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Philippines: 2007 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Authorities of the Executive Director for the Philippines

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2007 Article IV consultation with the Philippines, the following documents have been released and are included in this package:

- The staff report for the 2007 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on December 11, 2007, with the officials of the Philippines on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on February 19, 2008. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its March 12, 2008 discussion of the staff report that concluded the Article IV consultation.

- A statement by the Executive Director for the Philippines.

The document listed below has been or will be separately released.

Selected Issues Paper

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PHILIPPINES

Staff Report for the 2007 Article IV Consultation

Prepared by the Staff Representatives for the 2007 Consultation with the Philippines

Approved by David T. Coe and Michael Hadjimichael

February 19, 2008

- ***Discussions:*** Manila, November 29–December 11, 2007. The mission met: Finance Secretary Teves, Bangko Sentral ng Pilipinas (BSP) Governor Tetangco, Budget Management Secretary Andaya, Energy Secretary Reyes, other senior government officials, and private sector representatives.

- ***Team:*** Messrs. I. Lee (head), Faulkner-MacDonagh, Ms. Fujita (all APD), Messrs. Botman (FAD), Halikias (PDR), and Baqir (Resident Representative). Mr. Takeda (APD) joined the mission during December 6–11. Ms. Mañalac (OED) also participated. An MCM technical assistance mission on debt management overlapped with the Article IV discussions.

- ***Focus of the consultation:*** Reducing vulnerabilities and securing a durable foundation for growth.

- ***Selected issues:*** Investment incentives and effective tax rates; measurement of the output gap; and overview of the international investment position from an asset/liability management perspective.

- ***Outreach:*** The mission held a press conference on December 11, which was well-attended and received extensive local coverage. The mission met: Senator Villar (President), chairs of the Senate Ways and Means and Finance committees, House Speaker De Venecia, and chairs of the House Ways and Means and Appropriations committees to explain the need to raise fiscal revenue.

- ***Exchange rate policies:*** Largely market determined. The Philippines has accepted obligations under Article VIII, sections 2, 3, and 4 and maintains an exchange system free of restrictions on payments and transfers for current international transactions.

- ***Context of past surveillance:*** The authorities and staff agreed broadly on the thrust of policies—progress in fiscal consolidation, prudent monetary regime aimed at anchoring inflation expectations and building international reserves, and sustained reforms of banking supervision and the financial system. Political constraints have held back a full legislative package that would enhance monetary and financial policy management.

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EXECUTIVE SUMMARY

The economic performance and outlook has improved markedly over the past few years. Founded on fiscal consolidation, investor confidence revived; strong remittance income led a surge in balance of payment inflows. Faced with a less favorable global outlook, the Philippines needs to further reduce vulnerability and place growth on a firmer footing.

Medium-term growth prospects are favorable, although subject to global economic uncertainties. Upgrading public infrastructure, regarded as a key bottleneck, would catalyze private investment and provide a rebound in domestic employment.

There has been a marked turnaround in fiscal accounts. Performance of public enterprises has improved, and the national government has lowered its deficit through expenditure restraint and VAT reform in 2006. However, the success in revenue collection from VAT reform was short lived, and a key priority is to reverse the weakening revenue collection.

New tax measures and continued collection efforts would be essential to finance needed infrastructure without weakening fiscal discipline. Implementation will take time. Hence, the planned balanced budget in 2008 will have to rely on expenditure-driven consolidation.

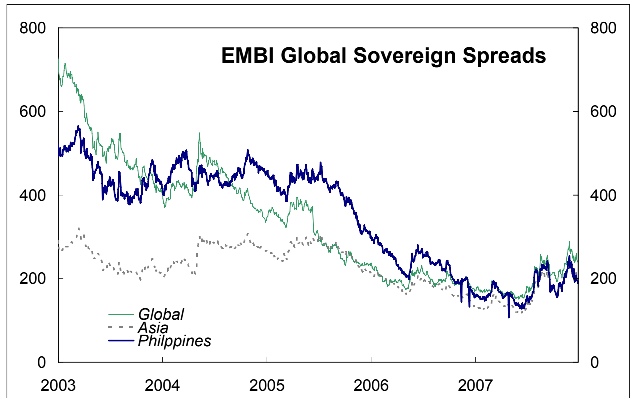
Inflation remained low because of an appreciating peso and prudent monetary policy. Intervention to smooth fluctuations and scale up buffers for increased currency flows resulted in a rapid increase in foreign reserves. The latter were sterilized successfully by widening access to the Special Deposit Account. Continuing the policy mix of easing rates, capital account liberalization, and early repayments of external debt is appropriate. Greater peso-denominated financing would reduce exposure to exchange rate risks.

Banking soundness has improved substantially. Non-performing assets were reduced without government support, and risk management facilities have been upgraded as Basel II is phased in. Yet, some banks remain exposed to interest rate risks. Efforts should focus now on lifting bank performance, which could be facilitated by passage of bills on creating a credit bureau and reforming insolvency rules. Amending the BSP charter would help strengthen bank supervision, monetary policy operations, and economic surveillance.

Privatization has attracted large interest from investors. Around 40 percent of power generating capacity has been sold to date. The firmer peso and smaller external debt service payments helped partially offset the effect of higher commodity prices on the performance of public enterprises. However, efforts should continue in finding efficiencies.

INTRODUCTION

1. ***Investors have responded positively to recent government economic policies.*** Fiscal and power sector reforms have substantially eliminated chronic public deficits, helping to cut the ratio of public debt to GDP by over one-third since 2003. Banks' asset quality has improved and banking supervision has strengthened substantially. The reforms were well-timed and allowed the Philippines to capitalize on heightened investor interest in emerging markets. The payoff is evident: stronger external capital account, a firm peso, a buoyant equity market, tighter spreads on sovereign debt, and active foreign participation in the government's privatization program.



Source: Bloomberg L.P.

2. ***The political situation remains stable.*** A December security incident, where only a small group of rebel soldiers took over a tourist hotel for a few hours calling for President Arroyo's resignation, received little public support.

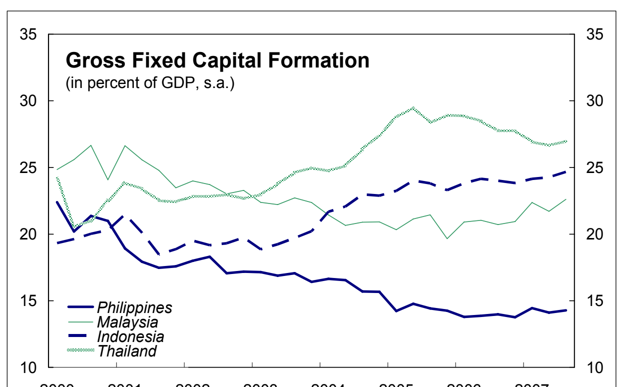
3. ***However, growing uncertainty over the global outlook adds urgency to strengthening reform momentum to cement recent gains.*** Ongoing turmoil in the financial markets portends tighter credit, and a possible global slowdown presages weaker external demand. Although the Philippines is better prepared than during previous turns of the business cycle, risks could be further reduced and growth placed more on a sustainable path. Thus, the Article IV discussions centered on *further reducing vulnerabilities and providing a durable foundation for growth*.

ECONOMIC BACKGROUND

Background

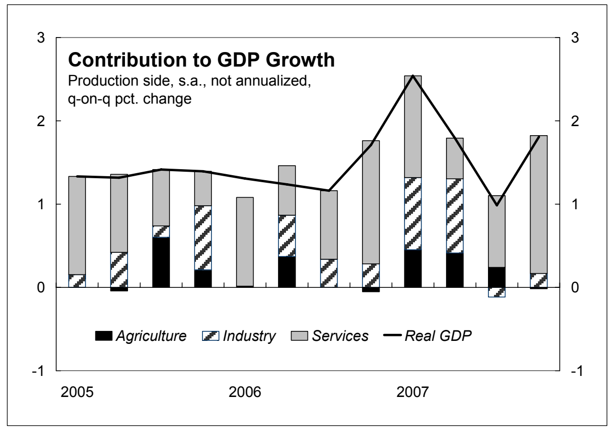
4. ***Economic activity accelerated while inflation stayed low (Figure 1).***

- *GDP rose 7¼ percent (annual average) in 2007.* Private consumption firmed as remittances remained strong, part of which financed home purchases. Fiscal impetus from government spending, including on infrastructure, provided an added push to growth. Despite tentative signs of a pick up, overall investment is still very low by regional standards, contributing to a large private saving-investment surplus.

