanied by low inflation. Headline inflation maintained relatively low rates throughout the past years (see Figure 3). The decline in global prices of crude oil and ample food supply in the local market contributed to this favorable environment for consumers. Likewise, core inflation, which excludes food and fuel due to their volatility, exhibited the same trend.

#### Figure 3. Headline Inflation



#### Source: Bangko Sentral ng Pilipinas (BSP)

Low inflation has also been a boon for household consumption driven by remittances from abroad. Steady growth in remittance inflows continues to provide strong support for household consumption as the slower rate in deployment numbers have not yet affected the total amount of remittances (see Figure 5). Falling prices of crude oil and political tensions in the Middle East pose a moderate threat to deployment of Overseas Filipino Worker (OFWs) in that region.

The OFW phenomenon has played a significantly large role in the Philippine economy: by helping relieve unemployment, boosting household incomes and spending, and by stabilizing the country's external





Figure 4. Core Inflation

finances. A sustained credit mechanism to the domestic economy, such as through OFW remittance inflows, is arguably one of the main factors behind the growth in domestic liquidity. Expansion in domestic claims likewise reflects the steady growth in bank lending.

The total resources of both banking and non-banking institutions sustained its growth in 2015 amid uncertainty in the global environment. Bank deposits continue to rise, though at a slower pace of 8.9 percent compared to previous rates of 10.4 percent and 36.2 percent in 2014 and 2013, respectively. Bank lending has been adequately funding the constant expansion of the productive sectors of the economy for the past years.



#### Figure 5. OFW Statistics

Source: Bangko Sentral ng Pilipinas (BSP)

The increase in money supply also reflects the robust growth of the economy (see Figure 6). The rate of expansion of broad money or M3 slowed down to normal in 2014, after enjoying high growth during the second half of 2013. Faster-than-usual rates in 2013 period were attributed to the adjustments done to placements in the central bank's special deposit accounts (SDA). However, despite the slowdown in 2014 due to the completion of adjustments and base effects, M3 continued to grow with an increasing trend, supporting economic expansion.





Source: Bangko Sentral ng Pilipinas (BSP)



The country's sound banking system is crucial to ensure stability and growth in the financial system and to support the funding needs of the economy. The Bangko Sentral ng Pilipinas (BSP) has effectively pursued reforms to develop the different aspects of the banking system. The ratio of non-performing loans (NPL) to total loans has impressively declined because of banks' initiatives to improve their asset quality along with appropriate lending regulations, among other factors. Banks remained adequately capitalized as the industry's capital adequacy ratio (CAR) is well above regulatory standards of 10 percent by the BSP and 8 percent by the Bank for International Settlements. Meanwhile, lower bank lending rates helped support consumption and investment through cheaper loans such as home and auto loans for consumers and business loans for investors.

	2015*	2014	2013	2012
Deposits (PhP Billion)	7,278	6,683	6,053	4,449
Resources (PhP Billion)	12,406	11,546	10,312	8,358
Loans Outstanding - Universal and Commercial Banks (Php Billion, Gross of reverse purchase facility)	5,143	4,527	4,048	3,480
Number of Banking Institutions (Head offices)	635	652	676	696
Gross Non-performing Loan (GNPL) to Total Loans (%)	2.1	2.3	2.8	3.4
Net Non-performing Loan (NNPL) to Total Loans (%)	0.7	0.6	0.6	0.7
Capital Adequacy Ratio (CAR) (%)	16.4	17.0	19.2	18.4

#### Table 1. Selected Banking Statistics<sup>7</sup>

\*Note: 2015 figures are preliminary



#### Figure 7. Total Resources of the Financial System

Source: Bangko Sentral ng Pilipinas (BSP)

<sup>7</sup> BSP Annual Report 2015. Retrieved from http://www.bsp.gov.ph/downloads/publications/2014/annrep2014.pdf





Source: Bangko Sentral ng Pilipinas (BSP)



#### Figure 9. Philippine Stock Exchange index and Market Capitalization

Source: Philippine Stock Exchange (PSE)

As mentioned earlier, the health of the real economy has also supported the expansion of financial markets. Renewed investor confidence in the country's macroeconomic fundamentals facilitated the inflow of investments into the stock market.

The past years saw considerable interest in the Philippine stock market. Moderate growth was recorded in 2011 due to upgrades of the Philippines' sovereign credit rating, good fiscal performance, and within-target inflation figures. In 2012, sustained optimism of investors pushed the index up by 33 percent, with indices from the financial and property sectors leading the rally. Global geopolitical concerns and Typhoon Haiyan's effect on the local economy brought a sharp retreat in the overall and sectoral (except services) indices during the second half of 2013. In particular, mining and oil suffered the most drastic drop due to lower global prices of commodities and precious metals and domestic regulatory roadblocks. The indices were quick to recover in 2014. All sectors recorded higher levels compared to 2013. Continued affirmation of the country's investment grade status and robust local corporate earnings were some of the factors that pushed the stocks indices to increase.

The retreat of global oil prices, however, affected the mining and oil sector indices during the last guarter of 2014. Indices for most sectors continued to grow, albeit slower, in the first quarter of 2015. In the succeeding months of 2015 and until the first quarter of 2016, global concerns such as the slowdown of the Chinese economy, the Greek debt crisis, and the fall in oil prices took its toll on the market along with concerns on the El Niño phenomenon and slower economic growth. However, positive local developments such as the peaceful May 2016 elections and reports of the country's robust GDP growth and strong domestic corporate earnings in the preceding two quarters boost investors' perceptions during the second guarter of 2016. The Philippine Stock Exchange index registered a 9.3 percent guarter-on-guarter growth, while total market capitalization increased by 9.4 percent.

As a result of the market's steady climb in recent years, the price-earnings (P/E) ratio has also gone up. In 2013 and 2014, Philippine stocks were the second most expensive stock in Southeast Asia with a P/E ratio of 17.5 and 20.5, respectively. In 2015, however, the ratio went down to 19.9 as expensiveness of stocks has led to a correction in stock prices.



Figure 10. Price - Earnings Ratio

Source: Bangko Sentral ng Pilipinas (BSP)

Increased investor confidence and robust inflows of foreign funds have also helped keep the local currency relatively stable. The peso fared strongly against the dollar from 2012 to mid-2013. The weakening trend of the peso started in the latter part of 2013 when geo-political and economic issues in the Eurozone and Syria and the U.S. Federal Reserve's unwinding of its quantitative easing (QE) program put the peso at a disadvantage. The peso depreciated by an average of 0.51 percent that year relative to 2012. These concerns, especially the impact of the U.S. Fed's monetary policy path on emerging markets, were sustained in 2014 and brought down the yearly average by 4.4 percent. In 2015, the peso decreased by 2.4 percent compared to the previous year. Among other factors, uncertainty over the Chinese economy and normalization of interest rates in the US caused the depreciation. Sustained concerns over the Chinese economy and declining oil prices caused the peso to depreciate by 6.1 percent year-on-year during the first quarter of 2016. However, the peso appreciated in the second quarter as US inflation and Brexit concerns resulted in fund inflows toward emerging markets. Despite the weakening of the peso, its volatility of 2.4 percent implies that it has enjoyed more stability compared to other currencies in the region since 2014.





Source: Bangko Sentral ng Pilipinas (BSP)

Volatility in foreign capital inflows, weak exports, and slowing remittance inflows have weighed heavily on the balance of payments (BOP) of surplus. Nonetheless, this measure of the country's transactions with the rest of the world has remained largely positive. A declining trend in the BOP surplus was observed from 2011 to 2013.

In 2011, lower surplus was primarily caused by a slowdown in capital inflows and contraction in export of goods. The deficit in merchandise trade narrowed in 2012 but was more than offset by increased net liabilities that brought the surplus even lower than the previous year. Growth in the BOP surplus in 2013 was tempered by net outflows in other investments. In 2014, the BOP posted a deficit as continued increase in net outflows of investments in the financial account balanced out the continued improvement in the current account surplus. However, the reversal of the direct and other investment accounts to net inflows proved substantial to bring a surplus of US\$2.6 billion in 2015 amid wider trade-in-goods deficit and the decline in capital transfers to the government.





Source: Bangko Sentral ng Pilipinas (BSP)

Along with a BOP surplus, the country's high gross international reserves (GIR) is another indicator of the economy's ability to weather external economic headwinds. The GIR ended 2015 with a figure that is sufficient to cover imports of goods and payments of services and income for 10.3 months. The BSP requires a minimum level of GIR to finance at least three months' worth of the country's imports of goods and payments.

In 2014, the national government's deposits in net foreign currency and payments for its maturing foreign exchange obligations caused a slight decline in international reserves. In 2015, however, the country posted an end-2015 GIR of US\$80.7 billion, equivalent to a 1.4 percent increase from 2014, due to the government's net foreign currency deposits and the BSP's foreign exchange operations and income from investments abroad.

Ample international reserves served as a shield against external shocks. Among the Association of Southeast Asian (ASEAN) countries and big emerging economies such as China and India, the Philippines ranks third in the number of months its GIR can cover imports of goods.<sup>8</sup>

The country's resilient fiscal sector also helps insulate financial markets from external volatility. High reserves and low debt ratios lower the probability that the local economy will be affected by volatility in financial markets or reversal of capital flows. From 36.9 percent in 2010, the country's external debt to GDP ratio continually improved to 26.5 percent in 2015. Likewise, as seen in the decline of the debt service ratio, the country has adequate foreign exchange earnings to meet maturing obligations. The ratio went down to 5.3 percent in 2015 from 9.9 percent in 2010.

<sup>&</sup>lt;sup>8</sup> Selected Economic Indicators for Asian Countries. Retrieved from http://www.bsp.gov.ph/statistics/spei\_new/tab48\_sas.htm

Figure 13. International Reserves



Source: Bangko Sentral ng Pilipinas (BSP)



Figure 14. Import Coverage of International Reserves

Source: Bangko Sentral ng Pilipinas (BSP)





Source: Bangko Sentral ng Pilipinas (BSP)

Likewise, the decreasing share of expenditure allocated to interest payments reflect the national government's renewed effort in managing its liabilities and promoting the sustainability of its debt portfolio. Reduced spending for interest payments has freed fiscal space for government spending in other productive sectors.



Figure 16. Interest Payments

Source: Bangko Sentral ng Pilipinas (BSP)

On the revenue side, efforts of the government in tax administration and enforcement reforms have proved fruitful as the past six years recorded increasing revenues. This, along with a rise in non-tax revenues, lowered the deficit to 0.9 percent of the GDP in 2015 from 3.5 percent in 2010.





Source: Bangko Sentral ng Pilipinas (BSP)

#### Growth drivers and trends

On the demand side, remittances have long been a driver of consumption and of the economy's growth. On the supply side, the predominant services sector is supported by the information technology-business process outsourcing (IT-BPO), finance, real estate, and tourism industries. In recent years, however, the country has seen new opportunities for economic growth in an upsurge in investment and in the resurgence of the manufacturing industry. These and the advantages brought by trends in demographics and urbanization provide new stabilizers for the country's economy amid possible external shocks and global economic uncertainty.

٩

#### The pillars of remittances and

outsourcing. The Philippines is the world's third largest recipient of remittances from its citizens working overseas.<sup>9</sup> Remittances continue to be a driver of the country's consumption-driven growth and a "natural buffer" against volatility in the global economy despite declining growth rates since 2013. Remittances contributed US\$25.77 billion in 2015, corresponding to nearly 10 percent of the economy. During the first four months of 2016, cash remittances reached US\$8.67 billion, a 3.1 percent growth from last year's same period. The steady deployment of overseas workers is the key driver to the sustained growth in remittance inflows amid lower oil prices and political instability in some regions.

The BSP, however, is projecting a tempered 4-percent growth in remittances this 2016 because of concerns on weaker global commodity demand and slower global growth prospects. The BSP, through its Financial Learning Campaign (FLC), is continuously promoting to OFWs and their beneficiaries the importance of utilizing remittances to build savings and engage in productive investments.



#### Figure 18. Breakdown and Growth of Remittances

<sup>9</sup> Remittances to Developing Countries Edge Up Slightly in 2015. Retrieved from

http://www.worldbank.org/en/news/press-release/2016/04/13/remittances-to-developing-countries-edge-up-slightly-in-2015

Another steadily-rising sector that is set to rival OFW remittances in terms of contribution to the economy is the IT-BPO industry. The industry continues to be one of the most robust in the country as it earned US\$22 billion in revenues and directly employed 1.1 million in 2015.<sup>10</sup> Industry leaders project that by end of 2016, the sector's revenues will contribute 8 percent to the total GDP and will overtake OFW remittances by 2017.<sup>11</sup> Healthcare outsourcing, finance and accounting, software development and legal outsourcing are the fastest growing sectors in the industry.

There is a challenge in meeting the increasing demand for employment, however, as talent supply narrows. The IT & Business Process Association of the Philippines' (IBPAP) executive director for talent development pointed out that one of the significant limitations to the industry's growth is the adequate supply of globally competent talent.<sup>12</sup>





Source: Bangko Sentral ng Pilipinas (BSP)



<sup>10</sup> Department of Foreign Affairs. PhI Economic Sustainability, Investment Opportunities Highlighted In Private Sector-Led Investment Roadshow In Pittsburgh. Retrieved from

http://www.dfa.gov.ph/index.php/newsroom/phl-embassies-and-consulates-news/7629-phl-economic-sustainability-investment-opportunities-highlighted-in-private -sector-led-investment-roadshow-in-pittsburgh

<sup>11</sup> Domingo, R. (2015, August 5). BPO revenues seen to overtake remittances. Inquirer.net. Retrieved from

http://business.inquirer.net/196465/bpo-revenues-seen-to-overtake-remittances

<sup>12</sup> Santos, Mari-An C. (2015). IBPAP Boosts Talent Development Initiatives. Breakthroughs, 9.

http://www.ibpap.org/publications-and-press-statements/breakthroughs#





*Favorable demographic trends.* The country's young, growing population provides a stable base for economic growth as it indicates a big pool of trainable workers. Moreover, the total dependency ratio is projected to continue falling over the next three decades, freeing up resources at the

government and household levels for greater savings and investments.

Given a total population of around 100 million at present and steadily rising incomes, the country's demographics favor the expansion of the economy and greater consumption. In 2012, the country's middle class comprised about 3.6 million households, with a share of 32.2 percent of total household income in the country. However, the relative size of the middle class to all households has not significantly changed across the years. From 16.2 percent in 2006, the figure went down to 15.8 percent in 2009, but recovered to 16.7 percent in 2012.<sup>13</sup> The country's middle class is expected to create employment as business start-ups and boost investment and production as consumers. Unleashing investments. Before 2010, the country suffered from political upheaval and a crisis in the legitimacy of its leadership in the wake of allegations of widespread electoral fraud and high-level corruption. The entry of a new administration with a clear and

popular mandate to clean up the government marked a turn-around in the country's economic fortunes.

By 2013, the annual FDI inflow surged to almost US\$4 billion from an average of around US\$2 billion in previous years. This continued to grow to US\$5.7 billion in both 2014 and 2015. Mirroring the actual FDI inflows, a total of US\$5.4 billion worth of FDI pledges were recorded in 2015 from the country's seven investment promotion agencies.<sup>14</sup> The figure is a 31.2-percent increase from 2014's US\$4.2billion worth of pledges.<sup>15</sup> Although pledges are not counted as actual financial inflows, the rise in figure reflects growing confidence of investors. Approved investment projects, if concretized, are expected to generate an estimate of 38,906 jobs.<sup>16</sup>

<sup>13</sup> Albert, J. G., Gaspar, R. E., & Raymundo, M. M. (2015) Why we should pay attention to the middle class. Policy Notes, 13. Retrieved from http://dirp3.pids.gov.ph/webportal/CDN/PUBLICATIONS/pidspn1513.pdf

 $^{14}\,\textsc{Based}$  on Php 45.5 to 1 US\$ average exchange rate in 2015 (BSP)

 $^{15}\,\textsc{Based}$  on Php 44.4 to 1 US\$ average exchange rate in 2014 (BSP)

<sup>16</sup> Philippine Statistics Authority. Approved Foreign Investments in the Philippines Fourth Quarter 2015. (2016). Retrieved from https://psa.gov.ph/sites/default/files/6.%20Q4%202015%20FI%20Report\_FINAL%20(2)%20(1).docx.

In line with these positive developments, the contribution of investment or capital formation to the total economy has also steadily increased during the past six years. Strong capital formation has been a steady source of growth since 2013 when the sector's acceleration for that year was fueled by double-digit growths in intellectual property products, durable equipment, and construction. In 2015, increased investments in public construction and durable equipment pushed the 14-percent expansion of fixed capital formation.

The government's successful efforts at fiscal consolidation has also allowed for greater investment in public infrastructure. Allocation for public infrastructure spending as a percent of GDP has gone up from a measly 1.8 percent in 2010, to a mediocre 4.3 percent in 2015, and eventually to a better 5.2 percent in 2016. This has been complemented by a renewed push for public-private partnership projects (PPPs) in infrastructure development.





Source: Bangko Sentral ng Pilipinas (BSP)



*Increasing industrial output.* A shift to a more investment-driven economy is necessary for diversifying sources of growth, plugging gaps in infrastructure, and increasing industrial production. Industry, and manufacturing in particular, have been one of the beneficiaries of rising

investments in the country. Indeed, there are indications of a nascent structural change in the economy. On the demand side, this is seen in the increasing contribution of investment aside from consumption. On the supply side, this is reflected in the growth of industry aside from services.

The industrial sector and the manufacturing subsector have both sustained positive growth since 2010 until 2015. The government is also pushing for greater industrial development through the creation of industry roadmaps under the Manufacturing Industry Road Map and the Comprehensive National Industrial Strategy. Related to these is the Manufacturing Resurgence Program that seeks to build and upgrade production capacities in key industries.