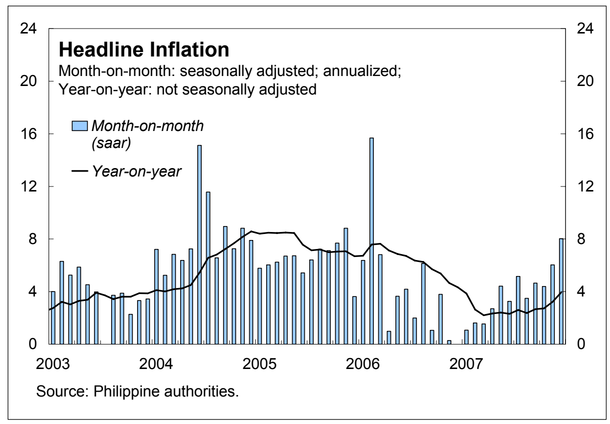


Sources: CEIC Data Company Ltd; and IMF staff calculations.

- *Services drove growth.* With strengthening domestic demand, the service sector grew 8½ percent through the third quarter (y-on-y). A construction boom continued with strong demand for residential condominiums from overseas workers, as well as for commercial office space from outsourcing businesses. Forestry and mining operations expanded in response to high commodity prices and legal reforms introduced in 2004 that allowed foreigners to enter into long-term mining contracts with Philippine landowners.

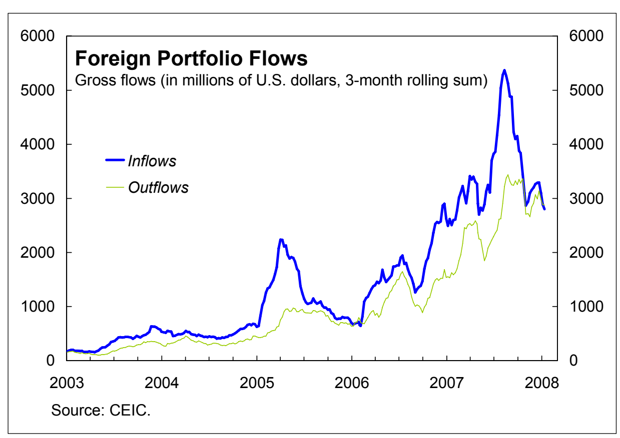


- *Price pressures remained muted.* Headline CPI inflation was only 2.8 percent (annual average) in 2007, aided by an appreciating peso and prudent monetary policy.



- *Favorable conditions led to a surge in inflows.* Although the trade deficit was large, the current account surplus was 5½ percent of GDP in the first half of 2007 (Figure 2) on high levels of transfers from overseas workers. Tighter spreads on Philippine debt lowered interest payments, and portfolio inflows turned the financial account into a small surplus. The peso appreciated 16 percent against the U.S. dollar since end-2006 (9¼ percent on a real effective basis through October). Reserves at the Bangko Sentral ng Pilipinas (BSP) reached $33¾ billion by end-December, compared with $23 billion a year earlier.

- *To date, fallout from turmoil in the global financial markets has been limited.* Philippine spreads rose as much as in other emerging markets and stabilized somewhat quicker as conditions normalized, suggesting distress no longer automatically raises a red flag as in the past. Even with heightened global risk aversion since mid-2007, foreign investors have remained active, with gross portfolio flows still high.



- *The domestic financial system felt few reverberations.* Throughout the summer, the Philippine money markets functioned with little signs of distress. At end-July, banks held around $1¾ billion (1¾ percent of asset or 15¾ percent of capital) in Credit Linked Notes (CLNs) and less than $⅕ billion in Collateralized Debt Obligations (CDOs). These, along with dollar denominated government bonds, incurred mark-to-market losses of just over $110 million when spreads rose. By end-September, however, these losses were erased as interest rates subsequently fell.

Outlook and risks

5. ***The economy is expected to enter 2008 with considerable momentum.*** Staff forecasts GDP growth of 6 percent for 2008, as fiscal impetus wanes. Net exports would contribute less to growth, reflecting a projected mark-down of global growth for the first half of the year.

6. ***Economic growth prospects are subject to growing downside risk with the unfolding uncertainties in the global financial market.*** Remittance income, particularly from workers based in non-dollar linked economies, could remain strong, and a sustained increase in investment could lift growth further. On the other hand, a sharper-than-expected global slowdown and credit crunch could undermine recent gains through a disorderly unwinding of currency flows, including possibly a sizable drop in workers remittances. Further increases in food and oil prices could weigh on consumer spending and push up inflation, and a large jump in the peso could dampen exports. However, improved fundamentals, prudent macroeconomic policies, and a strong reserve position should help the economy weather such shocks.

7. ***The medium-term outlook is broadly positive.***

- *Baseline.* Reforms to date would allow the economy to operate at a modestly higher pace of growth than in the past. With fiscal deficits under control, business sentiment would remain positive and spur private investment to expand beyond the housing rebound. The ample liquidity would provide relatively easy access to financing. Yet, without any further revenue effort, government will be unable to meet their priority targets in the medium-term expenditure framework. Thus, poor infrastructure will increasingly pose a bottleneck. On the other

Medium-Term Outlook and Saving-Investment Balance

	2006	2007	2008	2009	Avg. 2010-2013
Baseline scenario					
	(Percent change; unless otherwise indicated)				
Real GDP growth	5.4	7.3	6.0	6.0	6.1
Inflation	6.2	2.8	4.4	3.8	3.5
Tax revenue (percent of GDP)[1]	14.4	14.4	14.3	13.9	14.2
	(In percent of GDP)				
Net external saving	-5.0	-5.2	-2.7	-1.9	-0.6
Private sector balance	4.7	5.2	1.9	1.3	0.6
Saving	16.9	17.2	14.9	14.6	14.5
Investment	12.2	12.0	13.0	13.3	14.0
General government balance	0.4	0.0	0.7	0.5	0.1
Saving	2.5	2.7	3.2	2.6	3.1
Investment	2.1	2.7	2.4	2.1	3.0
Reform scenario					
	(Percent change; unless otherwise indicated)				
Real GDP growth	5.4	7.3	6.3	6.5	6.8
Inflation	6.2	2.8	4.4	3.8	3.5
Tax revenue (percent of GDP)[1]	14.4	14.4	14.8	14.8	15.6
	(In percent of GDP)				
Net external saving	-5.0	-5.2	-2.6	-1.3	0.4
Private sector balance	4.7	5.2	1.7	0.5	-1.2
Saving	16.9	17.2	14.8	14.6	14.3
Investment	12.2	12.0	13.1	14.1	15.5
General government balance	0.4	0.0	0.9	0.8	0.8
Saving	2.5	2.7	3.8	3.9	5.0
Investment	2.1	2.7	2.9	3.1	4.1

Sources: The Philippines authorities; and Fund staff estimates and projections.
[1] National government.

hand, buoyant domestic demand would lift imports, and with workers' remittances leveling off, the saving-investment balance would normalize.

- *Reform scenario.* Under the staff's "reform scenario," tax policies would be introduced that would strengthen the tax base, allowing higher capital and social spending. The expectation of better infrastructure in the medium term would catalyze private investment in the short run and throughout the period, leading to a rebound in domestic employment and a reduction in emigration. In addition, private capital inflows, led by foreign direct investment (FDI), would prompt a faster adjustment in the external balance toward its longer-term norm.

The authorities' views and policy discussions

8. ***The authorities also forecast robust growth in the short term, and a more buoyant outlook for the medium term, corresponding to the staff's strong reform scenario.*** The authorities' latest growth target for 2008 is 6.3–7.0 percent. Through 2010, the official government plan calls for a marked increase in infrastructure spending, to 4 percent of GDP. There was a shared view between the staff and the authorities that such a rebound in public investment would help drive a pickup in private activity, both in the short term and especially into the medium term. The authorities took a similar view to the staff that the fallout from the recent upheavals in the financial markets has been limited.

I. MENDING VULNERABILITIES AND SECURING A SUSTAINABLE GROWTH PATH

9. ***Discussions focused on further reducing vulnerabilities and building a solid platform for growth (Box 1).*** The policy discussions were framed around a broad assessment of external stability, focusing especially on an assessment of the exchange rate level, balance sheet vulnerabilities, and sectoral saving-investment balances.

- *Fiscal policy*: Meeting social and infrastructure needs, while balancing the budget to demonstrate fiscal prudence, would require a more sustained tax effort and a prioritization of expenditure within a medium-term framework. Shifting towards local currency debt would reduce vulnerability.

- *Monetary policy*: Maintaining the current policy mix of a flexible exchange rate, sterilized intervention, lowering policy rates, and capital account liberalization appears appropriate given the strong currency inflows and benign inflation outlook.

- *Private sector development*: Legislative changes are needed to lock in the benefits from the substantial improvement in banking supervision and to secure a better functioning financial system. The ongoing privatization program would further improve the fiscal position and rationalize government operations.

Box 1. Vulnerability Assessment

Over the past several years, the Philippines has made substantial progress addressing long-standing fiscal, external, and financial sector vulnerabilities. Ongoing economic reforms have put debt on a steadily declining path, rendering positive debt dynamics. In the general government sector, the decline in the ratio of external debt to GDP reflects sustained fiscal consolidation and debt buybacks. In the non-bank public sector, debt prepayments of power utilities have also been significant.