Figures from the April 2016 release of Monthly Integrated Survey of Selected Industries (MISSI) show the increase in indices of both volume and value of production from last year's same period.<sup>17</sup> Higher growth rate in the Volume of Production Index (VoPI) compared to the Value of Production Index (VaPI) indicate solid demand for manufactured goods, especially for food and furniture and fixtures products. Chemical products, which comprise 16 percent of the manufacturing sector, registered triple-digit growth in indices in January 2016. However, the sector contracted the next month pulling along with it the overall indices. Election-related expenditures and steady domestic consumption are expected to fuel the manufacturing sector's growth in 2016.

<sup>&</sup>lt;sup>17</sup> Philippine Statistics Authority. Monthly Integrated Survey of Selected Industries: February 2016. (2016). Retrieved from https://www.psa.gov.ph/statistics/survey/monthly-integrated-selected-industry.





Source: Philippine Statistics Authority (PSA)

#### Prospects for the Philippines

IDEA forecasts indicate that the economy will expand by 7.0 percent in 2016 due to an extra boost from election-related spending, robust consumption spending, and impressive investment spending. The higher government budget will allow an even brighter prospect as growth expands to 7.5 percent in 2017 due to a heavy public spending, investments, and infrastructure development fueling the construction sector. In the medium-term, there is reason to believe that the uptick in trend growth in the past years will be sustained going into the future. The ability of the new administration to build on and amplify the gains achieved in the last six years will determine whether the country will see a breakout of much more rapid and sustained growth in the long-term. In the short-term, the country will benefit from the fading effects of the El Niño-La Niña weather phenomenon and the investments funneled into the economy thus far. Moreover, investment commitments notably in power generation and transport infrastructure will start to materialize by 2017, thus, supporting continued expansion in the short- to medium-term. Among production sectors, both industry and services will lead the way with growth averaging 7.2 percent in 2016 to 2017. Meanwhile, household consumption will continue as a major growth driver with its stable expansion rate until 2017.



Figure 22. GDP, Supply Side

Source: Bangko Sentral ng Pilipinas (BSP), IDEA Staff Calculations



Figure 23. GDP, Demand Side

Source: Bangko Sentral ng Pilipinas (BSP), IDEA Staff Calculations

#### Upside Risks



*Lower oil prices.* Average inflation in 2015 eased to 1.4 percent, well-below the government target range of 3.0 percent  $\pm$  1.0 percentage point. Among other factors, the sustained decline in international crude oil prices dampened inflationary pressures. The downtrend in global oil

prices caused the downward adjustments in electricity rates thus lowering inflation for housing, water, transport, and electricity, gas, and other fuels. Moreover, decline in oil prices could lessen production costs of firms as well as boost household real income. These in turn would result to higher returns on investment for industries and bigger funds for household expenditure. According to BSP's inflation report for the first quarter of 2016, international oil prices are expected to remain below 2015 levels based on forecasts by multilateral agencies. However, uncertainty looms in the forecasts for oil prices as current environment of ample supply amid sluggish demand may be outweighed by the agreement between several Organization of the Petroleum Exporting Countries (OPEC) and major non-OPEC producers, such as Russia, to freeze production levels.



Sunshine industries. Aerospace, shipbuilding, and automotive are the promising industries under the manufacturing sector. Total export revenues from aerospace products has steadily increased since 2008, reaching US\$309 million by the third quarter of 2015. The Aerospace

Industries Association of the Philippines (AIAP) expects stronger growth in 2016 due to developments in the global market, and expansion of the supply chain. Likewise, data from their industry roadmap shows projected total revenue of US\$10.3 billion from 2013 to 2022.<sup>18</sup>

The Philippines is the fourth largest shipbuilder in the world, next to South Korea, China, and Japan, according to the Department of Trade and Industry (DTI). Competitive advantage of the local industry lies on readily available skilled workers, available areas to set up shipyards, and liberalized imports of raw materials. The approval of the Republic Act 10698 or the Naval Architecture Law in November 2015 paves the way for a more globally competitive and modernized shipbuilding industry. Meanwhile, fiscal incentives for small- and medium-sized domestic shipbuilders are expected to encourage more vessel production in the country. This is to fuel the expansion of the industry and to push the Philippines to top the global shipbuilding market.<sup>19</sup>

The Comprehensive Automotive Resurgence Strategy (CARS) program has been at the center of the manufacturing industry that has grown 8.1 percent over the last five years. Automotive has one of the highest multiplier or spillover effects among industries. The complexity of the manufacturing process in the industry provides strong forward and backward linkages to other manufacturing and services sectors. Under the CARS program, the government aims to strengthen the domestic automotive market base to build the necessary scale that would bring down costs. The industry's goal is to be able to compete with Thailand and Indonesia in the production and export of motor vehicles.

The local tourism industry accounts for 8.5 percent of the gross domestic product (GDP). In 2015, 5.3 million tourist

arrivals were recorded and revenues amounted to about US\$6 billion.<sup>20</sup> Among other factors, the Department of Tourism (DOT) expects greater air connectivity, expanding capacity and the agency's continued aggressive marketing and promotions campaign to be the drivers for a sustained growth in number of tourists. Meanwhile, to encourage investment in the sector, the DOT and the Department of Public Works and Highways (DPWH) will undertake US\$527.5<sup>21</sup> worth of projects for access roads to major tourism destinations in 2016.<sup>22</sup>



*Investment Climate.* The lack of hard infrastructure has been a limiting factor for investments in industries such as tourism and manufacturing. Tourism is a major driver of inclusive growth since it directly gives employment opportunities to the poor in rural areas. The Tourism

Infrastructure Enterprise Zone Authority (TIEZA) is being urged to hasten the pace of road and other accessibility points to major and developing tourist destinations to encourage investors and tourists. The new administration, through the Department of Budget and Management (DBM), has promised to bring the country to the "Golden Age of Philippine construction" in the next six years. DBM Secretary Benjamin Diokno said that infrastructure spending would be equivalent to five to seven percent of the GDP; however, Diokno added that it would still take 10 years of "continuous buildup" of projects to close the infrastructure gap.<sup>23</sup>

In addition to upgrading the country's infrastructure, DTI has also eased some trade restrictions and regulatory requirements to boost FDIs. Ramon M. Lopez, secretary of the DTI, said that the government is aiming for the country to be one of the top three destinations for FDI inflows in Southeast Asia by 2022.<sup>24</sup> Some of the reforms being done by the agency involve updating the Foreign Investment Negative List (FINL) and the review of corporate and personal tax rates.

<sup>21</sup> Based on Php 45.5 to 1 US\$ average exchange rate in 2015 (BSP)

<sup>&</sup>lt;sup>18</sup> Board of Investments. Aerospace. Retrieved from http://industry.gov.ph/industry/aerospace/

<sup>&</sup>lt;sup>19</sup> Board of Investments. Shipbuiding. Retrieved from http://investphilippines.gov.ph/industries/manufacturing/shipbuilding/

<sup>&</sup>lt;sup>20</sup> Miraflor, M. B. (2016, March 18). Tourist arrivals for this year seen exceeding 6 million. Manila Bulletin. Retrieved from

http://www.mb.com.ph/tourist-arrivals-for-this-year-seen-exceeding-6-million/

 <sup>&</sup>lt;sup>22</sup> Road projects complement tourism program. (2015, August 20). Retrieved from http://www.gov.ph/2015/08/20/road-projects-complement-tourism-program/
<sup>23</sup> Caraballo, M. (2016, July 20). Construction to see 'Golden Age' under Duterte. The Manila Times. Retrieved from

http://www.manilatimes.net/construction-to-see-golden-age-under-duterte/274980/

<sup>&</sup>lt;sup>24</sup> Oxford Business Group (2016, August 5). Philippines in bid to boost FDI. BusinessWorld. Retrieved from

http://www.bworldonline.com/content.php?section=Economy&title=philippines-in-bid-to-boost-fdi&id=131466

#### **Downside Risks**



External demand. The sluggish growth performance of Japan and China, the Philippines' top export markets, continue to weigh down on the country's export performance. Merchandise exports data from the Philippine Statistics Authority showed a decline of 5.6 percent in 2015 and 4.5 percent in February of 2016. However, despite the decline in outbound sales of most manufactured goods, the value of

exports for electronic products, which comprise around 50 percent of total merchandise exports, is on its ninth consecutive month of expansion.<sup>25</sup> In a statement in February of 2015, the DTI said that it is positive that the country's export will get back on track in 2016, amid sustained weakness in overall global demand, as the waning effects of El Niño will be felt and the robust exports of services sector continue to register growth.<sup>26</sup> Likewise, the government has laid out the Philippine Export Development Plan (PEDP) 2015-2017 to aid the export sector. Under the PEDP, strategies to maintain the country's market share, to tap new markets and to upgrade the quality of products will take place.



*Remittance arowth moderation.* The steady inflow of remittances continues to provide the country strong support for household consumption. However, a slower expansion rate of 4.6 percent was recorded in 2015 amid conflict in the Middle East and regulatory changes in remittance centers in the US. The BSP projects remittances to grow at a lower rate of 4 percent in 2016 as oil-exporting

countries affected by the downturn of oil prices may decrease their demand for foreign workers.



Inclusive growth. The agriculture sector continues to lag behind despite growth in overall economy, arowing only by 0.2 percent in 2015 and 1.6 percent from 2011-2015.27 There is an urgent need for the government to strengthen its support to uplift the sector's competitiveness. The Department of Agriculture (DA) cited that the government has increased its support in terms of agricultural

research and development, however, the challenge lies primarily on strengthening regulations to eliminate smuggling and to lower the cost of doing business in the sector. Likewise, guality infrastructure is crucial to help lower production costs and improve product quality.<sup>28</sup>

http://www.philstar.com/business/2016/02/02/1548629/da-seeks-more-government-support-agriculturedevelopment



<sup>&</sup>lt;sup>25</sup> Philippine Statistics Authority. (2016). Foreign Trade. Retrieved from https://psa.gov.ph/business/foreign-trade

<sup>&</sup>lt;sup>26</sup> Magkilat, B. (2016, February 16). Exports back on growth track in 2016. Manila Bulletin. Retrieved from http://www.mb.com.ph/exports-back-on-growth-track-in-2016/#20MaLcsa5kjOWYqi.99

<sup>&</sup>lt;sup>27</sup> Philippine Statistics Authority. (2016). National Accounts. Retrieved from

https://psa.gov.ph/nap-press-release

<sup>&</sup>lt;sup>28</sup> Simeon, L. M. (2016, February 2). DA seeks more government support for agriculture development. PhilStar. Retrieved from



# Consumption Spending and Economic Growth

The remarkable turnaround in the Philippines' economic fortunes in recent times has led to increased optimism in its prospects by both local and foreign observers. Steady economic expansion, with GDP growth outpacing population growth, has led to rising household incomes. If current growth rates are sustained in the medium-term, this would mean a doubling in average incomes. Robust economic growth in the long-term would even make it possible for the country to lick poverty within a generation, according to the World Bank<sup>1</sup>.

With its macroeconomic fundamentals better than ever, the consumption-driven economy is chugging along largely on twin engines of overseas remittance inflows and the billion-dollar sunshine industries of information technology (IT) and business process outsourcing (BPO).

## Incomes are rising with economic expansion

The Philippine economy has grown steadily in the past few decades, outpacing population growth for much of the period. Though poverty has persisted, sustained economic expansion has led to rising household incomes. Between 1960 and 2015, average income has grown by a factor of 11: income per capita has grown from US\$254.4 in 1960 to US\$2,870.5 in 2014. This translates to an increased standard of living for many Filipinos, with more people now earning enough to spend on an ever-increasing variety of goods and services ranging from smartphones and movies to automobiles and housing. The relationship between economic growth and average income is universal - for as long as the economy keeps growing faster than the population. average incomes will rise over time.

## Projected growth in GDP and per capita incomes

As the standard metric of a country's economic output or income, gross domestic product or GDP measures the market value of the total production or earnings in goods and services from all sectors of the economy. In current prices, the size of the Philippine economy as measured by GDP was estimated at US\$171.5million as of 2015 from data published by the Philippine Statistics Authority (PSA). During the same year, the country's GDP grew by 5.9 percent largely due to the rapid expansion of the services sector and a nascent resurgence in manufacturing.

In recent years, the Philippines has shed its moniker as the "sick man of Asia" to become one of the fastest growing economies in the region. We estimate the country's GDP to grow by around 7.3 percent in the next two years: 7.0 percent in 2016 and 7.5 percent in 2017. This is relatively more optimistic than theforecasts of multilateral development institutions such as the World Bank (WB) which expects 2016 growth to surpass the 6.0 percent mark, and the International Monetary Fund (IMF), which sees 2016 grow at 6.0 percent.<sup>2,3</sup>.

The consensus in terms of the outlook on the domestic economy is that strong private consumption will continue to drive growth in the medium-term at the very least. Consumption spending fuels demand, which in turn spurs production and therefore rising incomes. This virtuous cycle has been a main driver of the country's economic performance over the years (see Figure 1).



Darwin P. Virocel Audit Partner KPMG R.G. Manabat & Co.



#### Jose Fernando S. Morales

Research Associate Institute for Development and Econometric Analysis, Inc. (IDEA)

<sup>&</sup>lt;sup>1</sup> World Bank: PH can end poverty in a generation, Chris Schnabel, Rappler

<sup>&</sup>lt;sup>2</sup> East Asia Pacific Economic Update, April 2016: Growing Challenges, World Bank

<sup>&</sup>lt;sup>3</sup> World Economic Outlook, April 2016: Too Slow for Too Long, International Monetary Fund

Figure 1. Philippine Historical GDP Growth



Source: Philippine Statistics Authority (PSA)

GDP is a good measure of the income of the whole economy, but it does not give any clue as to its distribution among the populace. When focusing on the consumption patterns of the Philippine population, one must first examine the income of the individual. One measure of income that proves useful is per capita GDP. This metric gives a rough estimate of the purchasing power of an individual, and is calculated by dividing the total GDP of the economy by the total population. It provides an average value for an individual's income. In 2015, per capita GDP was estimated to be US\$2,835.56, with quarterly per capita GDP at US\$662.85, US\$720.07, US\$670.90, and US\$779.21.

Historically, per capita GDP has been accelerating: it grew by an average of 2.08 percent in the 1980s, 4.88 percent in the 1990s, 5.72 percent in the 2000s, and most recently, at a rate of 9.28 percent from 2010 to 2014. The National Economic Development Authority (NEDA) estimates GDP per capita to more than double from US\$2,843 in 2014 to US\$5,740 in 2028. Although per capita GDP has its flaws – as it assumes income is evenly distributed in the economy – it still proves useful by juxtaposing national income with a growing population. The historical growth of per capita GDP is compared with NEDA's projections in the graph below (Figure 2).



Figure 2. Trends in Average Incomes

Source: World Bank, NEDA

The aforementioned measures of income reveal an optimistic picture of the economy: GDP continues its robust expansion while per capita GDP growth is accelerating. This increase in national and individual incomes will have profound effects on consumption.

The Philippines can be described as a consumption-driven economy – private consumption accounts for 73.7 percent of GDP by expenditure group in 2015.<sup>4</sup> In 2015, growth in household consumption spending outpaced GDP with a rate of 6.2 percent. All of these point to a stable and growing source of demand for domestic production. Growing demand for outputs also spurs demand for productive inputs such as land, labor, and capital. For example, demand for services of the IT-BPO industry has propped up salaries for its workers. This, in turn, will beef-up consumption.

#### Sources of income growth

Income growth is the main factor behind the growth in consumption. But what are the key drivers behind its expansion?

On the demand side, remittances from overseas Filipino workers (OFWs) have played a major role in the changes seen in the domestic economy in the last few decades.

On the supply side, rapid growth in the services sector has transformed the Philippines into a predominantly service-based economy. Among the services sub-sectors, long-time leaders include real estate, finance, trade, and telecommunications. A fast-emerging and high-potential sub-sector is tourism. But the business process outsourcing (BPO) services industry has emerged as a major source of employment and dollar-earner that is catching up with OFW remittances in terms of contribution to the economy.



*Remittances.* Money sent home from abroad by OFWs has become a large and steady source of income for households in the Philippines. A study by the Asian Development Bank (ADB)<sup>5</sup> has pointed out that remittances allow households to spend more on non-essential goods and

services. In particular, remittance-receiving households spend less on food as a proportion of income and spend more on clothing, communication, transportation and leisure. This is consistent with the direct income effect of remittances and the fact that as income increases, spending on necessities as a proportion of income decreases.

The growth in remittance inflows, however, has slowed partly due to sluggish economic activity in international markets. Remittances grew by 4.5 percent to US\$25.8 billion in 2015, representing roughly 10 percent of GDP. This rate of growth, however, is significantly lower than the average growth of 7.3 percent in the preceding four years (2011-2014) based on data from the Bangko Sentral ng Pilipinas (BSP).

The graph below displays the historical performance of remittances. Despite the slowdown, remittances will continue to be a major pillar of the economy in the mediumto long-term. The deceleration in remittance growth, however, ultimately means that the Philippine economy will have to find other sources of strength in terms of absorbing excess labor, augmenting household incomes, and providing foreign exchange earnings, among others.



#### Figure 3. Historical Remittance Inflows

Source: Bangko Sentral ng Pilipinas (BSP)

<sup>4</sup> National Accounts data, PSA

<sup>&</sup>lt;sup>5</sup> Remittances and Household Behavior in the Philippines. et. al. ADB Economics Working Paper Series. 2009







*Business Process Outsourcing.* Fortunately for the Philippine economy, a new source of growth has emerged in the last decade that is set to match and potentially eclipse the contribution of remittances. The outsourcing industry is an offshoot of global trends in business operations enabled by the development of information technology and the Philippines has become one of its major players. BPOs largely service foreign clients, in the process creating

domestic employment and earning foreign exchange for the country.

While remittance growth has slowed, the outlook from the IT-BPO industry sector remains upbeat. In terms of dollar earnings, the BPO industry is fast catching up with remittances. Despite the slowdown in global demand, the IT and Business Process Association of the Philippines (IT-BPAP) is expecting industry revenues to expand by 14.0 percent in 2016. In 2014, industry revenues reached US\$18.9 billion, and further expanded to US\$22 billion in 2015.

This growth is reflected in worker earnings in the industry. IT-BPO workers command some of the highest salaries for all position levels compared to other industries, according to the National Salary Report by online employment portal JobStreet. The expansion of this industry provides a local source of jobs for the Philippines' large, young and growing population. In 2014, the IT-BPO industry provided jobs for over a million employees. Estimated employment was at 1.1 million in 2015.

Unlike remittances, the development of local industries such as IT-BPO also increases domestic economic activity apart from raising incomes and consumption spending. Some have observed the emergence of a new consumer segment in the form of IT-BPO workers who now have greater spending power and particular consumer needs and preferences. Aside from indirect economic effects through the employment aspect, the IT-BPO industry also supports growth in other industries such as real estate and renting, utilities, communication, and other services. This is seen in the input contributions of other industries to call center activities, which is the major subsector of the IT-BPO industry (Table 1).

#### Table 1. Top Input Sources for Call Center Activities

Industry	Contribution
Banking institutions	7.78%
Real estate activities	5.17%
Generation, collection and distribution of electricity	3.45%
Radio and television activities	2.34%
Telecommunication services, n.e.c	2.10%

Source: Input - Output tables, Philippine Statistics Authority

Contribution in Table 1 measures an industry's inputs as a percentage of the recipient industry's total inputs. For example, a coefficient of 7.78 percent for real estate activities means that the inputs from the industry account for 7.78 percent of the value of total inputs for call center activities. This provides us with a picture on the linkages of different industries with the BPO sector – specifically call centers. The anticipated high growth of the IT-BPO industry will provide a growing source of demand for other industries such as the ones mentioned above.

## Consumption behavior is changing as income grows



#### A profile of the Filipino consumer

The positive prospects of the Philippines for economic growth and the rise in per capita incomes will have implications on consumption. Naturally, the two are positively related in that those who earn more have greater spending power.

One of the peculiarities of the Filipino consumer is that lower-income households tend to buy products that are smaller in volume or mass even if these turn out to be more expensive than larger packages in terms of unit costs. This is best seen in shampoos which are sold in sachets instead of in bottles and are very popular with consumers.

Aside from the convenience of smaller product packages, this sachet culture may be attributed to low incomes of Filipino consumers in general. Many consumers cannot afford to buy in bulk even if these are more cost-effective on a per unit basis because the one-time costs are simply beyond their spending budgets. But sustained income growth that significantly increases the incomes at the bottom of the population has the potential to alter this dynamic in consumer markets. It goes without saying that the behavior of consumers will differ according to their income levels.

Using data from the 2014 Annual Poverty Indicators Survey, we can extract data on consumers according to their incomes by population deciles. This is done by dividing the range of income data into ten equally-sized parts, so the first income decile would include the lowest 10 percent earners, while the tenth income decile would include the highest 10 percent earners. The average income and total expenditures in US\$ per decile is shown in Table 2. Note that total expenditure in this case comprises expenditures on food, clothing, furnishing, health, recreation, education, housing and water, transport, communication, miscellaneous, and other expenditures.

#### Table 2. Income Distribution by Deciles, in US\$

Income Decile	Income	Spending
1	507.55	530.94
2	824.10	817.60
3	1,063.75	1,036.42
4	1,294.63	1,218.61
5	1,568.09	1,448.49
6	1,927.16	1,711.78
7	2,425.36	2,139.00
8	3,197.41	2,717.55
9	4,498.37	3,732.44
10	9,588.37	6,806.75

Source: Annual Poverty Indicators Survey, Philippine Statistics Authority

The data shows that the average expenditure of the households in the highest (10th) income decile is more than 12 times greater than those in the lowest (1st) income decile. This is intuitive, since those who earn more have greater command on goods and services with their purchasing power. Note that households spend more than they earn in the lower income levels, and the gap between income and spending increases as you go from the 1st to 10th income decile. The changes in household expenditures across incomes are illustrated in Figure 4.

<sup>&</sup>lt;sup>7</sup> BSP Annual Report 2015. Retrieved from http://www.bsp.gov.ph/downloads/publications/2014/annrep2014.pdf

Figure 4. Expenditure by Income Group, in US\$



Source: 2014 Annual Poverty Indicators Survey, Philippine Statistics Authority

Note that the increased expenditures start to pick up markedly at the eighth decile or when incomes breach the US\$3,000 mark and sharply accelerates even further at the ninth decile or at the US\$4,500 average income level. This is consistent with international evidence showing a marked increase in consumption especially in higher-value goods such as motor vehicles when a country achieves average incomes between US\$2,500 to US\$10,000. Philippine GDP per capita already breached the US\$2,500 threshold a few years back and is now approaching the US\$3,000 level. The changes in consumption patterns are already evident in increasing motorization, not just in terms of cars but even more so for motorcycles. For many Filipino households, however, incomes remain low at less than US\$2,500 in the first to seventh deciles.

The composition of consumption expenditures for households differs with income levels. Expenditures on food account for 63.8 percent of total expenditures for the first decile earners, while it only makes up for 30.1 percent of total expenditures for tenth decile earners. The following graph (Figure 5) illustrates the change in the proportion of expenditures on food relative to total consumption.



#### Figure 5. Food and Total Expenditures, in US\$

Source: Annual Poverty Indicators Survey, Philippine Statistics Authority

As a basic necessity, food expenditure is also more or less invariable relative to income. Hence, annual food expenditures do not breach the US\$2,252-level for all income deciles. The proportion of expenditures that goes to food decreases with higher incomes because more money is available to spend on other goods and services such as education or recreation. The exception in this case would be expenditures on housing, which stay relatively stable at an average of 18.6 percent across all income deciles. Figure 6 below illustrates the shares of 'essential' expenditure groups across income deciles.



Figure 6. Essential Expenditures, in US\$

Source of basic data: Annual Poverty Indicators Survey, Philippine Statistics Authority

Figure 7. Non-Essential Expenditures, in US\$



Source of basic data: Annual Poverty Indicators Survey, Philippine Statistics Authority

Figure 7 compares shares of 'non-essential' expenditure groups across income deciles. Note how consumption on non-essential items, particularly other expenditures, increase rapidly after a certain income level. As pointed out earlier, the eighth income decile seems to be the threshold wherein further increases in income result in large increases in spending.
## Economic prosperity leads to changes in consumption



According to a report by the McKinsey Global Institute, the top three ways to achieve global prosperity is to capture a greater share of global trade flows, ride the urbanization wave and deploy disruptive technologies.<sup>6</sup> As the Philippines continues its economic progress and the purchasing power of Filipino households rise, retail industry players must be able to craft their strategies around these three areas to support as well as to capitalize on the economic rise of the Philippines.

Given the integration of the ASEAN region, the Philippines can enhance its advantages by continuing greater

economic cooperation and expanding free-trade arrangements with other countries. This includes trade in services that will potentially involve the retail sector. Already, retail segments in the Philippine market such as convenience stores have seen the entry of Asian players like Family Mart and Lawson from Japan, and Alfamart from Indonesia. For wearing and apparel, foreign brands such as Uniqlo and H&M are the more recent entrants. Interest by international brands in the Philippine market will only heighten as domestic incomes increase and advances in economic openness and integration are achieved.



<sup>6</sup> Three paths to sustained economic growth in Southeast Asia. J.Woetzel, O.Tonby, F.Thompson, P.Burtt, and G. Lee. McKinsey Global Institute. November 2014

As for the rise of urbanization, supporting the building of cities with high quality of life would encourage investment inflows leading to annual economic contributions of US\$520 to US\$930 billion in ASEAN<sup>7</sup>. In the Philippines, the BPO industry, with annual revenues of roughly US\$20 billion, has changed the consumer landscape in many urban areas. Because of 24-hour operations of BPO companies, demand for 24/7 convenience has also gone up. The incomes generated from the industry's direct and indirect employment and revenues also further support consumption.

The real estate market is also another industry that is benefitting from urbanization and the IT-BPO industry. According to Jones Lang LaSalle (JLL), demand for office space is strong thanks to BPO firms. An indicator of the increasing demand for real estate would be rising rental rates in Metro Manila, which according to JLL have expanded by '4 to 10 percent' from July 2015 to July 2016<sup>8</sup>. To meet this demand, real-estate players plan to increase office space supply this year. Ayala Land, Inc. (ALI) plans to increase their supply of office space by 825,000 square meters by the end of 2016, effectively more than doubling their current supply of 715,000 square meters of rentable office space<sup>9</sup>. Metro Manila was also ranked within the top 30 real estate investment cities in the world by JLL in its Commercial Attraction Index in 2015

Urbanization and economic growth also present opportunities for the automotive industry, along with other durable consumer goods. In the case of the Philippines, the build-up of the automotive industry began to be noticeable when the industry reached a double digit growth in 2011. This boom in automotive ownership was said to be attributed to factors including the development of the business processing sector, the ASEAN Economic Integration, remittances from OFWs, low interest rates on automobile loans and the increased purchasing power of the middle class<sup>10</sup>.





<sup>&</sup>lt;sup>7</sup> See footnote 6

<sup>&</sup>lt;sup>8</sup> Office property market in PH seen to sustain growth, Doris Dumlao-Abadilla, Inquirer

<sup>&</sup>lt;sup>9</sup> ALI targets 825,000 sqm office portfolio by yr-end, Catherine Talavera, The Manila Times

<sup>&</sup>lt;sup>10</sup> PHL's 'age of motorization' sets scorching pace in 2015. Aries B. Espinosa. BusinessWorld. May 12, 2015

## The rise of the millennial consumer



Once the largest and most influential population group, baby boomers are now passing the torch to millennials, those born in the early 1980s to early 2000s. This demographic change has widespread implications, and consumption patterns are not exempt. In the U.S., millennials now outnumber baby boomers, numbering 75.4 million.<sup>11</sup> The Philippines is experiencing a transition as well. Maybank states that the lower fertility rates of the population, with an average age of 23, will result in a larger productive workforce compared to young and old dependents.<sup>12</sup> This larger productive workforce will lead to an increase in consumption as average income rises.

Besides an increase in incomes and consumption due to the expansion of the productive workforce, consumption patterns and how goods are marketed to consumers will change as well. For example, surveyed company executives by KPMG have observed that millennials: value their health and wellness, are supportive of socially responsible brands, and place greater value in products that are produced locally.<sup>13</sup>

Local companies are starting to adjust to these preferences. Mondelez Philippines, Inc. has started a 'mass premium' marketing strategy for their chocolate products in order to better target millennials.<sup>14</sup> In an effort to connect with the millennial population, Max's Restaurant launched an online campaign in 2014 supporting the national basketball team, Gilas Pilipinas, on social media.<sup>15</sup> ABS-CBN Corp. recently revealed a new product, named the 'Digital Marketing Periodic Table of Elements', to assist advertisers in creating effective digital campaigns.<sup>16</sup>

<sup>&</sup>lt;sup>11</sup> Millennials overtake Baby Boomers as America's largest generation, Richard Fry, Pew Research Center, April 2016

<sup>&</sup>lt;sup>12</sup> How the millennial consumer is reshaping the PH economy, Chrisee Dela Paz, Rappler, August 2015

<sup>&</sup>lt;sup>13</sup> Seeking customer centricity: The omni business model, KPMG International, June 2016

<sup>&</sup>lt;sup>14</sup> Mondelez sees growing millennial interest in 'mass premium' products, Keith Richard D. Mariano, Business World, June 2016

<sup>&</sup>lt;sup>15</sup> Max's launches campaign to back Gilas, The Philippine Star, May 2014

<sup>&</sup>lt;sup>16</sup> ABS-CBN launches digital marketing tool, Karl Angelo N. Vidal, Business World, July 2016

### Technological change is an opportunity for disruptive growth



Digitization and other technological developments have the potential to change the economic order in various ways. Providing public and private support in building an efficient and reliable internet backbone would help maintain the economic growth and facilitate the adoption of new technologies.<sup>18</sup> The use of mobile phones for commercial transactions and purchases, for instance, is hampered by the relatively high costs and inefficient services of telecommunications companies. Addressing these limitations will facilitate disruptive technologies such as electronic commerce and online shopping to flourish potential game changers for the industry.

The widespread use of digital technology among individual consumers is an opportunity for businesses to improve their market presence. The increased prevalence of smartphone use for online transactions is still novel territory for companies. A survey conducted by KPMG revealed that 42.0 percent of companies report that their customers prefer to shop online, although only 27.0 percent of them were able to adjust their business model adequately.<sup>19</sup> This illustrates that the room for improvement is immense. In response to this, the companies disclosed that they would increase their investments on better data analytics and technologies. Data analytics is a new tool to increase a firm's revenues or profits without significantly increasing costs. As an example, Paulo Campos III, founder and CEO of Zalora Philippines, has a keen eve on his customer's consumer patterns. He shares that 'sales are highest on Wednesday and Thursday', and during any particular day, 'highest between 1pm and 4pm'. It's this kind of data analysis that other firms need to adapt if they are to take advantage of technological change. The challenge is how to include this in everyday decision-making.

The rise of digital banking supports the growth of electronic commerce or e-commerce, enabling consumers to make purchases and transactions through the aid of technology. While e-commerce has yet to really take off in the Philippines, the long-run potential to change the landscape of the consumer markets is there. Online shopping and e-commerce platforms are poised to overtake brick-and-mortar retailers. Traditional retail companies in developed and emerging markets such as the U.S. and China are losing ground to their online counterparts. There are signs of a significant shift in consumer behavior, with some seeing internet shopping reaching a tipping point, boosted in part by changing demographics as tech-savvy millennials replace baby-boomers as top consumers.

<sup>&</sup>lt;sup>18</sup> See footnote 6 <sup>19</sup> KPMG, "Becoming hyper customer centric," June 13, 2016



#### Michael Arcatomy H. Guarin

Advisory Partner KPMG R.G. Manabat & Co. Demographics, Urbanization and the Changing Consumption and Economic Landscape in the Philippines



#### Paul Michael M. Paraguya

Executive Director Institute for Development and Econometric Analysis, Inc. (IDEA) A former tiger finally awakened from its slumber, the Philippines has impressively outperformed its neighboring countries with a consistently remarkable growth of roughly five to eight percent since 2013. With an economy that is consumption-driven, the seemingly impossible task of recovering has finally come; brought about by a growing consumer base – the Filipino people. As the demographics transitions, the urbanization that is taking place continues to remarkably shape the economic landscape over time and space, moving forward along the path paved by the reforms introduced after the Marcos era.

The growth of cities in the Philippines has provided the country with several economic

engines that facilitated the increase in income – and thus consumption expenditure. The dynamics between population growth, growth in income shares from the service sector, and the remittances from the overseas Filipino workers (OFWs) has promoted an urbanization that enabled Filipino spending to heal its ailing economy. Natural population growth, influenced by fertility and mortality, and the –in and –out migration of Filipinos to and from different localities, influenced the population outcomes, and allowed the minor urban centers to grow into major cities over time.





The resulting demographics have influenced both the economic and development processes leading to the recent desirable outcome, from a population of roughly 668,000 Filipinos in 1591, the Filipino population has remarkably exploded to 92 million in 2010. Population growth has an average rate of 1.7 percent from 2010 to 2015 and a median age of around 23 years old. The number of children per woman has gone down, from six childbirths per woman in 1973 to three childbirths per woman in 2013. The mortality rate has also decreased. The fall in fertility and mortality rates has resulted in a declining dependency ratio – indicating an increase in the number of savers relative to consumers. A further decline in fertility rate will lead to a low number of youth dependents facilitating the demographic transition. Given its young population, the Philippines will enjoy a favorable population dynamics and in time, reap the fruits of its demographic dividend.

The country has also experienced a change in sectoral composition that proceeded with urbanization. With a movement away from agriculture, services and its three strongest sectors – transport, storage and communication; real estate, renting, and other business activities; and financial intermediation – provided the vehicles of growth as the country underwent several shocks such as the 1983 debt moratorium, the 1997 Asian Financial Crisis, the 2008 Global Economic Crisis, and the 2011 World Food Crisis. New cities and industries spurred demand for basic needs associated with an urbanizing economy. The Business Process Outsourcing (BPO) industry is among the urban phenomenon that has catalyzed the matching of a large pool of labor and services in urban areas. Furthermore, the demand for housing, transportation, retail, recreation, and other services has increased.

With its urbanization, the country's growing labor force can free up more of its resources for savings and investment as fertility rates continue to decline, allowing for human capital investment. Prior to the tremendous jobs challenge are the necessary prerequisites to prepare the youth for productive employment - primarily healthcare, education, and skills training. Foreign and domestic investors may take interest in the provision of human capital enhancing facilities such as hospitals, health clinics, schools and training centers as the demand for these facilities go up. The Philippines is in a position to prioritize investment in human capital given that regions in the country with low productivity levels have relatively higher poverty incidences. A growing population may be detrimental to growth and development without these necessary investments. Furthermore, there is also a correlation between the level of productivity and the number of technical and vocational graduates in the Philippines. Capitalizing on human capital enhancement will provide investors with an attractive labor force that they can rely on.