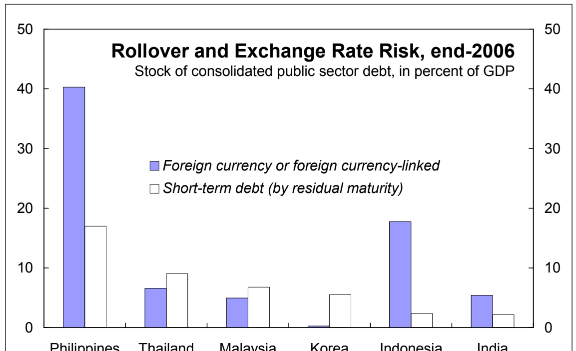
The markets have responded positively to this improvement in debt fundamentals. Since 2001, Philippine EMBI spreads have fallen by around 500 basis points and moved more closely with the overall index. Lower domestic interest rates have left debt relatively insensitive to increases in interest rates.

Selected Vulnerability Indicators[1]
(in percent of GDP, unless otherwise indicated)

	Philippines		Median, of 48 emerging market economies
	2003	2007	
External sector			
Gross reserves in percent of short-term debt[2]	124.2	222.5	139.7
Total gross external debt	78.8	43.3	45.8
Current account balance	0.4	5.2	-3.3
Gross external financing requirement[3]	16.5	4.4	15.1
Public sector			
Overall balance	-5.6	0.0	-1.8
Consolidated public sector gross debt	100.8	62.3	41.5
exposed to: Exchange rate risk[4]	68.3	36.4	16.3
Rollover risk[2]	23.2	19.5	6.2
Financial system			
Capital adequacy ratio, in percent	17.4	19.3	13.8
Nonperforming loans, in percent of total loans	16.1	7.0	3.8
Return on average assets, in percent	0.8	0.9	1.7

Source: IMF staff estimates.
[1] For the Philippines, data refer to the latest available information for 2007, where available. For other emerging markets, data refer to 2006 for stocks and mostly 2007 for flows. The 48 countries form a representative sample of major emerging market economies.
[2] Short-term debt at residual maturity (maturing medium and long-term debt, domestic and external, excluding external debt to official creditors).
[3] Current account balance plus maturing external debt.
[4] Debt in foreign currency or linked to the exchange rate, domestic and external.

However, the currency and maturity structure of public debt remains a cause for concern. The share of public debt exposed to exchange rate risk is well above the emerging market average. A plausible 30 percent depreciation would lift ratios substantially (Appendix I). In addition, the maturity structure of public debt remains tilted toward the short end, almost three times the emerging market average. This renders the debt dynamics vulnerable to a deterioration in investor sentiment.



Sources: IMF staff estimates.

Despite the impressive progress in reducing non-performing assets, banks still struggle with low profitability and high exposure to government debt. Over the past four years, the Special Purpose Vehicle law and its successor have allowed banks to sharply reduce the outstanding stock of nonperforming assets without relying on public funds. However, the share of nonperforming loans is still almost twice the emerging market average. The rate of return on assets remains low, as a large number of banks have difficulty in determining good credit risks. With large holdings of sovereign debt, banks lost just over $100 million when spreads increased sharply in end-July. While the losses were subsequently recouped, banks could suffer more significantly if spreads again widened.

A. Securing the Benefits from Fiscal Consolidation

Background

10. ***Despite recent gains in the fiscal position, additional tax efforts are needed.***

- *There has been a remarkable turnaround in the fiscal accounts* (Figure 3). Nonfinancial public sector debt is projected at about 64 percent in 2007 (from a peak of over 100 percent of GDP in 2003) because of improved performance of Government Owned or Controlled Corporations (GOCCs) and the Social Security Institutions (SSIs), lower central government deficit owing to the 2006 VAT reform, and several years of expenditure restraint. External factors also contributed, such as peso appreciation and lower interest rates. Better performance of the GOCCs reflects policy changes, most notably in the power sector, and for SSIs, higher contributions.

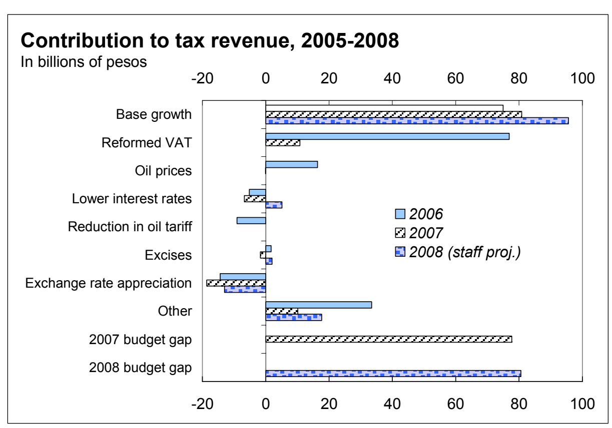
- *However, the momentum gained in revenue collection from the VAT reform was short lived.* The government deficit widened to about 1½ percent of GDP in 2007 as expected improvements in tax administration did not materialize, while there was a welcomed pickup in public investment. While the deficit is likely to be fully financed by privatization receipts, no progress was made in further reducing the debt-to-revenue ratio, which is high relative to other countries.

- *The 2008 budget relies on expenditure-driven consolidation.* New tax policy measures are minimal. The authorities again count on significant gains from stronger tax administration, which may take more time to materialize. Relative to 2007, infrastructure spending is set to fall as a share of GDP. Civil service reform is progressing, and most departments and GOCCs have submitted their rationalization proposals. Any saving is currently scheduled to be channeled to higher operating expenditures of implementing agencies.

Policy issues and staff views

11. ***High priority should be placed on regaining the momentum in tax collection.***

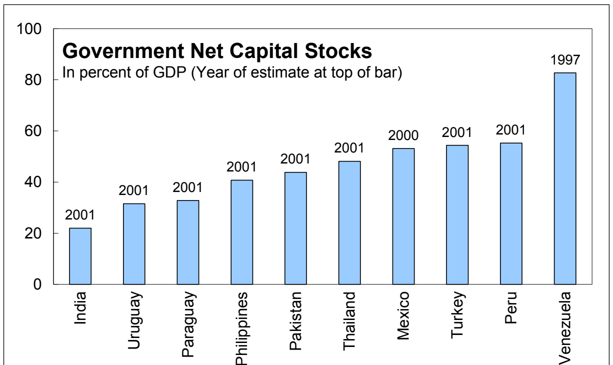
- *It is difficult to identify a single cause for the decline in tax receipts.* Possibilities include: election-related tax evasion, discontent in the ranks of the revenue agencies, decline in compliance from repeated amnesties (which aimed to improve taxpayer registration), lifting of the VAT input cap, peso appreciation, and higher smuggling despite better screening technology at Customs.



- *Staff recommended focusing on strengthening the tax base* (Box 2). Significant gains could be made through streamlining tax incentives, as proposed by the Department of Finance (DoF). Staff also argued for increasing and indexing select excises to inflation to at least partly recoup revenue lost over the past decade, amounting to 1½ percent of GDP. These tax policy measures, together with accelerated reforms at GOCCs (see below) form the basis for staff's strong reform scenario, leading to higher public, and, over time, private investment and growth.

- *Reforming the pay-for-performance system at the revenue agencies would be effective only if coupled with deeper reforms.* Higher pay should be based on a broad set of performance indicators. For pay reform to be meaningful, it will be important to first identify and address fundamental systemic weaknesses, including the lack of an effective and systemic control process of filing and payments.

12. ***More resources are needed to fund priority spending and maintain fiscal discipline.*** Staff estimates that revenue should rise by about 1½ percent of GDP, from 16¼ percent to 17¾ percent of GDP over the medium term, to meet capital spending goals of about 4½ percent of GDP while balancing the budget. These objectives are in line with the authorities' Medium-Term Expenditure Framework (MTEF) although funding sources have yet to be identified. A dearth of public investment—roads and irrigation by the government and power and other infrastructure by GOCCs—is frequently mentioned as a barrier to FDI.



Source: Arestoff and Hurlin, 2006, "Estimates of Government Net Capital Stocks for 26 Developing Countries, 1970-2002," World Bank Policy Research Working Papers 3858.

13. ***Staff suggested anchoring policies more firmly in a medium term fiscal framework and improving public-financial management.*** This could help policy makers better develop a debt management strategy. Staff welcomed the intention to set expenditure plans for Local Government Units (LGUs) in a medium-term context, which should reduce LGU concerns over cash releases and contribute to increased social spending. The authorities intend to improve budget execution and cash management, which will help better track social spending.