While macroeconomic growth has been impressive, the improvement in the standard of living of many poor Filipinos has lagged behind. Support should be provided, not only to the OFWs who have an impact on poverty, but also to the relatively weaker sectors of the country – agriculture and industry – to achieve the needed structural transformation of the economy and the improvement of agricultural productivity. Public investments in infrastructure that promote the emergence of new growth centers in the countryside and spur development in remote areas can also help diversify the spatial distribution of economic activities, an endeavor that may need fiscal and institutional reforms. These action plans and the challenge of an inclusive economic growth may be addressed by the new administration, which banked on a campaign of change. Given its evident political will, it is with high hopes that the economic landscape may further evolve as the rural and urban demographics undergo a transition in response to the reforms that may be implemented – an economic landscape that facilitates inclusive growth with a change in the consumption pattern not only for those who are already benefitting from the recent economic success but also for the poor.

#### The rise of cities

The McKinsey Global Institute<sup>1</sup> estimates that the world's urban population will grow by 65 million people annually until 2025 or almost 179,000 every day. Currently, more than half of the world's population live in cities and that figure is projected to increase to 60 percent, representing an additional 1.4 billion people by 2030. From 2011 until 2025, McKinsey estimates that around 600 urban centers will account for about 60 percent of global GDP. In particular, cities in developing countries with populations of between 150,000 and 10 million are seen contributing more than half of the global growth by that time. While the economic role of large cities varies widely as do their future growth patterns, there is no mistaking the important role of cities and urbanization in economic growth.

In Southeast Asia, rapid urbanization has led to booming cities that now account for more than two-thirds of the region's GDP. The Philippines is no exception. In 1975, the rural population was almost twice that of the urban (Table 1). The country experienced steady urbanization in the four decades since, such that by 2010, the urban population had caught up and the level of urbanization had reached almost 50 percent. The increase in population, particularly in urban areas, has been accompanied by tremendous growth in income shares from the services sector and from the inflow of dollar remittances from abroad.

	1975	2015
Total Population (in thousands)	42,071	100,979
Rural Population (in thousands)	26,352	56,548
Urban Population (in thousands)	14,541	44,431
GDP (constant 2000, billion pesos)	1,702	7,594
GDP Growth Rate (in percent)	5.6	5.9
GDP per capita (constant 2000, pesos)	40,455	74,770
Agri, Hunting Forestry, and Fishing Sector (constant 2000, billion pesos)	294	720
Industry Sector(constant 2000, billion pesos)	672	2,536
Service Sector(constant 2000, billion pesos)	737	4338
Net Primary income (constant 2000, billion pesos)	-500	1,541
Household Consumption Expenditure (contannt 2000, billion pesos)	1,060	5,264
Government Consumption Expenditure (constant 2000, billion pesos)	273	785
AHFF sectoral composition to GDP at constant 2000 prices (percent)	17.2	7.9
Industry sectoral composition to GDP at constant 2000 prices (percent)	39.4	27.8
Service sectoral composition to GDP at constant 2000 prices (percent)	43.3	47.5

#### Table 1. Comparison of Key Indicators (1975 and 2015)

Source: IDEA, Inc. computation; Source of raw data: Philippine Statistics Authority

<sup>&</sup>lt;sup>1</sup> Bouton, S., J. Dearborn, and Y. Sergienko [2015] "Unlocking the future: The keys to making cities great," McKinsey Global Institute.

#### Figure 1: Dynamics of Urbanization



Source: Adapted from the United Nations (2012)

Natural population growth is not the only factor that affects the country's demographic dividend. Figure 1 shows the dynamics of urbanization. Aside from the natural growth in population that increases the permanent concentration of people in urban areas, migration from rural areas is also a factor (Table 2). With a more lucrative offer relative to the agricultural sector, there is enough incentive for migrants to relocate to villages, towns or cities with opportunities.

Region of current residence	Population five years and over	Population change, past five years	Net migrants / population change
Philippines	81,866,777	-	-
NCR	10,624,908	289, 650	-70.2
CAR	1,441,546	96,020	6.5
Ilocos Region	4,247,894	201, 583	-7.2
Cagayan Valley	2,880,682	177,676	-9.8
Central Luzon	9,043,895	428,560	17.9
CALABARZON	11,215,644	852,048	27.5
MIMAROPA	2,399,972	184,880	-4.2
Bicol Region	4,748,440	314,251	-7.0
Western Visayas	6,350,722	258,795	-10.4
Central Visayas	6,033,218	399,482	2.6
Eastern Visayas	3,610,759	186,182	-2.5
Zamboanga Peninsula	2,990,266	177,259	-10.1
Northern Mindanao	3,775,186	344,886	-0.3
Davao Region	3,938,406	309,094	3.2
SOCCSKSARGEN	3,613,780	279,071	-0.2
ARMM	2,815,970	-864,655	2.6
CARAGA	2,135,789	135,878	0.9

#### Table 2. Net migrants and population change, 2010

Source: Philippine Statistics Authority (PSA)

Growths in population, urbanization, and remittances have led to ever-increasing household consumption, which has become the main driver of the economy. Urbanization has proceeded along with changes in the sectoral composition of the economy, particularly the movement away from agriculture. It is estimated that around three-quarters of recent GDP growth was fueled by a shift from agriculture to urban employment as well as rising numbers of young people entering the labor force. The decline of the share of agriculture in employment and output has been accompanied by the expansion of services and, to a lesser extent, industry. Roughly 60 percent of GDP comes from services and at least 30 percent from industry, with agriculture accounting for less than a tenth of total output.

Furthermore, the potential for more employment provided by the industry and service sectors has resulted in the birth of new cities. More than 50 cities were newly chartered since the year 2000. The households from the industry and service sectors in these urban areas have reaped the benefits of urbanization while contributing to growth. As the households increased in concentration in these sectors, expenditures from those employed in the industry and service sectors went up as well.

The growth of BPOs, for instance, is an urban phenomenon as the industry draws from the pool of labor and support services available in urban areas. BPO locations need a large pool of college graduates, support infrastructure such as roads, airports, hotels, power, telecommunications and real estate. From 2010 to 2015, information technology (IT) and outsourcing revenues have grown from US\$8.7 billion to an estimated US\$20 billion with a compounded annual growth rate of almost 20 percent. Similarly, the industry has grown from 500,000 full-time employees to about 1.2 million over the same period.

The employment impact, however, is not limited to the industry itself. Because of linkages with other industries such as real estate and support services, the BPO industry enjoys an employment multiplier of an additional 2.5 jobs per worker. The jobs and incomes created by the industry have changed the economic landscape in many urban areas, with cafés and 24-hour convenience stores sprouting. The demand for housing, transportation, retail, recreation, and other services have also gone up.



For 2016, a new set of "Next Wave Cities" is poised to offer competitive locations for the BPO industry. These are Baguio City, Cagayan de Oro City, Dagupan City, Dasmariñas City, Dumaguete City, Lipa City, Malolos City, Naga City, Sta. Rosa City in Laguna and Taytay in Rizal. Meanwhile, Metro Manila, Metro Cebu, Metro Clark, along with the cities of Bacolod, Davao, and Iloilo are considered "centers of excellence" or cities that have demonstrated capability in sustaining growth through attracting, hosting and marketing to major locators. "Ten Emerging Cities", showing high potential in hosting IT-BPM activities, were also named: Balanga, Batangas, Irigas, Laoag, Legazpi, Puerto Princesa, Roxas, Tarlac, Tuguegarao, and Zamboanga.

The Next Wave Cities scorecard is a collaboration between the IT and Business Process Association of the Philippines (IBPAP), the Information and Communications Technology Office (ICTO), and Leechiu Property Consultants. Since 2009, reports have been released every two years ranking the suitability of cities for BPO operations using four criteria: talent availability (40 percent), infrastructure (30 percent), business environment (20 percent), and cost (10 percent). BPO jobs in cities across the country have the potential to provide employment and fairly high incomes that will in turn support the dispersion of economic activity.

Given that the agricultural sector has consistently registered weak economic performance and industry remains underdeveloped, the reliance on emerging services sub-sectors such as BPO is understandable. There is room for improvement, however, in terms of supporting a more balanced structural transformation of the economy by refocusing on agriculture and industry. Concomitant to this would be generating new sources of growth through the countryside. Industry observers note, for instance, that there has been massive construction activity in the provinces with as much as 55 business districts being built across the country, indicating increased wealth-generation and investment in the provinces. This bodes well for a country whose demographic distribution has been described as monocentric, with the population concentrated in one urban area. Like many developing countries, the Philippines has a primate city that accounts for a disproportionate share of the population and wealth of the country. Both population and economic activities are concentrated in Metro Manila and its surrounding areas.

Diversifying the spatial distribution of economic activities is possible by promoting the emergence of new growth centers through public investments in infrastructure. Enhancing connectivity will be crucial for decongesting the primate city and spreading out economic activity—which would require both fiscal and institutional reforms. For one, the government has to invest five percent of GDP annually on infrastructure development. A new approach to managing metropolitan areas in an efficient and coordinated manner may also result in better outcomes in the wake of rapidly growing urban areas.

These challenges are expected be addressed by the new administration, which has promised sweeping changes in the country throughout its term. Inclusive growth is one of its economic priorities; and it is possible that the demographic landscape would further evolve as the rural and urban compositions undergo a transition in response to the reforms that may be implemented.





#### The demographic dividend

Many contemporary demographic economists such as David Canning and David Bloom view a population's evolving age structure as a key determinant of real GDP growth. While population aging is becoming an imminent problem for countries like China and Thailand, other Asian countries have seen their population age much more slowly, notably, India, Indonesia, Pakistan, the Philippines, and Vietnam – all of which have yet to enjoy favorable population dynamics of their demographic dividends.

Despite aging in some countries, population trends continue to be more dynamic in Asia than in developed economies. Latest census data show the Philippine population growing by an average of 1.7 percent from 2010 to 2015. The Philippines



### Figure 2. Philippine Population and Growth Rates for each Cencus year

Source: Philippine Statistics Authority

has a young population and with a median age of around 23 years old, the country enjoys more youthful population than its neighbors like Indonesia, Malaysia and Vietnam.

By 2025, Southeast Asia's working-age population will account for 68 percent of the region's total population from 60 percent in 1990. Alongside this development is a decline in dependency ratios from 0.77 to less than 0.60 over the same period. Falling total dependency ratios, including in the Philippines, indicate a fast increase in the number of savers relative to consumers.<sup>4</sup> For many ASEAN countries, falling fertility and mortality rates along with rapidly growing working-age populations, will enable them to boost GDP growth in the next 20 to 30 years. Malaysia, Indonesia, the Philippines and Vietnam are expected to see double-digit growth in their labor force beyond 2020.

The economic success of many countries in the Asian region - such as Japan, South Korea, Taiwan, Singapore and China – has been attributed in part to their reaping the benefits of their demographic dividends. Falling fertility rates led to a decline in dependency ratios as households started having fewer children. This indicates an increase in the number of workers and savers (working-age population) relative to dependents and consumers (young dependents aged 0-14 and old dependents aged 65 or more). The labor force grows rapidly, freeing up resources for savings and investment in the welfare of families and society at large. Fewer children make it possible for households to invest more on human capital like the health and education of children. Meanwhile, with fewer children, government spending can be reallocated to growth-promoting investments. Consequently, this is accompanied by higher per capita incomes.

<sup>4</sup> Silipo, L. [2009] "The truth about 'demographic dividend' in Asia", Flash Economics, NATIXIS. Retrieved from: http://cib.natixis.com/flushdoc.aspx?id=49917

This is known as the first demographic dividend (FDD), which may last for five decades or more. As demographic transition proceeds, however, the demographic window will wind down and eventually close. If a fall in fertility was a boon to Asian countries in the earlier stage of demographic transition, it has become a bane in the latter stage as populations age and the number of elderly dependents increase due to improved living standards. Consequently, per capita incomes grow slower.

Even then, there is opportunity for reaping a second demographic dividend (SDD) which can be larger than the first. A population bulge at the older working ages who now face retirement provides greater incentive for saving and asset accumulation, especially when people have little social and institutional safety nets to rely on. The economy has the potential to greatly benefit from greater saving and investment driven by the aging working class.

This demographic dividend is also called a "sweet spot" or "goldilocks" period in which fertility falls to the replacement level and is neither too high nor too low for a generation or two. The Philippines' relatively high fertility rate, however, is slowing its demographic transition. Thus, it might take several decades more for the working-age population to peak. This means that countries experiencing faster demographic transition such as Vietnam may reap their dividends and enjoy better economic conditions over the same period.

These dividends are not guaranteed. Countries must design and implement policies to realize these benefits. While the demographic dividend does not automatically assure higher standards of living, it is often thought of as a window of opportunity that can be exploited. Key to maximizing the demographic dividend is the extent to which people consume and produce goods and services. The stage at which people's production outstrips their consumption typically lies within the working age of 15-64 years old. Countries have at least a few decades wherein consumption grows rapidly and output growth per effective consumer gets a considerable boost.

One of the main challenges to exploiting the FDD is accelerating job creation to a rate that is faster than the growth of the working-age population. This means creating jobs in numbers that match or outstrip the entry of people into the labor force. More than just the numbers, the quality of employment will also matter. Towards this end, improving the labor market and enhancing mobility will be key. Prior to this tremendous iobs challenge are the necessary prerequisites to prepare the youth for productive employment – primarily health care, education, and skills training. Later on, the challenge will shift to social safety nets and policies that promote savings.

Productivity during the economic lifecycle plays a key role in influencing these outcomes. The extent to which workers' production outstrips their consumption is dependent on worker productivity, which is in turn determined by fertility choices, schooling decisions, employment practices, social safety nets and other government policies and incentives. This means that the government needs to put in place an institutional architecture that incentivizes desired behavior and promotes positive outcomes in education, health, employment, consumption, saving, and investment.

A major part of this involves setting aside capital outlays and resources for the social infrastructure that makes these positive outcomes possible. A flexible and expanding labor market is also necessary in order to effectively utilize the workers entering the labor force. A framework needs to be put in place that promotes labor mobility across industries (from agriculture to industry) and space (from rural to urban areas). But policies and institutional arrangements, such as pension and retirement systems, are also important. Along these lines, developing an inclusive financial system will become increasingly important as well as creating a fair and appropriate tax system that assures workers of the ability to enjoy the fruits of their labor and encourage productive activity.



<sup>&</sup>lt;sup>5</sup> Mapa, D., Balisacan, A., and Corpuz, J. ., (2012), "Towards the Goldilocks Period: Accelerating the Demographic Transition in the Philippines." Policy Brief 2011-01, Philippine Center for Population and Development (PCPD).

#### Philippine demographic trends

Over time, the country's demographic transition has gradually shaped both population and development outcomes.

Of the population processes affecting population growth, fertility is arguably the most controversial. The Senate and the House of Representatives passed the Responsible Parenthood and Reproductive Health Act (RH Law) in December 2012, which took roughly 13 years in the Congressional mill as proponents for and against the said policy vehemently pushed their respective agenda.

Despite its passage, the RH Law effectivity was delayed when this polarizing issue dragged on as the anti-RH law proponents questioned its constitutionality. The Supreme Court upheld the RH law and declared that it is constitutional on 8 April 2014. In 2015, however, the Supreme Court imposed a temporary restraining order that covers the government's contraceptive program.<sup>6</sup> Nonetheless, the new president vows full implementation of the RH Law in his term.<sup>7</sup> Figure 3 shows the trend in fertility rates from 1973 to 2013. The trend in fertility rates has been going down for decades, from six childbirths per woman in 1973 to just three in 2013.







Falling fertility rates have also been accompanied by a decrease in infant mortality (Figure 4), in line with the targets under the Millennium Development Goals<sup>8</sup>. At a more granular level, however, the data points to a mixed performance. Some groups point out that neonatal mortality or deaths occurring within 28 days after birth has remained persistently high. Nonetheless, the progress made in this regard signals improvement in healthcare services over time.



#### Figure 4. Trend in Infant Morality Rate, 1973-2013

Sources: 1993 National Demographic Survey; 1996 Family Planning Survey; 1998 National Demographic and Health Survey; 2003 National Demographic and Health Survey; 2008 National Demographic and Health Survey; 2011 Family Health Survey; 2013 National Demographic and Health Survey

<sup>6</sup> Quismundo, T. [2015] "High court stops DOH contraceptive implants", Inquirer.net. Retrieved from:

http://newsinfo.inquirer.net/702730/high-court-stops-doh-contraceptive-implants

<sup>&</sup>lt;sup>7</sup> Marcelo, E. [2016] "Duterte vows full implementation of RH Law," GMA News Online. Retrieved from:

http://www.gmanetwork.com/news/story/575011/news/nation/duterte-vows-full-implementation-of-rh-law

<sup>&</sup>lt;sup>8</sup> In 2000, 189 member-states of the United Nations signed the Millennium Declaration, a global commitment of countries, rich and poor alike, to achieve peace and security, respect for human rights, good governance, and human development - with attention given to the needs of the poor, the vulnerable and the children of the world. This commitment was further spelled out in the Millennium Development Goals - or MDGs - a set of eight time-bound goals and targets which are anchored on eradicating extreme poverty and hunger by 2015. (Retrieved from: http://www.un.org.ph/mdgs-and-post-2015)

Improvements in healthcare, however, have the effect of promoting population growth and a longer life expectancy. As mortality rates for both the young and elderly decrease, this helps increase the dependency ratio or the ratio of those who are below 15 years and above 64 years to the working-age. Coupled with still relatively high fertility rates, this slows the process of demographic transition. As seen in Figure 5, while the total dependency ratio of the Philippines has declined in the last four decades, the pace has been slow. Total dependency has been driven by youth dependency, which is in turn determined by similarly gradual decline in fertility.



Figure 5. Trends Dependency Ratios, 1970

Source: Philippine Statistics Authority (PSA)

With a declining number of young dependents and a stable growth of old dependents (Figure 6), there will be sufficient resources and transfers from the working population to support them. In 2015, 64 percent of the total population was of working age, while 32 percent were young dependents and the remaining four percent comprised old dependents. Over time, the demographic transition has resulted in roughly 57 dependents per 100 Filipinos, 50 of them are below 15 years old. This strong base of working age Filipinos, roughly 97 percent of which are literate, will provide the economic backbone of the country's rise as a formidable economic player in the years to come.