The authorities' views and policy discussions

14. ***The authorities plan to balance the 2008 budget while at the same time beefing up priority spending.***

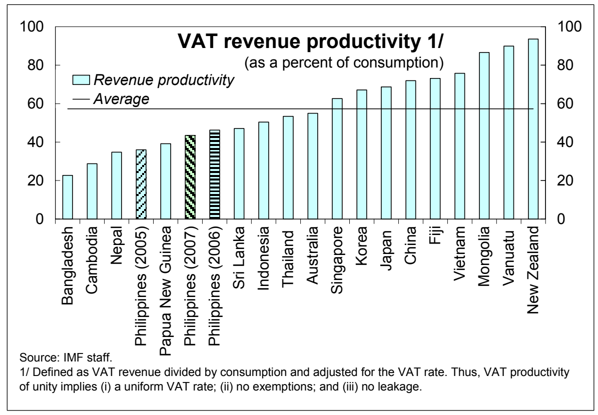
- *The priority in 2008 is to balance the budget to cement investor confidence.* To the extent that additional revenue may not be forthcoming in the short term, expenditure restraint would be inevitable. However, spending cuts would be across the board, rather than only on capital expenditure. If revenue exceeded targets or saving emerged from

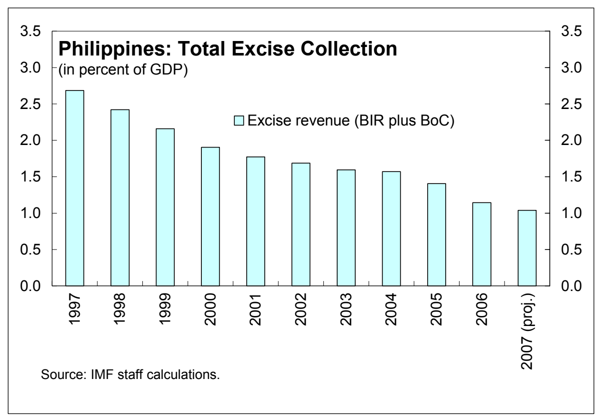
Box 2. Options for Establishing a Durable Tax Base

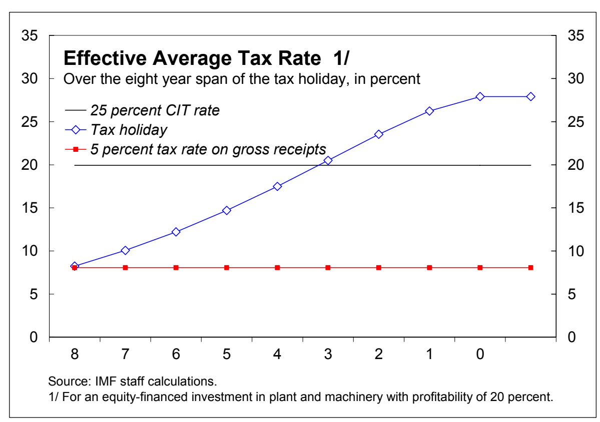
Tax collection has trended markedly lower over the last decade in the Philippines. Key reasons include: generous tax incentives, tariff reform, and a gradual erosion of excise revenue due to non-indexation. This changed in 2006, with the successful implementation of the VAT reform and tentative signs of improvements in tax administration. In 2007, however, the collection momentum slowed again at both the Bureau of Internal Revenue (BIR) and Bureau of Customs (BoC). This slowdown needs to be reversed to fund priority spending and further reduce fiscal vulnerabilities.

Options for reversing the slump in tax revenue:

Accelerating tax administration reform. There is ample scope for improvements in administration. After gains in 2006 from the VAT reform, which raised the rate to 12 percent and expanded the base, VAT productivity declined in 2007 and remains low compared to other countries (see first chart). The authorities' reform priorities at the BIR include: taxpayer registration, arrears collection, and improving audits. At the BoC, a comprehensive reform agenda is lacking. However, based on previous FAD recommendations, priorities include: strengthening management controls and the integrity of import and export clearance system; and upgrading enforcement and intelligence functions.







Raising and indexing excises. Revenue from fuel, cigarettes, and alcohol has declined by about 1½ percent of GDP since 1997, largely because most excises are not indexed to inflation (see second chart). Periodic rate increases for cigarettes and alcohol have not protected the revenue base—a task made more complicated by a four-tier rate system on tobacco. By unifying these rates, and raising and indexing excise rates, policymakers could recover revenue lost over the past decade.

Rationalizing tax incentives. Tax incentives substantially reduce effective tax rates on corporate income. Staff estimates (see third chart) suggest that the rationalization bill supported by the Department of Finance (DoF)—phasing out tax holidays and instead offering a reduced corporate income tax rate or a 5 percent tax on gross receipts—would broadly retain the current effective tax rates, while enabling the government to tap into tax redundancies (see Chapter 2 of the 2007 *Selected Issues Papers* for more details).

lower interest costs or from civil service reform, staff suggested higher public works spending, as in 2007; the authorities agreed, provided that the spending is covered by appropriations. Staff also agreed that after 2009, modest deficits could be tolerated to make room for higher social and capital spending provided tax efforts are sustained.

- *The government is targeting higher capital and social spending.* The authorities agreed that privatization is only a short-term measure, and that their MTEF would require 1½ percent of GDP additional revenue efforts. In this regard, the DoF looked forward to passage of revenue-enhancing fiscal bills.

- *In meetings with legislators, staff shared results of alternative tax reform scenarios and answered questions on bills under consideration.* The mission cautioned against proposals that would narrow, rather than broaden, the tax base. Key legislators and DoF officials agreed with staff that the decline in excise revenue needs to be reversed and tax incentives reformed.

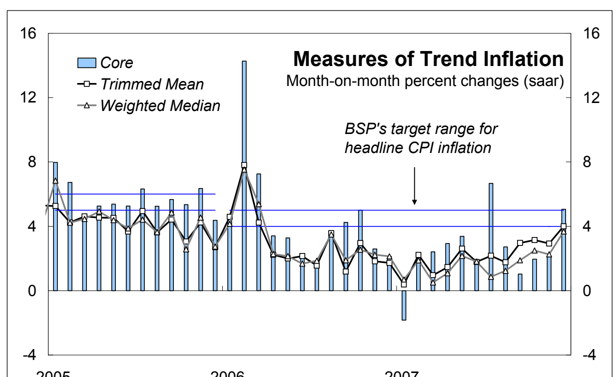
15. ***Public-private partnerships (PPPs) will continue.*** The cumulative value of PPP projects has grown to around 12 percent of GDP. The authorities foresaw additional PPPs as part of plans to expand capital spending. Staff cautioned against promoting PPPs purely as a means of fiscal saving and recommended installing a single unit in the DoF in charge of monitoring and approving all outstanding guarantees, a suggestion which was welcomed by the authorities.

B. Policy Response to Global Financial Pressures

Background

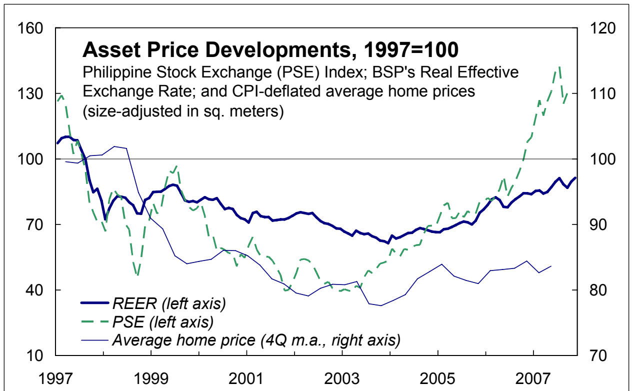
16. ***With a stable outlook for prices, the BSP has gradually eased monetary policy.***

- *Trend inflation remains low.* Headline inflation reached 3.9 percent at end-2007, slightly below the BSP's target band of 4-5 percent. Core inflation (which excludes volatile energy and food items) grew 2.6 percent (y-on-y). Measures of trend inflation, the trimmed median and weighted median, have remained below the BSP's target in 2007, suggesting inflation expectations remain anchored. However, these measures are inching up and require close monitoring.



Source: Philippine authorities and IMF staff calculations.

- *There is no clear evidence of an emerging bubble.* Partly reflecting developments in Asia, asset prices have bounced back. However, property prices are still below the 1997 level. Equity market prices have risen faster with the PE ratio reaching 15½ at end-2007. Equity prices have fallen by more than 10 percent during the first three weeks of 2008, now implying a PE ratio well below the worldwide average of 21 during 2001–06.



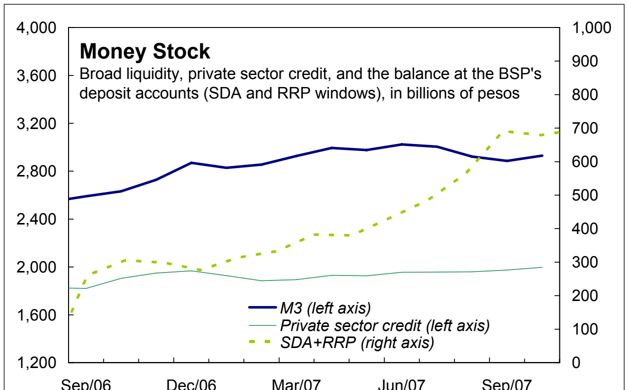
Source: CEIC Data Company Ltd.