### Figure 6.: Growth Rate of the Young, Working Age, and Older Sectors of the Population: 1970-2010

Source: Philippine Statistics Authority (PSA)

#### Implications of urbanization and demographic change

Demographic change and urbanization can be disruptive forces that may lead to game-changing developments in consumer markets. Population growth expands markets and is usually associated with greater demand for goods and services while urbanization is associated with rising incomes, thus resulting in greater purchasing power.

Herrin provides a framework showing the interrelationships of development and population<sup>9</sup>. This framework sheds light as to how population outcomes such as population size, age-sex structure and spatial distribution, affects consumption and leads to development outcomes that may or may not be favorable. The development outcomes are determinants of fertility, mortality and migration that further shape population outcomes (Figure 7). This framework provides a better understanding and appreciation of the country's demographic transition and process of urbanization.



#### Figure 7. Population and Development Outcomes10

Adopted from: Herrin (1993)

<sup>&</sup>lt;sup>9</sup> Herrin, A. [1993]. Framework on Population and Development Inter-relationships. National Economic Development Authority (NEDA) Integrated Population and Development Planning (IPDP).

<sup>&</sup>lt;sup>10</sup> Herrin, A. [1993]. Framework on Population and Development Inter-relationships. National Economic Development Authority (NEDA) Integrated Population and Development Planning (IPDP).



#### Transportation and motor vehicles



Historically, economic development has been accompanied by an increase in the demand for transportation and in the number of road vehicles. This relationship between the growth in vehicle ownership and per capita income, however, is non-linear. While wealth is strongly associated with

vehicle demand, other factors such as tax policies, public transport, and urban planning have also been shown to slow the expansion of the vehicle stock<sup>11</sup>.

Income is a major determinant of demand for motor vehicles. It is not surprising therefore that motor vehicles are concentrated in urban areas where there is higher economic activity and incomes. This is especially true in the Philippines where economic activity and incomes are highest in Metro Manila and its surrounding areas. To a lesser extent, this is also reflected in other metropolitan areas such as Davao, Cebu, and Baguio.

At the national level, income explains more than 90 percent of the variation in motorization levels. Motorization increases more rapidly at the national level compared to the urban or city level. On the demand side, this is due to the availability of substitutes for personal motor vehicles in the form of public transport and mass transit. On the supply side, this is because of the limited number of road space and congestion costs. Congestion is a limiting factor in motorization levels across cities. While urban income growth leads to a rapid increase in the number of vehicles, the growth in urban road length is much slower because of physical constraints in the built-up areas. This leads to a negative externality of motorization: worsening urban congestion.<sup>12</sup>

The country is undoubtedly on the cusp of, if not already in the nascent stages, of the so-called motorization age. This is seen in the sustained growth in vehicle sales, ranging from motorcycles to passenger cars. Auto sales reached 288,609 units in 2015, up by 23.1 percent from 234,747 units in 2014 according to the Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI).<sup>13</sup>

Sales are driven by the increasing purchasing power of the middle class on the back of billions of dollars in remittances and a boom in BPOs. This is supported by low interest rates and favorable financing terms, as well as greater regional economic integration in ASEAN and beyond. Strong and sustained economic growth will further raise incomes and enhance purchasing power.

While not getting as much attention as the automotive industry, motorcycles are an affordable and efficient transportation option for many Filipinos in both rural and urban areas. People in the provinces have long relied on motorcycles, and their derivative forms of transport, for even the most rugged and inaccessible areas. The same is true even in urban settings, where motorcycles lend themselves better to weaving through the traffic and gridlock. Thus, the motorcycle industry is a prime candidate for benefiting the most from the early stage of the country's push towards motorization.

<sup>&</sup>lt;sup>11</sup> Dargay, J., Gately, D., and Sommer, M. [2007] "Vehicle ownership and income growth, worldwide: 1960-2030,"The Energy Journal, Vol. 28, No. 4.

<sup>&</sup>lt;sup>12</sup> National Academy of Engineering [2003] Personal cars and China, The national Academies Press, United States

<sup>&</sup>lt;sup>13</sup> Mercurio, R. [2016] Car, truck sales up 23percent in 2015. Retrieved from http://www.philstar.com/business/2016/01/13/1541874/car-truck-sales-23-2015





#### Source: Philippine Statistics Authority (PSA)

#### Housing, real estate development, and construction



The growth of cities and the influx of people into urban areas means greater demand for housing, real estate development and infrastructure. Demand for infrastructure will be driven by growth in the population and in the economy, along with increased motorization. The construction industry stands to benefit from all of these.

Focus on improved infrastructure and expansion of residential and commercial buildings will continue to push the Philippines' rate of construction growth up until 2020.<sup>14</sup> High growth in construction activity averaging at 9.2 percent per year will propel the construction industry to reach US\$47.0 billion in value by 2020 from US\$30.2 billion in 2015.<sup>15</sup>

This is due to a renewed focus on infrastructure development complemented by public-private partnerships (PPPs) and sustained expansion in residential and commercial developments. It is infrastructure development that will be the fastest growing market for the industry.



#### Figure 9. Private Construction Gross Value Added

Source: Philippine Statistics Authority (PSA)

<sup>14</sup> Timetric provides information solutions and technologies that enable organizations to drive business value and manage business risk. Its Construction Intelligence Center is the complete source for project, industry, market, company and macroeconomic intelligence on the global construction industry

(Retrieved from: http://www.construction-ic.com/AboutTimetric and https://timetric.com/sectors/construction/)

<sup>15</sup> Mercurio, R. [May 26, 2016] "Philippine construction works seen growing over 50 percent by 2020," The Philippine Star. Retrieved from:

http://www.philstar.com/business/2016/05/26/1586914/philippine-construction-works-seen-growing-over-50-2020



#### Figure 10. Real Estate, Renting & Business Activities, Levels and Growth Rates

Source: Philippine Statistics Authority (PSA)

Residential and real estate development will continue to be the largest market of the construction industry. The residential and housing sector is underpinned by the growth of the middle class, increasing urbanization and developers tapping into the low- and middle-income housing segments. Towards this end, housing finance particularly the Home Development Mutual Fund (HDMF) will play a role in supporting continued growth in housing especially when one considers the extent of the housing backlog in the country. More broadly, the real estate sector is seen benefiting from economic expansion, increased spending power, and demand from the BPO industry.

In 2010, the National Capital Region (NCR) had the greatest mobility in its demographic process, ranking second and first for in-migrant and out-migrant, respectively, with a 2.8 percent in-migration rate and a whopping 4.9 percent out-migration rate (Table 6). CALABARZON is the top destination of migrants, with an in-migration rate of four percent, while Bicol is second only to NCR as the leading source of migrants at 1.9 percent. Taking the net-migration, CALABARZON region which is created as a result of the split of the Region IV in May 2002 and comprises five provinces, namely, Cavite, Laguna, Batangas, Rizal and Quezon is the region that experiences the greatest mobility, both in terms of inflow and outflow of Filipinos.



With the natural dynamics of in- and out-migrants, and the demand from the OFWs, the need for housing services will therefore be persistent. Investors could capitalize on this bright prospect of guaranteed spending; and ride the promising waves of the housing and real estate development.■

	Population,	In-mig	ration	Out-mi	gration	Net m	igration
Region of current residence	five years and above	Rate in percent	Rank	Rate in percent	Rank	Rate in percent	Rank
Philippines	81,866,777						
NCR	10,624,908	2.8	2	4.9	1	-2.1	17
CAR	1,441,546	2.0		2.6	7	0.5	3
Ilocos Region	4,247,894	1.1	13	1.5	8	-0.4	11
Cagayan Valley	2,880,682	0.8	14	1.5	9	-0.6	15
Central Luzon	9,043,895	2.2	3	1.3	12	-0.9	2
CALABARZON	11,215,644	4.0	1	1.6	6	2.3	1
MIMAROPA	2,399,672	1.3	10	1.6	5	-0.4	10
Bicol Region	4,748,440	1.4	8	1.9	2	-0.5	13
Western Visayas	6,350,722	0.8	16	1.2	14	-0.4	12
Central Visayas	6,033,218	1.3	11		16	0.2	5
Eastern Visayas	3,610,759	1.6	6	1.7	4	-0.1	9
Zamboanga Peninsula	2,990,266	0.8	15	1.5	10	-0.6	14
Northern Mindanao	3,775,186	1.3	9	1.4	11	-0.0	8
Davao Region	3,938,406	1.5	7	1.2	13	-0.3	4
SOCCSKSARGEN	3,613,780	1.2	12	1.2	15	-0.0	7
ARMM	2,815,970	0.2	17	1.0	17	-0.9	16
CARAGA	2,135,789	1.9	5	1.9	3	0.1	6

#### Table 6. In-migration, out-migration, and net migration rates by region, 2010

Source: Philippine Statistics Authority





# The Philippines: Asia's New Investment Hub

In recent years, the Philippines has risen to become one of the fastest-growing economies in the region.<sup>1</sup> Most measures of the macroeconomy have shown considerable progress: from a pick-up in economic growth to lower unemployment and benign inflation. In line with the improvement in the real economy, the public perception of the Philippines by the business community both here and abroad has marked a dramatic turnaround.

The enhanced image is reflected in the country's rise in various competitiveness rankings. In the 2015-2016 Global Competitiveness Report, the Philippines placed 47th out of 140 countries.<sup>2</sup> This represents a jump of 38 places above its 2010 ranking of 85th – making it the most improved country in the period from 2010 to 2014. A similar jump was seen in the World Bank's Doing Business Report: from 144th in 2010 to 103rd in 2015.<sup>3</sup>

Part of the story lies in the Aquino administration's reform-oriented and good governance agenda that won a strong mandate from the people in 2010. While problems persist, there has been considerable progress in the public's perception of corruption. The country's ranking in Transparency International's Corruption Perception Index improved by 39 places to 95th in 2015 from 134th in 2010.

While financial markets have cheered and benefited from this turnaround, real investments have also significantly increased over the past years. From around US\$1 billion in foreign direct investment (FDI) inflows in 2010, the country's annual investment haul has gone up to almost US\$6 billion in the last two years. Investment spending's contribution to gross domestic product (GDP) growth is also rising. More investment-driven growth bodes well for building the country's productive capacities and thereby its economic prospects now and in the future.

<sup>&</sup>lt;sup>2</sup> Schwab, K. [2014]. The Global Competitiveness Report 2015-2016. Geneva, Switzerland: World Economic Forum. Retrieved from: http://www3.weforum.org/docs/gcr/2015-2016/Global\_Competitiveness\_Report\_2015-2016.pdf <sup>3</sup> The Ease of Doing Business Reports over the years do not lend themselves to direct comparisons, however, due to methodological changes adopted in recent years.





#### Emmanuel P. Bonoan

Vice Chairman and Chief Operating Officer KPMG R.G. Manabat & Co.



#### Bernadette P. Destura

Statistician Institute for Development and Econometric Analysis, Inc. (IDEA)

<sup>&</sup>lt;sup>1</sup> BusinessWorld Online [2015, December 29]. Moody's keeps growth forecast after Q3 uptick. Retrieved from: http://www.bworldonline.com/content.php?section=TopStory&title=moody&rsquos-keeps-growth-forecast-after-q3-upt ick&id=120752

## Investing in the Philippines

#### Foreign ownership issues

A provision in the 1987 constitution limits foreign ownership of Philippine companies in certain industries to no more than 40 percent.<sup>4</sup> For example, for a corporation to be granted authority to operate a public utility, at least 60 percent of its capital must be owned by Filipino citizens. The Omnibus Investment Code in 1987 aims to clarify, harmonize, and integrate basic laws on investment and their provisions for the guidance of domestic and foreign investors. The Foreign Investment Act of 1991 liberalized the entry of foreign investment into the Philippines with a further amendment in 1996, removing restrictions on foreign investment in "adequately served" sectors.5

Currently, 100 percent foreign equity is allowed. Even financial institutions and banks can now be 100 percent owned by foreign nationals given the signing of RA 10641 in 2014, amending RA 7721. However, there is an exception of foreign ownership for those included in the Regular Foreign Investment Negative List (RFINL). The **RFINL** lists areas reserved to Filipinos by mandate of the Constitution and specific laws. These include mass media except recording, practice of licensed professions, retail trade, cooperatives and small-scale mining, etc. where foreign ownership is prohibited; and advertising, ownership of land, operation and management of public utilities, etc., where only majority foreign ownership is prohibited.<sup>6</sup> It also covers areas that involve security, defense, risk to health and morals, and protection of small-and-medium-scale enterprises.

The country's reforms to its legal framework for investment started with the enactment of Omnibus Investment Code (OIC) in 1987. The OIC provides guidance for the registration, investment protection and incentives granted to enterprises. In reassuring that foreign investors were protected in the country, the OIC provides investors the guarantees that they are allowed to invest, manage business operations, hire employees and provide foreign investors with a right of residence and free repatriation of capital. The protection against expropriation without fair compensation is also included in the OIC.

As an extension of incentives to foreign investors, the Foreign Investment Act (FIA) was passed in 1991. It provides the general legislative regime for foreign investment. It also liberalized foreign investments in the country since it opened the domestic market to 100 percent foreign investment sans the restrictions contained in the Foreign Investment Negative List (FINL).

The list enumerates the areas of economic activities reserved, whether partially or totally, for Philippine nationals. It is divided into List A and B. The Philippines issued the 10th Foreign Investment Negative List on 29 May 2015 to reflect the changes in its List A. This list describes areas of activity, such as mass media, retail trade, advertising and public utilities, which are reserved for Philippine nationals by the mandate of the Constitution and specific laws. List B includes those areas which are either defense-related, requiring prior clearance and authorization from the Department of National Defense (DND), or with implications on public health and morals. The FIA also redefined export enterprises to be those with at least 60 percent of production dedicated to exports. It also allowed 100 percent ownership of the business activities outside the FINL.

There are several types of business enterprises that a foreign investor can

establish in the Philippines. These are sole proprietorship, partnership, and corporation.

Sole proprietorship is a business structure owned by an individual who has full control/authority of its own and owns all the assets. This type of business must apply for a Business Name and be registered with the Department of Trade and Industry (DTI).

Partnerships may be either general or limited. In general partnerships, partners have unlimited liability for the debts or obligations. However, in limited partnerships; parties have liability only up to the amount of their capital contribution, which has no minimum or maximum limits. A partnership with more than US\$141,000 capital must register with the Securities and Exchange Commission (SEC).

Corporations can be classified as stock or non-stock companies regardless of nationality. A corporation is a Filipino corporation if at least 60 percent of the total equity is Filipino-owned. If equity of the foreign investor is more than 40 percent, then it is considered a foreign-owned corporation. A minimum paid-up capital for corporations is US\$ 235,000.

For foreign investors that opt to have joint ventures with existing local companies, there are also rules in terms of ownership. Holding foreign equity in excess of 50 percent is allowed as long as the area of activity involved is not covered by the 9th RFINL. If it is a joint venture, majority of the directors must be Filipino citizens. For firms engaged in a nationalized or partially nationalized activity, the maximum number of foreign directors must not exceed the proportion of actual foreign equity in the firm, and all of its executive and managing officers must be Filipino citizens.

http://www.keepeek.com/Digital-Asset-Management/oecd/finance-and-investment/oecd-investment-policy-reviews-philippines-2016\_9789264254510-en#page3 <sup>6</sup> Desiderio, L. [ 2015, June 6]. Gov't relaxes foreign investment restrictions.

<sup>&</sup>lt;sup>4,5</sup> Organization for Economic Cooperation and Development [2016]. OECD Investment Policy Reviews: Philippines 2016. Retrieved from:

Retrieved from: http://www.philstar.com/business/2015/06/06/1462581/govt-relaxes-foreign-investment-restrictions

Apart from identifying the types of business activities investors can avail in the Philippines, there is also the option of establishing a presence in special economic zones (SEZs) that were created through the Special Economic Zone Act of 1995 or Republic Act 7916. Business operations in these areas are facilitated by Philippine Economic Zone Authority (PEZA), which is tasked with promoting investments, extending assistance, registering firms, and granting incentives. At present, there are several special economic zones supervised by different government agencies or government-owned and controlled corporations (see Table 2).

#### Table 2. SEZs in the Philippines

<b>SEZs</b> Aurora Pacific Economic Zone	<b>Characteristic / Location</b> Investment hub of the Pacific, dubbed as the "Gateway of the Pacific" for its stratigic location facing the Pacific Ocean.
Freeport of Bataan (Bataan Export Processing Zone)	It is located between Manila Bay and the South China Sea
Cagayan Special Economic Zone and Free Port	One of the country's most important agro-industrial commercial, tourism, recreational and transshipment hub.
Phividec Industrial Estate in Misamis Oriental	One of the largest industrial estates in the Philippines.
Subic Bay Freeport	Industrial commercial, financial and investment center with a 67,000 hectare land area.
Zamboanga City Special Economic Zone Authority	The only economic zone with Freeport status in cetral and southern Philippines.

Source: Philippine Economic Zone Authority (PEZA)

#### Investment incentives and the tax regime

*Investment Priorities Plan.* Aside from economic zones that offer financial incentives, there are also investment activities that are given preferred status through incentives packages at the national level. This is embodied in the Investment Priorities Plan (IPP) that spells out the economic sectors being actively promoted by the government for investment with a mix of incentives and a favorable regulatory framework.

The Philippines' new industrial policy, for instance, was embedded in the 2014-2016 IPP. This provided the framework for an investment policy regime that focuses on improving productivity, developing human resources, and upgrading technology aimed at upgrading and transforming manufacturing industry to create more jobs. Preferred activities included four broad sectors (manufacturing, agribusiness and fishery, services, and infrastructure and logistics) and four specific activities (energy, housing, hospitals, and public–private partnership projects).

The IPP serves both as a developmental tool for investment decisions of the private sector and a promotional tool for government to encourage first movers in new investment areas. It supports the FIA in regulating the entry of investments or industries. But unlike the FIA, there are no restrictions on foreign ownership and/or pioneer enterprises that will engage in the activities listed in IPP. Investment areas are classified as: Preferred Activities, Export Activities, Activities with Special Laws and the Autonomous Region in Muslim Mindanao (ARMM) list.

<sup>&</sup>lt;sup>7</sup> DPT Law. The Investor's Guide to Doing Business in the Philippines. Retrieved from:

http://www.dptlaw.asia/forms/PRIMERS,%20GUIDES%20&%20FAQs/The%20Investor's%20Guide%20to%20Doing%20Business%20in%20the%20Philippines.pdf

The Export Activities List covers the production and manufacture of export products, services exports and activities in support of exporters. Under export activities, industries that are allowed are the following:

Logistics

Enterprise

Tourism

Facilities

Halal Industry

Brunei Darussalam-Indonesia-Malaysia-Philippines East ASEAN

Growth Area Trade and Investment

Health and Education Services and



Agriculture, Agribusiness/Aquaculture and Fishery



Basic Industries: production of pharmaceuticals such as antibiotics and medical devices, textile and textile products, inorganic and organic fertilizers using solid waste materials, exploration and development of natural gas and mineral resources which includes small scale as defined under P.D. 1899<sup>8</sup>



Infrastructure and Services



Industrial Services Facilities



Engineering Industries

Activities with Special Laws cover all areas or activities where the inclusion in the IPP and/or the grant of incentives under the Omnibus Investments Code is mandated by law. New laws which require inclusion in the list include the Renewable Energy Act of 2008 and the Tourism Act of 2009. The ARMM List encompasses priority investment areas that have been determined by the Regional Board of Investments of the Autonomous Region in Muslim Mindanao (RBOI-ARMM) in accordance with Executive Order 458.<sup>9</sup>

One of the objectives of the 2014 IPP is to reinforce the Philippine Development Plan's focus on inclusive growth by setting specific objectives meant to optimize the impact of incentives in attracting investments which is in line with the current theme "Industry Development for Inclusive Growth". The 2011–2016 Philippines' Development Plan, which focuses on industrialization, identified six broad sectors as priorities. These sectors are agroindustry, manufacturing, IT-BPM, tourism, logistics, and construction.

In aligning its investment strategy with this industrial plan, a new approach was undertaken through the Investment Priorities Plan starting in 2014. Instead of an annual listing of industries to be granted fiscal incentives, the plan will be effective for three years to provide investors with predictable policies for investing in new areas identified by the government.

<sup>&</sup>lt;sup>8</sup> The Presidential Decree 1899 or Establishing Small-Scale Mining as a New Dimension in Mineral Development which was signed on January 23, 1984

<sup>&</sup>lt;sup>9</sup> Official Gazette [1991]. Executive Order No. 458, s. 1991. Retrieved from: http://www.gov.ph/1991/05/17/executive-order-no-458-s-1991/

There are several qualifications for foreign businesses or enterprises to be established in the country. In order to be qualified, firms will be evaluated based on certain criteria. The first criterion is their employment contribution, including the labor intensity of an activity and the firm's contribution to total employment. Other criteria are the firm's potential to move up the global value chain, if they will create spill-over effects, their impact on the output of other sectors, and if the firm will create competition. The last criterion is important to ensure that promotion of the activity would not impair competitive outcomes in both input and output markets. The next step is identification of gaps in the industry's supply or value chain (upstream, midstream, or downstream). After identifying the gap, it is important to determine the different obstacles or constraints that prevent firms to move up in the value chain. Factors that may affect their movement are the following:

- 1. High production cost, power, logistics, and infrastructure
- 2. Lack of raw materials or suppliers of intermediate inputs
- 3. Lack of scale economies
- 4. High risks for first movers especially for activities requiring large capital
- 5. Government regulations: franchises, licenses, smuggling (due to inefficient regulation)
- 6. Others: finance access, inability to comply with international product standards and quality, lack of R&D, lack of skilled workers, lack of competition, etc.

Lastly, the policy mix will be determined to help address the challenges to the new entry of firms. The policy mix will consist of horizontal and vertical interventions as well as coordination mechanisms to allow firms and industries to increase their competitiveness. These include:

- 1. Policy reforms, sound and reasonable regulations, and other non-fiscal interventions, and
- 2. Fiscal incentives with other non-fiscal interventions and support

Fiscal incentives will be granted by the State for enterprises that venture into identified priority areas, provided they qualify for the above criteria and fulfill the terms and conditions of their registration. These incentives would typically include income tax holiday from four years to a maximum of eight years, depending on whether the activity is pioneering or not, and provided that the registered enterprise meets the targets of its project. Registered projects also have the privilege of importing capital goods free of duties. However, the extent of entitlement to incentives shall be based on the project's net value-added, job generation, multiplier effect and measured capacity.

Depending on business activities and certain conditions, incentives will be applied in some enterprises that are listed below:

- 1. Export producers operating a customs bonded warehouse and exporting.
- 2. For the first ten years of operation, importation of breeding stocks and genetic materials will be exempted.
- 3. Enterprises registered in less developed areas may deduct the cost of constructing necessary and major infrastructure and public facilities from their taxable income.
- 4. Subject to a prescribed capital to labor ratio, a registered enterprise is allowed an additional deduction from taxable income the amount equivalent to 50 percent of the wages of additional skilled and unskilled workers.
- 5. Pioneer enterprises registered with the BOI are exempted from local business tax for a period of six years, while registered non-pioneer enterprises are exempt for four years.

*Tax Regime.* For businesses that do not avail of fiscal incentives, the general taxation framework for the Philippines is embodied in the National Internal Revenue Code of 1997 or the Philippine Tax Code. Foreign corporations, non-resident citizens and aliens are subject to Philippine Tax. Firms that are not allowed to avail certain entitlements are subject to regular taxes, which are classified as either local or national.

National taxes consist of: value added tax (VAT), percentage tax, excise tax, and other national tax. The 12 percent VAT is imposed on imported goods or properties that are tangible and non-tangible objects with certain exceptions. Percentage tax varies depending on the type of business to be established. For bank and other non-bank financial intermediaries, taxes will range from 0-7 percent; life insurance companies (2 percent), common carriers, radio and television franchisees (3 percent); gas and water utilities (2 percent); and for other business categories, taxes will range from 3 to 30 percent. Foreign establishments or companies selling products such as alcohol, tobacco, petroleum, mineral products, automobiles, jewelry need to pay excise tax at varying rates.

Manufacturers, wholesalers, distributors, dealers and contractors are also subject to local business tax. The amount of tax is based on the gross sales of the prior calendar year and not exceeding two percent. It may also vary depending on the location of the business. However, the local business tax for banks and other financial institutions will not exceed at 0.5 percent of their gross receipts and may vary depending on the locality of the business. In addition, local government units collect real estate tax and community tax.

Currently, legislators are still reviewing proposed amendments to the FIA. One of these is the expansion of foreign ownership because, at present, foreign firms are only allowed to own up to 40 percent in certain sectors. The Joint Foreign Chambers of the Philippines (JCF) is asking leaders to pass the amendments including Senate Bill No. 2517, which allows foreign investors to own up to 100 percent of a domestic investment house. Other measures proposed by JCF are House Bill (HB) 4402 that proposes to allow foreigners to practice their professions here by lifting the ban under the government's negative list, while HB 5544 seeks to remove foreign equity restrictions in banks and financial institutions.<sup>10</sup> Once the amendments have been passed, the group believes that these would benefit the Philippines in terms of additional direct foreign investment and employment, linkages with global and regional markets, and transfer of knowledge and technology.

Towards the end of its term, the Aquino administration passed several measures that aimed to improve the legal framework for foreign investment in the country. This includes Republic Act 10541 or An Act Allowing the Full Entry of Foreign Banks in the Philippines. The law allows more foreign banks to operate in the country by acquiring, purchasing or owning up to 100 percent of the voting stock



<sup>&</sup>lt;sup>10</sup> Tubadeza, K.M., Monzon, A. [2016, January 20]. Congress moves forward on foreign ownership liberalization measures. BusinessWorld Online. Retrieved from: http://www.bworldonline.com/content.php?section=Economy&title=congress-moves-forward-on-foreign-ownership-liberalization-measures&id=121728



of an existing bank. New entrants can also do the same for a new banking subsidiary incorporated under existing laws or they can establish branches with full banking authority. Another relevant law is the Philippine Competition Act, which seeks to prohibit anti-competitive practices and establishes a Philippine Competition Commission towards this end.

For its part, the new administration has expressed willingness to open up the economy to greater foreign participation through changes in the constitution. Moreover, it has also signaled openness to reforming the income tax system that would lower tax rates, adjust them to inflation and restore progressivity.<sup>11</sup>

#### Recent trends and prospects

In this light, the Philippines stands to reap the benefits of building on its gains in the last few years and cementing itself as a new investment hub in the region. The economy is experiencing nascent structural transformation as investment and industry have increasingly become new drivers of growth in recent years. This shift towards a more investment-driven and industry-oriented growth comes at a crucial time of moving towards greater regional integration and economic liberalization. Investing in the country's productive capacity and plugging the gaps in industrial development is necessary if the Philippines is to sustain its place as Asia's rising star. The time to invest in the Philippines is now.

#### Economic integration and liberalization

The last few decades have seen increasing economic liberalization as economies became more integrated through international trade flows in goods, services, labor and capital. The trend toward greater international economic cooperation and integration is also expected to support investment spending. As economies integrate as in the Association of Southeast Asian Nations or ASEAN Economic Community (AEC), restrictions to the flow of goods, services, and capital will go down. Business and trade-facilitation procedures will also tend to harmonize towards best-practices. And more economic openness and liberalization will, by themselves, create opportunities.

In the late 1980s to early 1990s, the Philippines shifted from import substitution to export-oriented policies and introduced more liberal trade and investment policies. Key to this was attracting foreign investment in manufacturing, which today remains to be the industry with the largest amount of committed foreign investments.

<sup>&</sup>lt;sup>11</sup> Demystifying Duterte's Eight Points. (n.d.). Retrieved July 07, 2016, from: <u>http://www.bworldonline.com/content.php?section=Opinion</u>



The ASEAN Economic Community (AEC) aims for freer movement of goods, services, capital, and skilled labor across the region. The establishment of the ASEAN Economic Community is seen as a major milestone. Progress made and challenges encountered in deepening regional integration vary across key policy areas: trade in goods; trade in services; investment and capital market liberalization; competition and consumer protection; intellectual property; infrastructure and connectivity; small- and medium-sized enterprises; food, agriculture and forestry; tourism; human and social development; and the Initiative for ASEAN Integration (IAI). Relevant economic agreements of ASEAN are ASEAN Trade in Goods Agreement (ATIGA), ASEAN Investment Area (AIA), ASEAN Investment Guarantee Agreement, and ASEAN Comprehensive Agreement (ACIA).

There is a general consensus over the successful implementation of the AEC integration plan as significantly

increasing trade and creating a single market of 600 million consumers.<sup>12</sup> Moreover, ASEAN can expand its free-trade agreements and attract additional production from multinationals as labor costs in China continue to rise. Together, these opportunities could create some US\$280 billion to US\$625 billion a year in economic value by 2030.

These opportunities will be textured by the region's changing demographics. The booming cities of Southeast Asia account for more than 65 percent of the region's GDP today, and more than 90 million people are expected to move to urban areas by 2030.<sup>13</sup>

Taken together, ASEAN's ten member states are a veritable economic powerhouse. Though it is not a monolithic market, it is a growing hub of consumer demand where macroeconomic stability has provided a platform for growth.<sup>14</sup> The region is home to many globally competitive companies and intraregional trade could significantly deepen with implementation of the ASEAN Economic Community, but hurdles to realizing the ASEAN vision of one community remain.

#### Trade Liberalization

The ASEAN Trade in Goods Agreement (ATIGA) outlined that 96 percent of the 99,434 total tariff lines in the region would have zero tariff by the end of 2015. Of the six major ASEAN economies, however, 99.7 percent of the total tariff lines are already at zero percent rate. The less developed economies of Cambodia. Laos, Myanmar and Vietnam have reduced import duties to 0-5 percent on 98.9 percent of tariff lines. ATIGA aims to lower transaction costs and bring to zero the tariff for goods moving across the region as if within a single country. This facilitates regional sourcing of both intermediate and final products and increases production efficiency within the region. It also facilitates intra- and inter-firm trade, hence increasing regional connectivity.

<sup>&</sup>lt;sup>12</sup> Moraje, S. and Thompson, F. Paths to shared prosperity for the Philippine economy. McKinsey&Company and McKinsey Global Institute. Retrieved from:

http://www.mckinsey.com/~/media/McKinsey%20Offices/Philippines/PDFs/Paths%20to%20shared%20prosperity%20for%20the%20Philippine%20economy\_final.ashx<sup>1</sup> <sup>13</sup> McKinsey. (2014, November ). Three paths to sustained economic growth in southeast Asia. Retrieved July 7, 2016,

fromhttp://www.mckinsey.com/global-themes/asia-pacific/three-paths-to-sustained-economic-growth-in-southeast-asia

<sup>&</sup>lt;sup>14</sup> McKinsey. (2014, May ). Understanding ASEAN: Seven things you need to know. Retrieved July 7, 2016, from

http://www.mckinsey.com/industries/public-sector/our-insights/understanding-asean-seven-things-you-need-to-know

The food processing industry, as a key component of the manufacturing sector particularly in the Philippines, holds great potential as a source of job creation. Yet, to develop the industry further and improve market access, policies should focus on enhancing standards, rationalizing rules and developing human capital. According to Pawan Kumar, director of Food and Agribusiness Research and Advisorv at Rabobank, the AEC brings a huge opportunity for the region's consumer food and beverage businesses. But a regional strategy should be addressed in order for the local food and agribusiness companies to compete with foreign companies (non-ASEAN) present in the region.

In addition, Rabobank stated that packaged food and meat will gain most and grow at compound annual growth rates of five and four percent respectively by 2020. This growth is attributed to the rising Southeast Asian demand for products in these two sectors that could exceed 52 million tons for packaged food and 20 million tons for meat in the region by 2020.

In terms of consumer goods, companies thrilled at the prospects of the AEC single market should not lose sight of the fact that the ASEAN will remain a highly diverse region in many regards - from incomes and levels of socio-economic development to language, culture, politics and religion. Intra-ASEAN trade has seen an uptrend in trade of final consumer goods, which is an encouraging sign of the growing importance of domestic consumption within ASEAN. According to the International Monetary Fund (IMF), the increasing role of intraregional trade in final consumption goods, together with a large domestic market appears to provide the region with a potential source of resilience against global demand shocks<sup>15</sup>.

intraregional trade in final consumption goods, together with a large domestic market appears to provide the region with a potential source of resilience against global demand shocks.<sup>15</sup>

Free trade in goods within the ASEAN region is largely a reality already, but the free flow of skilled labor is complicated by political concerns. Thus, the liberalization of services and investment remain to be key parts. realizing the vision of the AEC and its economic benefits. With its relatively sophisticated human resources in high-value services, the Philippines is seen as one of the beneficiaries of services integration along with Singapore and Malaysia. Progress towards greater integration, however, is hampered by failure to harmonize regulations and the persistence of non-tariff barriers.

#### Services liberalization

The initiative on services liberalization started in the ASEAN Framework Agreement on Services (AFAS). One of the goals of the AEC is the free flow of services within the region. Services consist of diverse activities ranging from basic services such as healthcare, education and water-provision infrastructure services such as telecommunications, transport and energy services. According to ASEAN Investment Report 2015, ASEAN Member State now generates about 45 to 55 percent of its GDP. ASEAN's export of services is continuously growing. It increased from US\$291.9 billion in 2013 from US\$113.6 billion in 2005.

The Philippine retail trade sector is one key market that will be affected by commitments under the AFAS. According to a report by HSBC, modern retail formats like convenience stores and hypermarkets have substantial multi-year growth potential. Retail mall development is also expected to grow in the coming years, spurred by rising demand and a relatively low base especially in the countryside. In particular, areas such as Cebu, Davao, Cavite, and Pampanga were cited for positive investment opportunities for developers and retailers as rising wages and disposable incomes translate into sales potential.

Asian retail sales are estimated at around US\$10 trillion. For investors who are interested to establish retail store in the Philippines, investments will be subject to the following four categories:

Category A – Enterprises with paid-up capital of the equivalent in Philippine Peso of the US\$2.5 million shall be reserved exclusively for Filipino citizens and corporations wholly owned by Filipino citizens.

Category B – Enterprises with a minimum paid-up capital of the equivalent in Philippine Pesos of US\$2.5 million but less than US\$7.5 million and foreign participation shall be limited to not more than sixty percent of total equity.

Category C – Enterprises with a paid-up capital of the equivalent in Philippine Pesos US\$7.5million, or more may be wholly owned by foreigners: Provided, however, That in no case shall the investments for establishing a store investments in Categories B and C be less than the equivalent in Philippine pesos of US\$830,000.

Category D – Enterprises specializing in high-end or luxury products with a paid-up capital of the equivalent in Philippine Pesos of US\$250,000.00 per store may be wholly owned by foreigners.

<sup>&</sup>lt;sup>15</sup> ASEAN Financial Integration. G. Almakinders, S. Fukuda, A. Mourmouras, J. Zhou, and Y. S. Zhou. IMF Working Paper. February 2015



In addition, foreign entities that will engage in the retail business or invest in a retail store in the Philippines must meet the following criteria:

a. Net worth of at least US\$200 million of the parent corporation, for those that want to establish enterprises under Categories B and C, and net worth of at least US\$ 50 million for Category D.

b. Ownership of at least five retail stores or franchises anywhere in the world or at least one branch with minimum capitalization of US\$25 million

c. Five-year track record in retailing; and

d. The foreign retailer's home country offers reciprocity rights to Filipino retailers.