- *Policy has turned to easing.* In July, the Monetary Board removed tiering that was introduced in late 2006 to encourage credit expansion and set the reverse repurchase (RRP) policy rate at 6 percent. With inflation still low, the Monetary Board thrice reduced the RRP rate late in the year, leaving it at 5¼ percent by end-December.

17. ***The authorities aided an orderly adjustment in the exchange rate.***

- *The strong balance of payments reflected largely an increase in remittances and, to a lesser extent, net capital inflows.* In response, the peso appreciated significantly vis-à-vis the U.S. dollar and in nominal effective terms (by 14¼ percent during 2007), notwithstanding the large buildup of gross reserves by the authorities. The authorities also intervened to smooth fluctuations of the peso along a firming trend, with no exchange rate objective. Gross reserves, inclusive of swap positions, doubled in 2007 to reach $44½ billion by year end. The authorities also prepaid external debt and relaxed limits on investment abroad in two stages.[1]

- *The BSP expanded its sterilization operation.* In May, access to the Special Deposit Account (SDA) window was widened to more financial institutions to mop up liquidity.[2] SDA deposits offered maturity-adjusted rates, just above the RRP, for up to six months. The SDA grew quickly, reaching near 9 percent of GDP, halting the growth



Sources: CEIC Data Company Ltd; and IMF staff calculations.

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[1] In April 2007, the BSP raised the limit on investment abroad (allowed without prior BSP approval), from $6 million to $12 million, and streamlined the application process. In late December 2007, a second round of liberalization removed even more restrictions and raised the annual investment limits to $30 million. Banks also gained access to longer-dated swap and forward contracts to manage currency and interest rate risks.

[2] Specifically, the trust units in deposit money banks and nonbank government institutions.

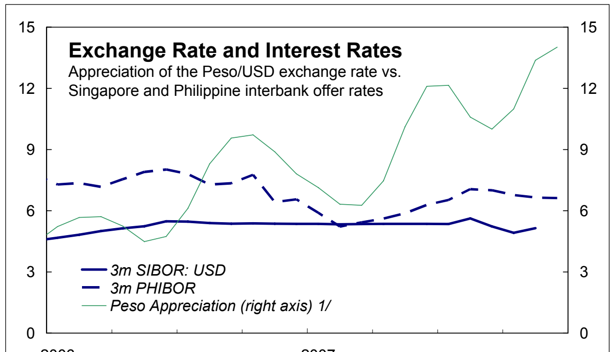
of M3, which also allowed the easing of policy rates during 2007. The swap facility was also used more extensively to sterilize intervention.

Policy issues and staff views

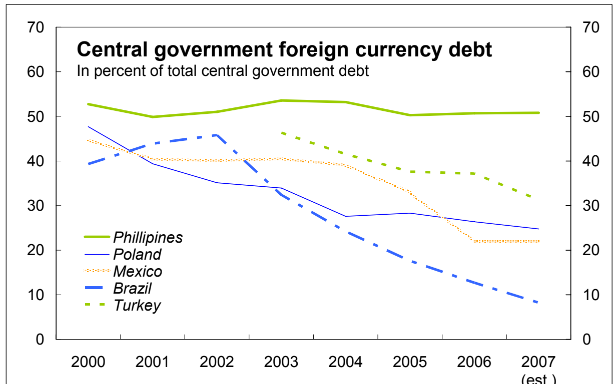
18. ***The current policy mix is broadly appropriate and the peso appears to be broadly in equilibrium.***

- *Current monetary stance.* The staff and private sector analysts forecast inflation at around 4–4½ percent in 2008 against a target of 4 percent ±1 percent, which was set in 2006. The inflation target for 2009 at 3½ percent ± 1 percent aims to continue the steady process of disinflation.

- *Current level of the exchange rate and de facto exchange rate regime.* Staff estimates the underlying current account balance to be only slightly larger than the norm, suggesting the level of the current real exchange rate only slightly undervalued or close to its equilibrium level (Box 3). Staff considers that, while it is difficult in practice to differentiate between intervention and reserve buildup, and in view of the authorities' explanations that the bulk of the intervention was for reaching their gross reserve goal at this opportune time, the de facto exchange rate regime remained independent float. The staff recommended maintaining a flexible exchange rate regime with intervention limited to smoothing erratic movements, and saw merit, in the period ahead, in pre-announcing the BSP's intended buildup of reserves as this would help the market better price the peso and underscore the authorities' commitment to a market-determined exchange rate.



Sources: CEIC Data Company Ltd; and IMF staff calculations.
1/ Year-over-year percent change of 3 month centered moving average.

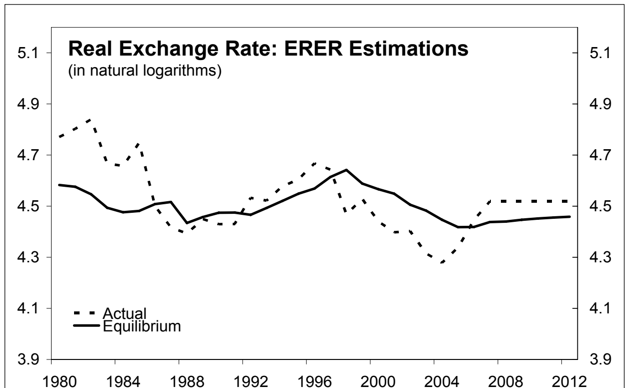


Source: Country authorities and IMF staff calculations.

- *More broadly, policy should respond flexibly if capital inflows were to strengthen significantly.* With Philippine interbank rates still modestly higher than comparable rates abroad, there is some scope to further ease policy should inflows strengthen. However, rising food prices in the region and higher oil prices internationally pose upside risks to the inflation outlook and warrant caution.

Box 3. Assessment of the Level of the Exchange Rate

Tentative staff estimates indicate the current level of the peso is broadly in line with fundamentals. The latest CGER estimates, after adjusting for multilateral consistency, range from an undervaluation of 13–14 percent to an overvaluation of 6 percent. While the magnitudes are somewhat different, the mission team's estimates approximate those of the CGER (see text table). The narrowing of the undervaluation from last year appears to be due to the strengthening of the peso, which in real effective terms appreciated by 15 percent (y-o-y) through mid-2007.



Source: IMF staff estimates

Equilibrium Exchange Rate Estimates

	Current account assumptions			Real exchange rate	
	Elasticity	Underlying balance[1]	Equilibrium balance[1]	Gap[2]	Gap, adjusted for multilateral consistency[2]
Macroeconomic balance approach: [3]					
CGER[4]	0.24	1.0	-1.9	-11.2	-12.7
Mission team	0.24	0.4	-1.4	-6.8	—
Equilibrium real exchange rate approach:					
CGER[4]	—	—	—	—	6.0
External sustainability approach: [3]					
CGER[4]	0.24	1.0	-2.3	-12.8	-14.2
Mission team	0.24	0.4	-2.3	-10.6	—

Sources: CGER and mission team estimates.
Note: Reference period for the CGER and the mission team's assessments are September and November, 2007, respectively.
[1] Ratio of current account balance to GDP.
[2] Undervaluation="-".
[3] Based on medium-term projections through 2012.

The mission team estimated the equilibrium current account deficit at 1.4 percent of GDP under the Macroeconomic Balance (MB) approach. This is smaller than the norm of 1.9 percent deficit provided by the CGER as an adjustment of 0.5 percent of GDP was made to reflect precautionary savings from the overseas Filipino workers' remittances originating from oil producing countries.

The underlying current account surplus is estimated to be about 0.4 percent of GDP. This is based on the assumption that the following temporary and cyclical factors have played out: (i) portfolio-type flows in tandem with the overall reflow to Asia that started in 2005-06 (about 2 percent of GDP); (ii) a slowdown in workers going abroad in response to somewhat faster domestic GDP growth (about 1 percent of GDP), and (iii) a pick up in capital goods and oil imports, in response to improved investor confidence and the expected stay of the further hike of petroleum prices in early 2008 over the medium term. Imports may have also been low in 2007 from possible under-recording due to election-related lenience this year (potentially as much as 2 percent of GDP).

Notwithstanding the relatively large margins of error surrounding such estimates, the mission's tentative assessment is that the current level of peso is broadly in equilibrium.

19. ***The government could adjust its borrowing mix, with greater financing from peso-denominated bonds, to reduce exposure to exchange rate risks.*** The Philippines is somewhat of an outlier: foreign currency borrowings are large and, unlike in many Latin American countries, the share has not fallen in recent years. Greater issuance in pesos would reduce vulnerabilities and improve standings with ratings agencies. However, it would be prudent to maintain a modest foreign currency presence in international markets to allow the authorities to tap external funding sources if the need arose. These moves could also be part of a broader strategy to help reduce pressures on the peso.