These domestic regulations, however, will have to change and be harmonized with regional norms in order to realize commitments under the AFAS. Already, the entry of foreign players is quite evident in the retail sector. Apart from foreign and regional brands like Uniqlo and H&M in the ready-to-wear market, the local convenience store industry has also seen the emergence of regional players like Family Mart and Lawson from Japan and Alfamart from Indonesia. These players are hoping to tap a growing urban consuming class across developing countries like the Philippines and ASEAN.

Forbes forecasts that by 2017 the country's retail market will be worth US\$75 billion.<sup>16</sup> However, the impact of technology on retail as well as other services in the Philippines and in the ASEAN region is proving to be a game-changer. A 2010 McKinsey report notes that disruptive forces such as new technologies can cause dramatic reversals, of which the consumer-and-packaged goods sectors have been no exception. In 2000, Kmart was one of the top U.S. retailers with US\$36 billion in sales. More than a decade later in 2014, the company's annual revenues had declined by two-thirds. The same period has seen the rise of Amazon from sales of US\$2.8 billion to US\$89 billion. Similarly, Alibaba has emerged as the top player in China's e-commerce business filing a historic initial public offering of US\$25 billion in 2014.17

<sup>&</sup>lt;sup>16</sup> KPMG International (2014). ASEAN dawn: What does Asia's new economic community mean for brands and retailers? Consumer Currents Issue No. 18. Retrieved from: https://www.kpmg.com/ID/en/industry/CM/Documents/consumercurrents-18v4.pdf

<sup>&</sup>lt;sup>17</sup> McKinsey. (2015, December ). The consumer sector in 2030: Trends and questions to consider. Retrieved July 7, 2016,

fromhttp://www.mckinsey.com/industries/consumer-packaged-goods/our-insights/the-consumer-sector-in-2030-trends-and-questions-to-consider

Undoubtedly, retail of fast-moving consumer goods is going online. Will another Amazon or Alibaba emerged in the wake of the AEC? That remains to be seen. Asian markets have ventured to e-commerce which expanded to mobile commerce (m-commerce) and social media commerce (s-commerce).

In the country, SM Investments Corporation has recently partnered with the Philippine unit of Rocket Internet's Lazada to sell online merchandise from toys to clothes. It can be considered as a profitable venture for the corporation since according to Macy's, an American corporation, the supermarket chain is the tenth-largest internet retailer.<sup>18</sup> Vice Chaiman Teresita Sy-Coson stated that SM will initially sell light-to-carry non-food items through Lazada and they are planning to include home furnishings and appliances in the future.<sup>19</sup>

According to the World Bank (2012), the Philippines is well known to have one of the highest percentage of internet users, up from only 5.2 percent in 2004.<sup>20</sup> At the end of 2015, the Philippines had about 118 million mobile phone subscribers. Thus, the Philippines' e-commerce market is forecast to grow at a compounded annual growth rate of 101.4 percent from 2013 through to 2018, according to a 2014 report by Ken Research Ltd. In addition, the online retail market, a component of e-commerce, is projected to rise 189.2 percent over the same period.

The ASEAN 6's retail e-commerce market is estimated to be worth US\$7.1 billion. Although, these countries have 158 million Internet users, which are about 29 percent of their population, the share of online shoppers among Internet users in Malaysia, except Indonesia (13 percent) averages 72 percent, and relatively close to the number of online shoppers in Japan (78 percent) and the U.S. (73 percent).Thus, it can be concluded that there is a high demand of online shops to ASEAN consumers shop similar to their global counterparts.<sup>21</sup>

However, e-commerce remains relatively underdeveloped in Southeast Asia, which only accounts for less than one percent of total retail sales, compared to rates of 6 to 8 percent in Europe, China, and the U.S. As purchasing power increases, Internet penetration spreads, and online offerings improve, online retail in ASEAN markets is expected to grow as much as 25 percent annually.<sup>22</sup>■



- <sup>18</sup> KPMG International (2014). Reinventing Retail: The profit behind data analytics. Consumer currents Issue No. 16. Retrieved from:
- https://www.kpmg.com/ID/en/industry/CM/Documents/consumercurrents-16-v2.pdf

- http://www.bworldonline.com/content.php?section=Corporate&title=billionaire-sy-lazada-team-up-for-online-retail&id=124461
- <sup>20</sup> The World Bank. Internet users per (100 people) Retrieved from: http://data.worldbank.org/indicator/IT.NET.USER.P2?page=2

<sup>21</sup> CIMB ASEAN Insight. Opportunities in Retail E-commerce in ASEAN. Retrieved from:

https://www.atkearney.com/documents/10192/5540871/Lifting+the+Barriers+to+E-Commerce+in+ASEAN.pdf/d977df60-3a86-42a6-8d19-1efd92010d52

<sup>&</sup>lt;sup>19</sup> BusinessWorld Online [March 14, 2016]. Billionaire Sy, Lazada team up for online retail. Retrieved from:

http://aseaninsight.economist.com/2015/07/06/opportunities-in-retail-e-commerce-in-asean/

<sup>&</sup>lt;sup>22</sup> AT Kearney. CIMB ASEAN Research Institute. Lifting the Barriers to E-commerce in ASEAN.Retrieved from:

## The billion-dollar club

In 2015, eight Philippine companies made it to the Forbes' Global 2000, the listing of the world's largest and most valuable public companies based revenues, profits, assets and market value. These firms are listed in Table 1.

Company	Rank	Assets	Revenues	Profits	Market Value
SMIC	911th	\$15.9 B	\$5.9 B	\$640 M	\$16.7 B
BPI	1243rd	\$32.4 B	\$1.5 B	\$406 M	\$9.1 B
PLDT	1259th	\$9.8 B	\$3.9 B	\$768 M	\$14.2 B
Metrobank	1297th	\$35.9 B	\$1.8 B	\$448 M	\$7.1 B
Ayala Corp.	1344th	\$16.3 B	\$3.5 B	\$422 M	\$11.2 B
JG Summit	1525th	\$11.3 B	\$3.6 B	\$398 M	\$11.9 B
Top Frontier	1792nd	\$27.9 B	\$4.8 B	\$246 M	\$763 M
MERALCO	1808th	\$5.9 B	\$6.0 B	\$407 M	\$6.8 B

#### Table 1. Philippine Firms in 2015 Forbes' Global 2000

The top Filipino firms are a mix of conglomerates and companies engaged in retail trade, real estate, banking, telecommunications, food and beverages, mining, petrochemicals, infrastructure and utilities. Reflecting the structure and dynamics of the Philippine economy, these companies have largely tapped into the country's every-expanding consumer markets and services sectors. They have benefited from and capitalized on the opportunities presented by the country's robust domestic demand as seen in remittance-led consumption and, more recently, increased investment.

For instance, the growth of SM Investments Corporation (SMIC) rode on the rapid growth of retail trade and the mushrooming of malls and mixed use commercial centers that have become a ubiquitous feature of urban centers across the country. To a certain extent, the same is true of Ayala Corporation where retail and real estate development are core business areas.

More recently, however, major conglomerates like Ayala, Metro Pacific Investments Corporation (MPIC), and Top Frontier have also diversified into infrastructure development, power generation, and public utilities. As such, they are well-positioned to take advantage of the opportunities that come from the country's overall macroeconomic growth and increasing urbanization. The growth of urban areas will require investments in infrastructure and public utilities, as well as generate greater demand for power.

In the same manner, Ayala and MPIC's entry into education and healthcare services also appear to be premised on key developments in the country's process of demographic transition in the next few decades. Education and healthcare are needed investments to prepare the youth for their eventual entry into the labor force. Falling fertility will also increasingly allow Filipino families to afford greater human capital investments in their children, spurring demand for quality education and health services.

In recent years, Philippine conglomerates have also expanded their presence outside the country through acquisitions ranging from food and beverages, to real estate and utilities, to oil and energy. These acquisitions are mostly concentrated in the major industries that Filipino firms dominate, indicating that Filipino firms are starting to position themselves in the region by building on their existing strengths in the wake of closer economic integration under the ASEAN Economic Community. With growth in revenues and profits supported by strong domestic demand along with favorable liquidity conditions, Philippine conglomerates have built up the financial wherewithal to finance foreign takeovers. Deals are estimated to have been worth US\$6 billion between 2014 to 2015. In the food and beverage sector, several multi-million dollar deals were sealed by JG Summit's Universal Robina Corporation and snack-food maker Monde Nission Corp. Local beverage company Emperador Inc. also spent around US\$1 billion for a string of acquisitions in Europe. In ASEAN, Ayala has interests in water-utility and property development companies in Malaysia and Vietnam. SMIC also has a growing presence in retail and property development in China.

#### SMIC

Founded by the Philippine's richest tycoon, Henry Sy, SMIC is a holding company with interests in retail (SM Retail), properties (SM Prime) and financial services (BDO Unibank) in the Philippines and a growing property and retail presence in China. Its operating units have become market leaders in their respective business areas. SMIC's property unit is engaged in mall, residential, and commercial developments, as well as the operation of hotels and convention centers. Its business includes retail and wholesale trading ranging from dry goods and wearing apparels to food and other merchandise. Its financial services business is centered around BDO Unibank, the country's largest universal bank, and associated financial services.

The slowdown in the domestic real estate market, particularly in the mid- to high-end condominiums, and in the Chinese economy, where it has significant investments, pose headwinds for the conglomerate in the short- to medium-term. In the longer term, however, its prospects are still secure.

The Philippine property sector is seen to benefit from large potential demand for retail, housing and residential developments, particularly in urban areas, on the back of urban growth and increasing consumer affluence as the working age population expands. China's economic rebalancing, if successfully pulled off, will also mean greater consumption spending that will benefit SMIC's retail business in the mainland.

#### BPI

The Bank of the Philippine Islands (BPI) is the country's oldest commercial bank that traces its establishment to the year 1851 during the Spanish colonial period. BPI engages in the provision of commercial banking services and operates through the following services: consumer, corporate and investment banking. With a net worth of US\$ 7.2 trillion, it is the third largest bank in the country with total assets of US\$ 70.5 trillion as of 2015. Both revenues and income growth improved in 2015, with the former accelerating to 7.4 percent to US\$3.3 trillion and the latter rebounding to positive 1.1 percent from -4.1 percent the previous year. The bank continues to expand and build up its presence given greater financial sector liberalization especially under the context of the ASEAN financial services agreements.

#### **PLD**

The Philippine Long Distance Telephone Company (PLDT) is the country's first and top telecommunications company. Its range of telecommunications services covers three main business groups: fixed line, wireless, and information and communications technology (ICT). Apart from the legacy business in fixed line services, its growth has been driven mainly by its wireless business that consists of cellular services such as text messaging and wireless broadband. More recently, it has ventured into ICT and business process outsourcing (BPO) services through process solutions and tech investments.

Though total assets grew by 4.3 percent to PhP457 billion, PLDT's financial performance, in general, took a hit in 2015. Revenues were flat at 0.1 percent (US\$8 trillion) because of stiff competition, while net income fell at its steepest by 35.3 percent (US\$1.04 trillion) on the back of rising costs. The company has to keep on investing to expand and upgrade its network, especially as the industry comes under fire for relatively poor and expensive services.

#### Metrobank

Metropolitan Bank & Trust Corporation (Metrobank) is engaged in banking, financing, leasing, real estate and stock brokering services. It operates through the following segments: consumer, corporate, investment, treasury, branch banking, and others. It is also known for its investment banking services that arranges structured financing and participates in initial public offerings (IPOs), privatizations, and mergers and acquisitions. Its other services include remittances, leasing, account financing, and other support services. With a 2015 net worth of US\$7.9 trillion and assets of US\$84.6 trillion, it is the second largest bank in the Philippines.

#### Ayala Corporation

Ayala Corporation is the holding company of the Ayala family, led by chief executive officer Jaime Augusto Zobel de Ayala. It is engaged in the following businesses: real estate and hotels; telecommunications (Globe Telecoms, the rival of PLDT); water utilities (Manila Water Corporation, Inc.); electronics; IT-BPO; automotive; infrastructure and power; financial services and insurance (including BPI); international; and others.

In 2015, the company's net worth was estimated at US\$15.4 trillion with total assets of US\$37.4 trillion. It saw double-digit growth in both revenues (11.3 percent) and profits (19.8 percent) to US\$8.2 and US\$1.05 trillion, respectively. Perceived to be conservative in its business activities, this business philosophy along with diversification help explain the conglomerate's sterling record as it outperformed companies of a similar nature.

Ayala Corp.'s leadership has affirmed their commitment to invest in the country given its growth potentials, while still being on the lookout for opportunities in the Southeast Asian region. Ayala's water and property units, for instance, have ventured into Vietnam and Malaysia, respectively. In 2015, the conglomerate allotted US\$8.7 trillion PhP185 billion or at least US\$4 billion in capital spending for its Philippine businesses. In recent years, it has entered into joint venture agreements in bidding for the government's PPP projects mostly focused on the development, maintenance, and operations of public infrastructure.

#### JG Summit Holdings Ind

The second largest holding company in the Philippines with various business interests, JG Summit Holdings Inc. was founded by tycoon John Gokongwei, Jr. It engages in providing consumer foods; agro-industrial and commodities; air transportation; telecommunications (Sun Cellular, which has been folded into PLDT but where Gokongwei holds a minority interest); real estate development and hotels; petrochemicals; banking and financial services; power generation and other supplementary businesses.

JG Summit's assets were placed at US\$28 trillion in 2015, with net income rising by 23.9 percent US\$1.03 trillion due to doubled digit revenue growth of 29.1 percent to US\$10.78 trillion. Its business units include Universal Robina Corporation (URC), a major food and beverage manufacturer; Robinsons Retail Holdings Inc.; property developer Robinsons Land Corporation; budget airlines Cebu Pacific Air; industry pioneer JG Summit Petrochemicals Corporation; Robinsons Bank Corporation, and minority stakes in MERALCO and Sun Cellular both under Metro Pacific Investments Corporation Earnings were driven by the full operations of JG Summit Petrochemicals Corp., and its business units.

#### Top Frontier

Top Frontier Investment Holdings Inc. is an investment holding company established in March 2008 with businesses in beverages, food, and mining. It is the largest stockholder of San Miguel Corporation (SMC), which was established as a single-product brewery in 1890 but has since become the Philippines' largest food, beverages, and packaging company with over 100 facilities in the country, Southeast Asia and China. It also has an interest in Clariden Holdings, Inc. that is engaged in mining tenements in various areas in the Philippines.

The company's net worth and assets were US\$4.3 trillion and US\$65.8 billion in 2015, with revenues and net income at US\$31.67 trillion and US\$159.8 billion, respectively. Notably, Top Frontier owns 66.1 percent of SMC's outstanding common stock and started construction of a US\$1.5 billion dollar nickel plant in July 2015.

#### MERALCC

Rounding out the list of top corporations is Manila Electric Corporation (MERALCO), chaired by business mogul Manuel V. Pangilinan who also chairs PLDT. Founded in 1903, MERALCO is involved in power, and services and others. The power business includes electricity distribution, power generation, and retail electricity supply. The services and others side of the business involves electricity-related services such as electro-mechanical engineering, construction consulting, and related manpower; light-rail related services; electronic transaction and bills collection; insurance and electronic business development; and energy systems management. It is the largest electric distribution utility, servicing the Greater Metropolitan Manila area.

Assets and net worth as of 2015 were at US\$13.3 trillion and US\$3.8 trillion, respectively. Net income grew by 5.8 percent to US\$897.7 billion despite a three percent drop in revenues to US\$12.1 trillion Over the long term, the company plans to expand its distribution network to the southern island of Mindanao by establishing operations in the Zamboanga region.



#### Emmanuel P. Bonoan

Vice Chairman and Chief Operating Officer KPMG R.G. Manabat & Co.

# Developments in Value Added Tax

With the new administration seriously pursuing comprehensive amendments to the Philippine Tax Code much attention has been focused on the Value-Added Tax System, the country's broad-based consumption tax.

The Value-Added Tax (VAT) system has already undergone a number of major changes over the past three decades. It was first introduced in 1988, through Executive Order No. 273 by then President Corazon C. Aquino in order to rationalize the system of taxing goods and services through the imposition of a multi-stage value-added tax, to replace the tax on original and subsequent sales tax and percentage tax on certain services, and to simplify tax administration and make the tax system more equitable.<sup>1</sup> The initial rate of the VAT then was ten percent. The Philippines uses the tax credit method, wherein taxpayers are permitted to credit taxes paid on purchase input against taxes paid on final sales. Moreover, basic commodities have been granted exemption from VAT, whereas export-oriented transactions are subjected to VAT at zero percent.

The current VAT system, with its method of offsetting input VAT against output VAT, negates the cascading effect of the old sales tax, which was a tax on every transfer of goods through the supply chain, without the benefit of offsetting against the sales tax previously paid.

Republic Act (RA) No. 7716 took effect in 1994 to widen the VAT base and improve on the tax system already in place. The Congress subsequently passed RA No. 8241 to further modify the tax base by expanding coverage of exempt transactions.<sup>2</sup> In 2005 government, through R.A. 9337, introduced major amendments to the VAT law, which saw the removal of, among others, substantial exemptions on the sale of fuel and electric power. The law also raised the VAT rate from ten to its present twelve percent.

#### Changes in the VAT system

The last VAT rate increase was triggered by meeting the conditions provided in RA No. 9337; namely, that the value-added tax collection as a percentage of GDP of the previous year exceeds two and four-fifth percent, and that the national government deficit as a percentage of GDP of the previous year exceeds one and one-half percent. In 2005, the VAT collections in relation to the GDP reached 2.9%, while the budget deficit in relation to the GDP was at 2.7%. In a move that expended substantial political capital on the part of then President Gloria Macapagal-Arroyo, RA No. 9337 removed major exemptions such as those on petroleum products and other indigenous fuels, and on power and electric cooperatives.

RA No. 9337 also increased the VAT rate from 10% to 12%. Government allayed apprehensions of the Filipino public over the increased rate saying that "the higher VAT rate [is] a crucial component in [the] fiscal reform program... [and that] it will go a long way in improving social services and spurring economic activity by way of increased capital spending."<sup>3</sup>

 <sup>2</sup> Diokno, Benjamin E., Reforming the Philippine Tax System: Lessons from Two Tax Reform Programs. 2005 International Conference on Business, Economics and Information Technology, March 7-8, 2005.
<sup>3</sup> Gulane, Judy T. and Karen L. Lema, 12% VAT now in effect. Retrieved July 18, 2016 from http://www.gmanetwork.com/news/story/160/money/12-vat-now-in-effect.

<sup>&</sup>lt;sup>1</sup> Executive Order (EO) No. 273, July 25, 1987.

The positive effect of the 2006 reform was immediate, with revenue collections net of tax mitigating measures being estimated to have increased by 1.3% of GDP.<sup>4</sup> However, the Asian Development Bank (ADB) observed that since 2009, the impact of the 2006 VAT reform was short-lived, with the tax-to-GDP ratio declining because of the disproportionate increase between government expenditure vis-à-vis revenue collections.<sup>5</sup>

Another important aspect of the VAT system is its tax base. RA No. 7716 was enacted by Congress to broaden the VAT base. But the continuous grant of tax exemptions and incentives through the years has substantially eroded these gains.

#### The current VAT system

VAT is presently imposed on every person, who in the course of trade or business, sells, barters, exchanges, leases goods or properties, renders services, or engages in similar transactions, and/or any person who imports goods.<sup>6</sup>

The rate is equivalent to 12% of whichever is applicable among the gross selling price, gross value in money, gross receipts derived from the sale or exchange of services, or total value used by the Bureau of Customs in determining tariff and customs duties plus customs duties, excise taxes, if any, and other charges. The Philippines observes the destination principle<sup>7</sup> whereby the export sale of goods is subject to zero percent.<sup>8</sup> The list of items exempted from VAT run at 23 items, which includes the basic commodities, as well as other exemptions deemed necessary for various policy purposes.<sup>9</sup>

#### Tax reform

The Department of Finance (DOF) has stated that any changes to the VAT must be guided by the vision of a comprehensive, revenue-positive, and administratively-feasible tax reform.<sup>10</sup> Moreover, with the ASEAN integration in place, it is necessary to provide competitive tax rates and to facilitate streamlined tax compliance.

Country	Personal Income Tax (Max %)	Corporate Income Tax (Max %)	Value-Added Tax (%)
Brunei Darussalam	-	20	-
Cambodia	20	20	10
Indonesia	30	25	10
Lao PDR	24	24	10
Malaysia	25	24	6
Myanmar	30	25	5*
Philippines	32	30	12
Singapore	20	17	7
Thailand	35	20	7
Vietnam	35	20	10

#### Table 1. Comparative tax rates across the ASEAN region

Source: various country profiles retrieved from

https://home.kpmg.com/xx/en/home/services/tax/regional-tax-centers/asia-pacific-tax-centre/asean-country-tax-profiles.html. \*Commercial tax for specified services is applied at 5 percent of gross sales. For goods, products are split into various schedules, there is no standard rate. Rates can vary from 3 to 100 percent.

<sup>4</sup> Newhouse, David and Daria Zakharova, Distributional Implications of the VAT Reform in the Philippines. IMF Working Paper, July 2007.

<sup>5</sup> Public Sector Management and Sub-Sector Management (Summary): Fiscal Policy Assessment. Retrieved July 18, 2016 from

http://www.adb.org/sites/default/files/linked-documents/cobp-phi-2013-2015-oth-02.pdf.

amendedhttp://www.worldbank.org/en/news/press-release/2016/04/11/philippines-sustains-strong-growth-amidst-difficult-global-environment

<sup>7</sup> The destination principle in taxation states that goods and services are taxed only in the country where these are consumed. See Atlas Consolidated Mining and Development Corp. v. Commissioner of Internal Revenue, G.R. Nos. 141104 & 148763. June 8, 2007.

<sup>8</sup> Revenue Regulations No. 16-2005 (Consolidated Value-Added Tax Regulations of 2005), as amended, provides:

"SEC. 4.106-5. Zero-Rated Sales of Goods or Properties. — A zero-rated sale of goods or properties (by a VAT-registered person) is a taxable

transaction for VAT purposes, but shall not result in any output tax. However, the input tax on purchases of goods, properties or services related to such zero-rated sale, shall be available as tax credit or refund in accordance with these Regulations."

<sup>9</sup> See Sec. 109 of the National Internal Revenue Code of 1997 (NIRC), as amended.

<sup>10</sup> Holistic, Equitable, and Revenue-Positive Tax Reform Attainable. Retrieved July 18, 2016 from

http://www.dof.gov.ph/index.php/holistic-equitable-and-revenue-positive-tax-reform-attainable/

<sup>&</sup>lt;sup>6</sup> Secs. 105 & 106, National Internal Revenue Code of 1997 (NIRC), as

Although there are five elements considered to be viable for tax reform,<sup>11</sup> priority is placed on bringing the current income tax rates down. The comprehensive tax reform study by the previous administration proposes a blanket income tax exemption of P1 million to all wage earners while bringing down personal and corporate income taxes to 25%.<sup>12</sup> This measure is, however, expected to erode the revenue base by as much as P158 to P222 billion in the first year of implementation.<sup>13</sup>

The proposed expansion of the VAT gains significance when one considers the foregone revenues resulting from the above additional exemptions and lowered income tax rates. By removing all exemptions except those in in the agriculture, health, banks, and education, the DOF expects to compensate for lost revenue by as much as P163.4 billion by the year 2019.<sup>14</sup>

#### Change must come

Ultimately, what should be considered regarding the proposed expansion of the VAT rate is that it is part and parcel of a holistic tax reform program. While it is essential in ensuring that losses resulting from lowered tax rates are compensated, it is not the end of the reform itself and should be considered together with the other elements of the proposed reform.

Admittedly, the current VAT system is far from perfect. Continuous adjustments to its components are necessary to respond to the constantly changing fiscal and social-economic landscape. Rather than seeing the proposed reform as a threat, the same must be viewed as a step to making the Philippine tax system more dynamic and responsive.

The author is Vice Chairman and Chief Operating Officer of KPMG R.G. Manabat & Co. He is a former Undersecretary of the Department of Finance and led the DOF team that wrote and advocated for the passage of RA No. 9337, also known as the VAT Reform Law of 2005. He went on to successfully argue the constitutionality of the law before the Philippine Supreme Court.

<sup>&</sup>lt;sup>11</sup> The comprehensive tax reform program released by the Department of Finance last 30 May 2016 provides for the following viable elements for tax reform:

A tax exemption of P1 million for all wage earners, lowering corporate and individual income tax rates to 25%, and rationalization of fiscal incentives. The lowering of income tax rates will be triggered by reaching proposed GDP-to-tax ratios of 14%, 14.5%, 15%,

<sup>15.5%, 16%,</sup> and 16.5% in the years 1 to 6 of its implementation;

<sup>2.</sup> Expanding the VAT base by removing exemptions, replacing exemptions with subsidies, and increasing the VAT rate from 12% to 14%;

<sup>3.</sup> Indexing oil prices;

<sup>4.</sup> Bank Secrecy and anti-money laundering reforms; and

<sup>5.</sup> Improving organizational capacity of the Bureau of Internal Revenue and the Bureau of Customs.

<sup>&</sup>lt;sup>12</sup> Holistic, Equitable, and Revenue-Positive Tax Reform Attainable. Retrieved July 18, 2016 from http://www.dof.gov.ph/index.php/holistic-equitable-and-revenue-positive-tax-reform-attainable/ <sup>13</sup> Ibid.

<sup>&</sup>lt;sup>14</sup> Department of Finance exposition paper released to the Philippine business community for comment.

## Glossary

ADB	Asian Development Bank	ICTO	Information and Communications Technology Office
AIAP	Aerospace Industries Association of the Philippines	IMF	International Monetary Fund
ALI	Ayala Land, Inc.	IPO	initial public offerings
ASEAN	Association of Southeast Asian Nations	IT	information technology
BOP	balance of payments	JLL	Jones Lang LaSalle
BPI	Bank of the Philippine Islands	MERALCO	Manila Electric Corporation
BPO	business process outsourcing	MISSI	Monthly Integrated Survey of Selected Industries
BSP	Bangko Sentral ng Pilipinas	MPIC	Metro Pacific Investments Corporation
CALABARZON	Cavite, Laguna, Batangas, Rizal and Quezon	NCR	National Capital Region
CAMPI	Chamber of Automotive Manufacturers of the Philippines, Inc.	NEDA	National Economic Development Authority
CAR	capital adequacy ratio	NPL	non-performing loans
CARS	Comprehensive Automotive Resurgence	OFW	overseas Filipino worker
0, 110	Strategy program	OPEC	Organization of the Petroleum Exporting
FDD	first demographic dividend		Countries
FINL	Foreign Investment Negative List	PEDP	Philippine Export Development Plan
DA	Department of Agriculture	PLDT	Philippine Long Distance Telephone Company
DBM	Department of Budget and Management	PPP	public-private partnership projects
DPWH	Department of Public Works and Highways	PSA	Philippine Statistics Authority
DOT	Department of Tourism	QE	quantitative easing program
DTI	Department of Trade and Industry	SDA	special deposit accounts
FDI	foreign direct investment	SDD	second demographic dividend
FLC	Financial Learning Campaign	SMC	San Miguel Corporation
GCI	Global Competitiveness Index	SMIC	SM Investments Corporation
GDP	gross domestic product	TIEZA	Tourism Infrastructure Enterprise Zone
GIR	gross international reserves		Authority
HDMF	Home Development Mutual Fund	URC	Universal Robina Corporation
IBPAP	IT & Business Process Association of the	VaPI	Value of Production Index
	Philippines	VoPl	Volume of Production Index
ICT	information and communications technology	WB	World Bank

## About the Philippines



Rodrigo Roa Duterte (16th President of the Philippines)

6.2% GDP 6-year average

Global Competitiveness: 87th in 2010, 57th in 2016

Ease of Doing Business: 147th in 2010, 99th in 2016

Agency Ratings: Investment-grade status

STANDARD &POOR'S

FitchRatings

Moody's Investors Service



Sources: World Economic Forum's The Global Competitiveness Report 2016–2017 World Bank's Ease of Doing Business Index 2016



Capital: Manila



Languages: Filipino and English



Foreign direct investment has gone up 200%, from USD 1.9 billion in 2010 to USD 5.7 billion in 2015. The 10-point socioeconomic agenda of this administration highlights continuity in macroeconomic policies, push for tax reforms, relaxation of constitutional restrictions on foreign ownership, and infrastructure spending, among others.



KPMG International is a global network of professional firms providing Audit, Tax and Advisory services. KPMG has more than 174,000 outstanding professionals working together to deliver value in 155 countries worldwide.

#### Demonstrating the KPMG difference

KPMG professionals understand what clients need to navigate through today's business, regulatory, social and economic complexity. That is because – every day – people from KPMG focus on the needs of member firm clients. KPMG carefully assesses exactly what clients require to achieve their objectives and then work across the globe to deploy the right skills and the right experience to help meet their unique requirements.

KPMG recognizes that clients are looking for the best solutions and advice, locally implemented with a global mindset. KPMG helps client-facing teams coalesce around the issues that matter most with support from KPMG Centers of Excellence and our global methodologies and approaches. KPMG Centers of Excellence are small groups of mobile, global specialists who support our member firms in bringing high quality industry and technical expertise to our clients.

\* International Tax Review's World Tax 2017 Guide

#### KPMG in the Philippines

KPMG R.G. Manabat & Co. (KPMG RGM&Co.) is the Philippine member firm of KPMG International. It is one of the fastest-growing practices in the Philippines and among the KPMG practices in the Asia Pacific region. It has been recognized by the International Tax Review as a Tier 1 tax practice\*, Tier 1 transfer pricing practice\*\*, Tier 1 leading tax transactional firm\*\*\* and the National Transfer Pricing Firm in the Philippines in 2016. It was also recognized as the Best Consultancy and Advisory Firm in the Philippines by the International Alternative Investment Review in 2012.

KPMG RGM&Co. adopts a global approach spanning professional disciplines, industry sectors and national borders. It takes pride in imparting knowledge that adds value to its clients' businesses. The diverse public and private sector backgrounds of the partners and principals, coupled with their extensive training, and backed up by the wide knowledge resources and network of KPMG professionals, allow the firm to give real-world solutions to its clients' increasingly complex business and regulatory issues.

<sup>\*\*</sup> International Tax Review's World Transfer Pricing 2017 Guide

<sup>\*\*\*</sup> International Tax Review 2014



### R.G. Manabat & Co.

## Directory of Partners and Principals

Roberto G. Manabat Chairman & Chief Executive Officer rgmanabat@kpmg.com

Emmanuel P. Bonoan Vice Chairman & Chief Operating Officer ebonoan@kpmg.com Sharon G. Dayoan Vice Chairman & Head of Audit sdayoan@kpmg.com Henry D. Antonio Vice Chairman & Head of Advisory hantonio@kpmg.com

Pacifico Castañeda Chief Financial Officer pcastaneda@kpmg.com

Ma. Gracia C. Diaz mcdiaz1@kpmg.com

Emerald Anne C. Bagnes ebagnes@kpmg.com

Michael Arcatomy H. Guarin mguarin@kpmg.com

Ma. Carmela M. Peralta Head of Tax mperalta@kpmg.com

Noel A. Baladiang nbaladiang@kpmg.com

Carmel Lynne M. Balde cbalde@kpmg.com

Enrico E. Baluyut ebaluyut@kpmg.com

Alicia S. Columbres acolumbres@kpmg.com Imelda H. Corros icorros@kpmg.com

Dindo Marco M. Dioso ddioso@kpmg.com

Jerome Andrew H. Garcia jhgarcia@kpmg.com

Ma. Cynthia C. Hernandez mchernandez@kpmg.com

Dennis I. Ilan dilan@kpmg.com

Tireso Randy F. Lapidez tlapidez@kpmg.com

Vanessa P. Macamos vpmacamos@kpmg.com

Ricardo G. Manabat rmanabat@kpmg.com Karen Jane S. Vergara-Manese kvergara@kpmg.com

Maria Myla S. Maralit mmaralit@kpmg.com

Ador C. Mejia acmejia@kpmg.com

John Molina johnmolina@kpmg.com

Herminigildo G. Murakami hmurakami@kpmg.com

> Aline A. Novilla anovilla@kpmg.com

> Wilfredo Z. Palad wpalad@kpmg.com

Leandro Ben M. Robediso Irobediso@kpmg.com Kathleen L. Saga ksaga@kpmg.com

Manuel P. Salvador III msalvadoriii@kpmg.com

Gregorio I. Sambrano, Jr. gsambranojr@kpmg.com

Ma. Georgina J. Soberano gjsoberano@kpmg.com

Jeffree Mae M. Tapia jmtapia@kpmg.com

Darwin P. Virocel dvirocel@kpmg.com

Takashi Yano tyano1@kpmg.com

Vernilo G. Yu vyu@kpmg.com

## Mission

KPMG R.G. Manabat & Co. is a leading professional services firm that provides innovative and insightful solutions in assurance, tax and advisory. We are the clear choice of leading and emerging organizations to help them achieve their goals, while protecting the interests of their stakeholders. We do this by adopting global standards and practices driven by extraordinary people with a sense of purpose, passion and integrity.

Our Values We lead by example We work together We respect the individual We seek the facts and provide insight We communicate openly and honestly We improve communities Above all, we act with integrity For more information, please contact:



#### R.G. Manabat & Co.

#### Manila - Head Office

9/F KPMG Center 6787 Ayala Ave. Makati City 1226, Metro Manila

Telephone	+63 (2) 885 7000
Fax	+63 (2) 894 1985
E-mail	ph-inquiry@kpmg.com

#### **Cebu Office**

Unit 502, 5/F Keppel Center Samar Loop cor. Cardinal Rosales Ave. Cebu Business Park Cebu City 6000

Telephone	+63 (32) 233 9325
Telefax	+63 (32) 233 9329
E-mail	cebu@kpmg.com.ph

#### **Subic Office**

GT Solar Building B Unit 204, 2/F Sub 14-A Sta. Rita cor. Canal Road CBD area Subic Bay Freeport Zone 2222

Telephone	+63 (47) 252 2825
Telefax	+63 (47) 252 2826
E-mail	subic@kpmg.com.ph

#### **Iloilo Office**

3/F, ATM Business Center Cor. Jalandoni - Ledesma St. Iloilo City 5000

Telephone	+63 (33) 509 5358
Telefax	+63 (33) 338 0849
E-mail	iloilo@kpmg.com.ph

#### **Philippine Consumer Market Report**

2017 Investment Guide by KPMG in the Philippines

Emmanuel P. Bonoan Hadassah May R. Cordero Sharon G. Dayoan Bernadette P. Destura Michael Arcatomy H. Guarin Jose Fernando S. Morales Paul Michael M. Paraguya Darwin P. Virocel **Writers**  Emmanuel P. Bonoan *Editor-in-Chief* 

Mariel D. Javier Ma. Cristina Isabel R. Loquinario *Editorial Coordinators* 

Allan George S. Senga *Art Direction and Layout*