The authorities' views and policy discussions

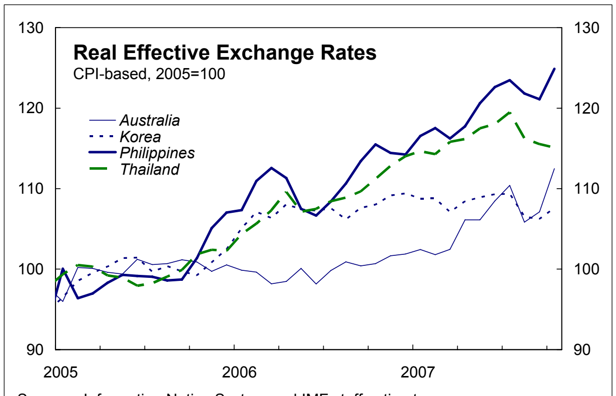
20. ***Emergent pressures will condition whether the easing cycle continues.***

- *The firm peso has helped temper the impact of higher import costs, particularly from resurgent food and oil prices.* There was a shared view that wider access to the SDA had helped reduce liquidity growth. Exceptional spikes in commodity prices were being watched closely for signs of second round effects on domestic prices and for evidence that higher costs have not dislodged inflation expectations.

- *The authorities also saw risks to the global inflation outlook.* Recent measures adopted by central banks to cope with seizures in the money markets have pumped a large amount of cash into the global financial system. Once conditions normalize, this liquidity could swamp markets with liquidity and add to price pressures.

21. ***The authorities remain committed to a flexible exchange rate system.***

- *BSP officials emphasized that the exchange rate is market determined.* Intervention is aimed at smoothing volatility of the peso. Staff questioned to what extent the exchange rate was managed in light of the large reserve accumulation. The authorities emphasized that they took the opportunity of favorable market conditions of low inflation and stronger balance of payments position to strategically build up reserves, and thereby reduce the country's vulnerability. Beyond that, the peso was left to the market. While other central banks accumulated reserves several years ago, the BSP has not had a similar opportunity until recently. Now, they plan to maintain a comfortable level of reserves, with memories of past financial crises still fresh, as a form of self-insurance against growing uncertainty.



Sources: Information Notice System and IMF staff estimates.

- *Indeed, despite large reserves accumulation, the peso has risen at one of the fastest paces in Asia.* The authorities agreed that the current level of the real effective exchange rate is broadly in line with fundamentals. However, they expressed concern about possible overvaluation in the future. The appreciating peso has adversely affected locally sourced exporters and overseas foreign workers, and both have scaled up complaints.

- *Staff supported the BSP's exchange rate policy and decision to continue using a mix of measures to moderate the impact of capital inflows on the economy, weighing costs and benefits of each measure.* The second round of foreign exchange liberalization was particularly important because it has facilitated free capital flows in an increasingly integrated market, which could also alleviate pressures on the exchange rate.

22. ***The authorities agreed that greater domestic borrowing would encourage local capital market development and reduce external vulnerabilities.*** DoF officials announced that more borrowing would be sourced locally, in pesos, with only $500 million in offshore commercial borrowing in 2008. The mission supported this shift, which would help gradually reduce exposure to currency risk—a source of vulnerability discussed in the DSA (Appendix I). At the same time, staff also suggested lengthening maturities to decrease rollover risk.

C. Financial and Structural Policies

Background

23. ***While challenges remain, the financial system has begun to turn the corner (Figure 4).***

- *Banks upgraded risk management facilities ahead of the July 2007 introduction of Basel II.* These included higher risk weights on non-performing assets (NPAs), new charges for operational risk, and a 100 percent weight (phased-in over three years) on Philippine foreign currency sovereign bonds.

- *The extension of the Special Purpose Vehicle Law has allowed a disposal of nearly P130 billion in distressed assets.* An improving property market has also helped banks unload foreclosed properties.

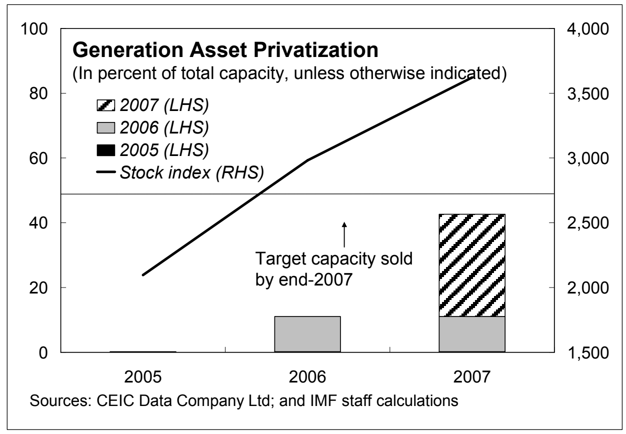
- *Surveillance over banks has improved.* BSP auditing functions have recently been overhauled, focusing on bank inspections, diagnostic accounting, and a clearer delineation of responsibilities within the BSP on oversight.

- *Large holdings of government debt render banks vulnerable to sharp spikes of sovereign spread risk.* Lack of good lending prospects, along with high reserve and liquidity requirements and the difficulty in taking legal action against defaulters, have led banks to place around one-third of assets in government securities. However, banks' direct holdings of structured debt instruments are around 1¾ percent of assets.

- *Critical legislation has stalled.* Despite repeated attempts, Congress has not passed bills that would: improve the credit reporting system; permit a broader range of investments, including real estate investment trusts; reform insolvency rules; and amend the BSP charter that would strengthen, *inter alia*, legal protection to bank supervisors and inspectors, enhance data collection, and allow the BSP to issue debt.

24. ***Good progress has been made in power sector reforms, and efforts for rationalization of other GOCCs have begun.***

- *With improved investor confidence, power sector privatization made good progress in 2007.* To date, over 40 percent of power generating capacity has been sold. A government owned power transmission corporation, the National Transmission Corporation (Transco), was successfully auctioned in December after repeated past failures.



- *GOCCs and SSIs had a good year in 2006 and in the first three quarters of 2007.* The appreciation of the peso helped mitigate higher oil prices and reduce external debt service payments. The National Power Corporation (NPC) is expected to record a small surplus in 2007 with higher sales. SSIs benefited from a strong stock market and an increase in payroll receipts after contribution rates were increased and more overseas workers contributed to the system.

- *However, selected GOCCs are still under strain.* The National Food Authority (NFA) and Light Rail Transit Authority (LRTA) have substantial, although declining, deficits stemming from cost increases and low cost recovery.

Policy issues and staff views

25. ***There appears to be little impact, to date, of the turbulence in global markets on the Philippine financial system.*** To be certain, portfolio inflows have tapered off and spreads have risen, but not disproportionately. Bank shares have been depressed, particularly for those holding large amounts of government bonds, and thus exposed to large changes in spreads. Continued vigilance is thus warranted, particularly if risk aversion builds or inflation picks up, leading to more adjustment in yields.

26. ***With vulnerability reduced, promoting effective financial intermediation emerges as a key challenge.*** Despite substantial progress in reducing NPAs, they remain large and depress bank profits. Bank lending remains low, well below funds raised in the capital

market in 2007, as banks are willing to lend to only their best clients. The credit reporting system is poor, only 5½ percent of adults are currently covered, and an inefficient bankruptcy code extends recovery time to 5¾ years and reduces recovery rates to 4¼ percent. Enactment of a full legislative package would help expand access to credit for small and medium-sized enterprises, reduce external borrowing, and encourage investment.[3]

27. ***The staff welcomed efforts to further strengthen the BSP's supervision and surveillance capacity.*** The staff recognized that training and reorganization of the BSP's Supervision and Examination Sector was well underway. Reforms, including a new Prompt Corrective Action framework and close collaboration with the Philippine Deposit Insurance Corporation, have empowered auditors to track banks' activities more closely. The mission urged BSP staff to keep monitoring developments in the property sector closely. Staff also welcomed the ongoing work within the BSP on the inaugural *Financial Stability Report*. The first report would be published this year, although only internally, as a dry-run.

28. ***The staff reviewed the GOCCs fiscal position and its durability.*** Staff welcomed plans to introduce performance contracts and medium-term deficit targets for GOCCs representing high fiscal risk, starting with the NFA.

The authorities' views and policy discussions

29. ***BSP staff emphasized that the banking system was relatively well prepared to withstand a tightening of the global credit cycle.*** Internal stress tests suggested that systemically important banks could comfortably withstand further widening of sovereign spreads. Furthermore, exposure to CDOs and underlying assets of CLNs were investment grade credits. However, widening spreads have led to mark-to-market losses, which have been manageable, and a few non-systemic banks may be vulnerable if government bond yields rose sharply.

30. ***Further legislative changes and reform efforts are important.***

- *The BSP Charter Amendment is critical.* The delay in the passage of the law has required the BSP to offer indemnity insurance to its supervisory staff, reducing the fear of lawsuits, as a temporary alternative. The amendment would also allow the BSP to issue its own debt and give more power to collect data on the non-bank sector for its surveillance activities. Cooperation with the Philippine Deposit Insurance Corporation (PDIC) has enabled the BSP to take action against some banks.

[3] The Corporate Recovery Act would aid creditors in a speedy liquidation of a borrower's assets. The Credit Information Systems Act would establish a publicly-charted corporation (with the BSP holding a 40 percent equity stake) to collect credit information (similar to private credit bureaus in other countries).

- *Internal reorganization in bank supervision has made headway.* The process of improving management within the BSP has been difficult. Human capital skills have been upgraded through very short-term secondment at offshore investment and commercial banks.

31. ***While recognizing the banking system could be more efficient, the authorities emphasized significant work has begun in this area.***

- *Process of bank restructuring is ongoing.* The reduction in NPAs has occurred entirely through a private-sector led framework, with no public funds used for bailouts. Moreover, banks have been consolidating. Basel II implementation, preparation for which began several years ago, has forced higher provisioning and greater attention to risk. The improved property market, however, has increased the value of the Real and Other Property Acquired, reducing the provisioning requirements. The BSP has also been active in promoting micro credit and SME lending programs.

- *Capital market development is proceeding apace.* There have been welcome moves toward deepening domestic bond and equity markets. This has meant greater corporate reliance on security issuances over bank lending.

- *The BSP is not overly concerned about banks' increased lending to the property sector.* Strict exposure limits prevent real estate lending from exceeding 30 percent of loan portfolios. Related party lending is also limited to 20 percent of portfolio. Moreover, recent demand for property mainly reflects acquiring dwellings for ownership, rather than speculative investment.

32. ***The process of more fundamental reforms of the GOCCs is underway.***

- *With ADB technical assistance, the government is currently setting up a framework of performance contracts for GOCCs,* mainly for the National Development Company, the LRTA, the Philippine National Railways, and the Home Guarantee Corporation.

- *The authorities are completing the framework for streamlining the operations and strengthening the management of the NFA.* However, the scope for saving may be limited since most of the NFA's deficit is driven by factors outside its control, such as the administratively-set rice price and subsidies for school food programs.

STAFF APPRAISAL

33. ***The Philippine economy is reaping the benefits of reforms, but further progress is required as uncertainties in the global outlook grow.*** Sustained fiscal prudence has helped to erase chronic public deficits. Bank supervision has been substantially strengthened, and the banking system's health improved. Markets have taken note, resulting in readily available

financing for the current expansion. However, attention should now turn to address infrastructure bottlenecks and social needs and to strengthen the financial sector's ability to efficiently channel resources, including from foreign currency inflows.

34. ***Already, much has been done to streamline the public sector.*** The government's privatization program has attracted strong investor interest. The 2006 tax reform has improved the VAT's efficiency. These improvements, together with tight control over spending and improved performance of GOCCs, have slashed the public sector deficit and improved the Philippines' debt dynamics further. The government's plan to maintain a balanced budget through 2008, as a demonstration of fiscal prudence, should further cement credibility.

35. ***However, there is an urgent need to raise the tax effort to place priority spending on a sustainable footing.*** Balancing the budget and reaching targets for social and capital spending will require additional tax effort of at least 1½ percent of GDP over the medium term. While administrative reforms will help, legislation is needed to restore the tax base by rationalizing fiscal incentives and by adjusting excise taxes. Although PPPs are useful, plans to more closely monitor these projects, particularly guarantees extended to private investors, would help the government manage its exposure and further reduce fiscal risks.

36. ***The authorities managed the foreign exchange inflows well, while maintaining price stability.*** The authorities have smoothed peso fluctuations as they took a strategic opportunity to build reserves, which now appear adequate. There was a compelling case to raise the level of reserves, and staff continue to view the exchange rate as market determined. Wider access to the Special Deposit Account, together with operations through the Reverse Repurchase facility and greater use of swaps, have successfully sterilized the reserves buildup and reduced liquidity growth. Well-anchored inflation expectations and an appreciating peso have helped counter the effects of sharply higher commodity prices into 2008. If the inflation outlook remained comfortable, and capital inflows continued to put pressure on the peso, there could be scope for further easing. Nevertheless, higher regional food and oil prices warrant caution.

37. ***The underlying current account balance is slightly larger than the norm, suggesting the exchange rate is broadly in equilibrium.*** Nevertheless, groups that have been adversely affected by the peso's strength have scaled up complaints. Continued use of a mix of measures, including a flexible exchange rate with intervention limited to smooth erratic movements and build up reserves, is appropriate. Also, the recent two-step liberalization of the financial account should help moderate net capital inflows. The government's decision to tilt the borrowing mix more heavily toward domestic sources is encouraging; it could reduce vulnerabilities and potentially ease pressure on the peso.

38. ***The outlook for the financial system has improved substantially.*** Welcome progress has been made in disposing of non-performing assets. Following the introduction of international accounting standards and introduction of Basel II, banks have upgraded risk

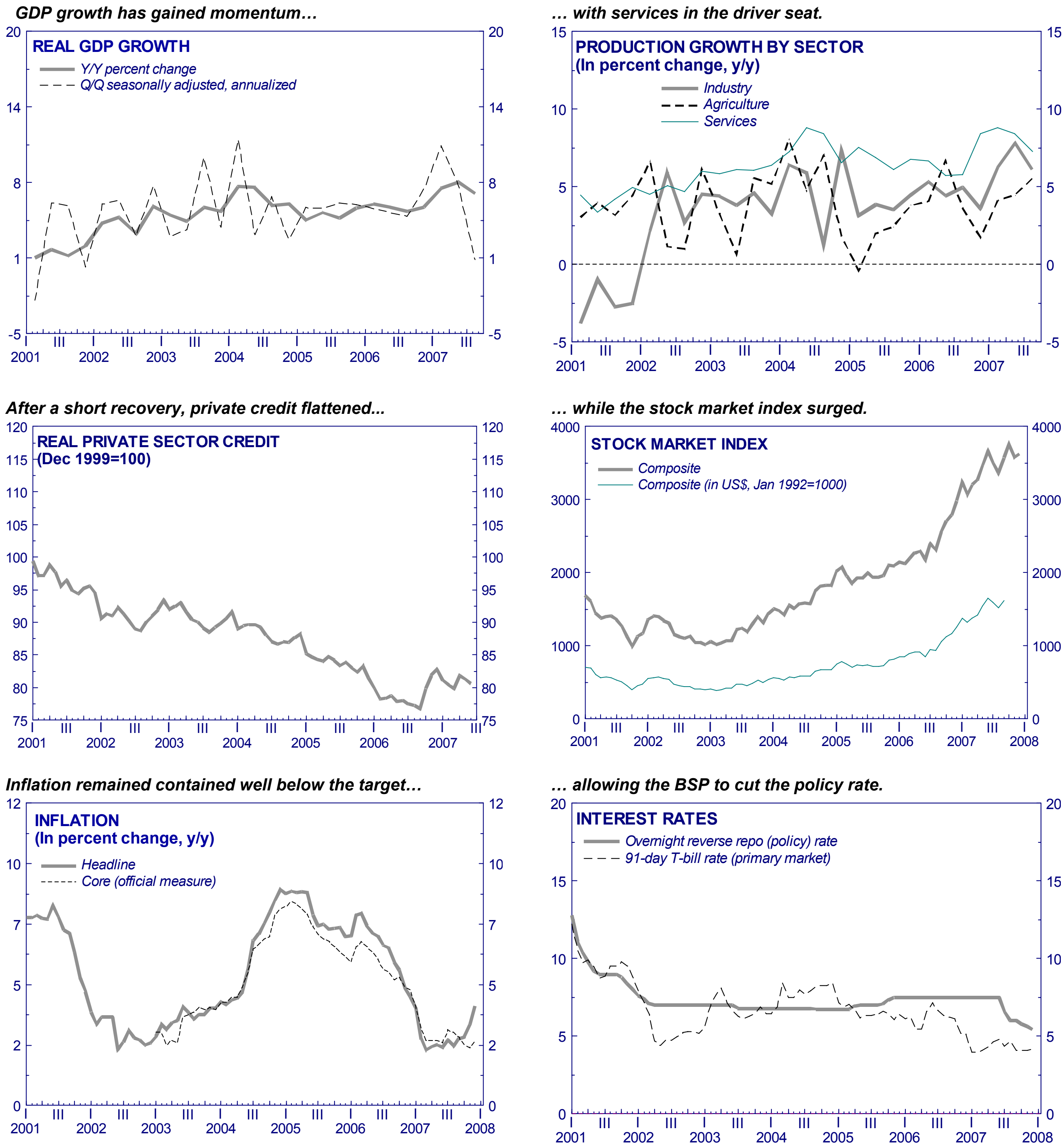
management facilities, raised capital, and merged. Bank monitoring has also improved, thanks to a reorganization that has created a more streamlined and effective supervision unit at the BSP. However, passage of the BSP Charter Amendment will be essential to lift the threat of legal action against supervisors, facilitate the operation of monetary policy, and improve economic surveillance of the non-bank sector.

39. ***Nevertheless, much work remains if the economy is to weather a serious turn of the credit cycle.*** The remaining stock of non-performing assets is large, depressing the return on assets—one of the lowest in the region. Banks hold a large stock of government debt that is sensitive to changes in sovereign spreads. Pending key legislation such as the Corporate Recovery Act and the Credit Information Systems Act could help improve bank profitability and lending through better pricing of loans and greater recovery rates from loans that sour.

40. ***Ongoing power sector privatization efforts have been successful.*** Sales of government assets have generated more income than expected. Greater debt prepayment and pricing reforms have allowed the NPC to improve its financial picture. The final auction of Transco, after repeated failures, is particularly welcome. These developments should help support the government's effort to ensure that growth is not impeded by power shortages.

41. Staff recommends the next Article IV Consultation be on the standard 12-month cycle.

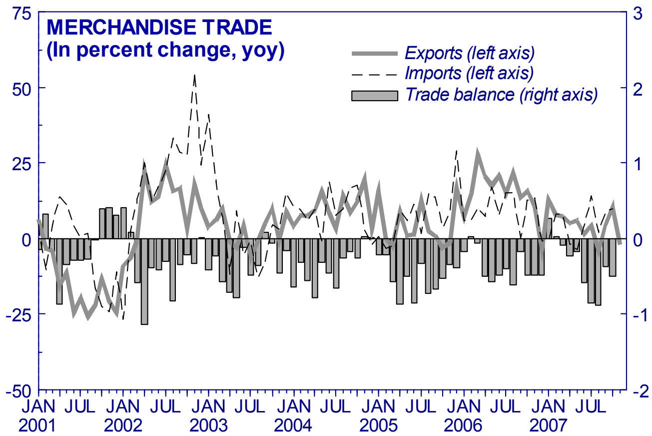
Figure 1. Domestic Developments



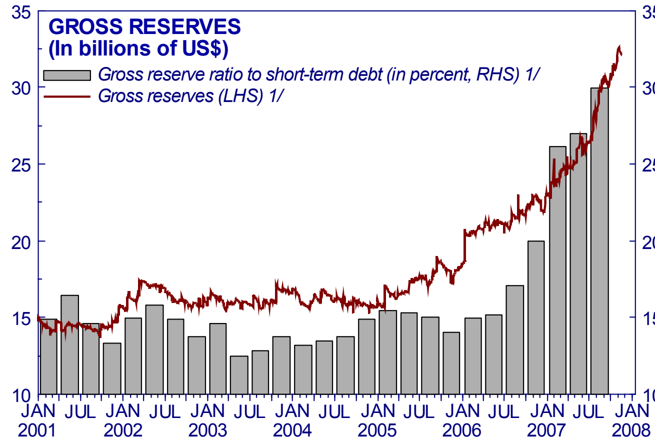
Sources: Data provided by the Philippine authorities; CEIC; and Fund staff estimates.

Figure 2. External Developments

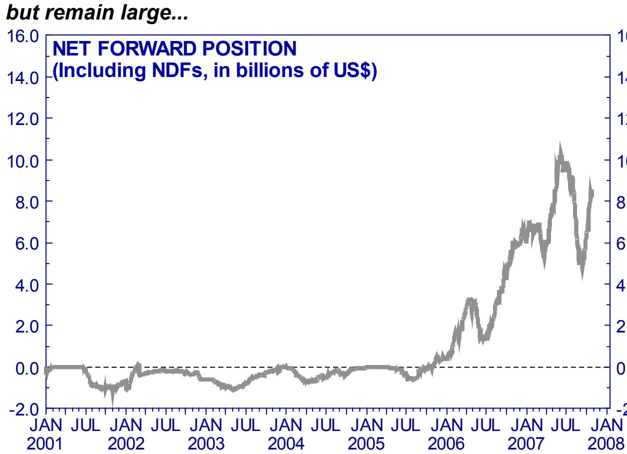
The trade deficit narrowed in the first months of 2007, but has been widening recently…



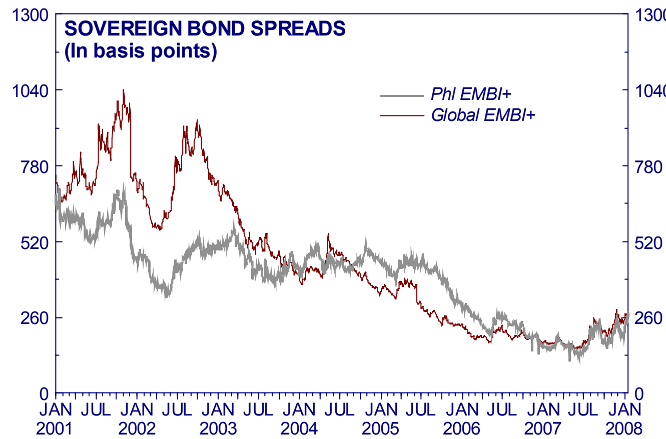
…but reserves and short-term debt coverage continued to increase.



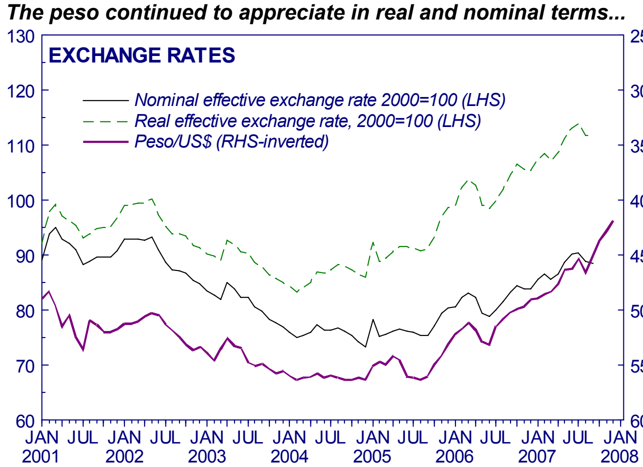
The stock of outstanding swaps have come off of recent highs but remain large...



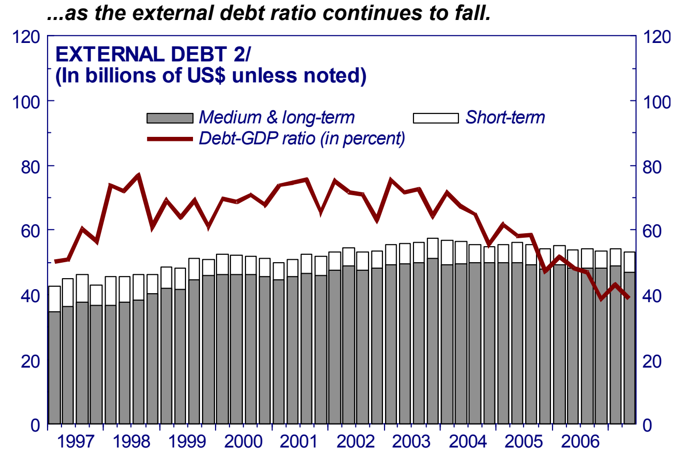
...and spreads remained tight, as bond prices weathered the turbulence in financial markets over the summer.



The peso continued to appreciate in real and nominal terms...



...as the external debt ratio continues to fall.

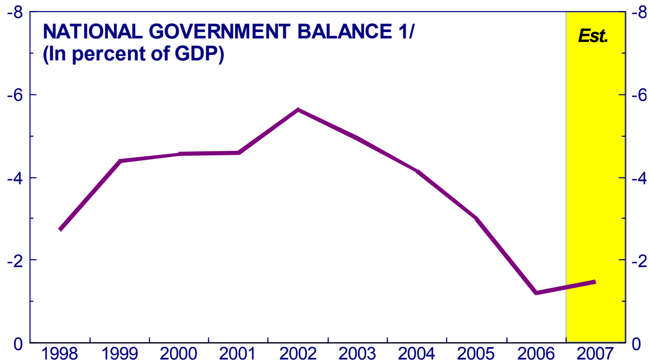


Sources: Data provided by the Philippine authorities; CEIC; and Fund staff estimates.

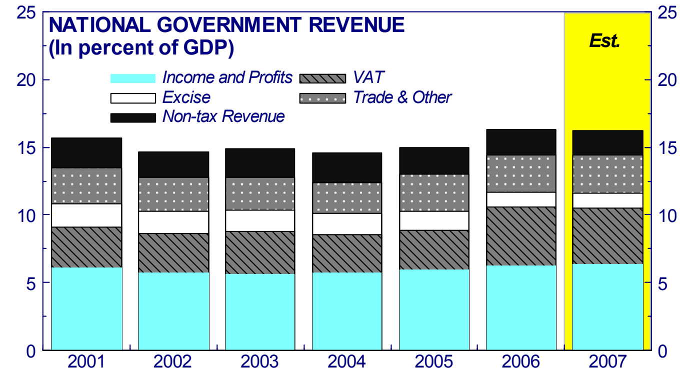
1/ Adjusted for pledged assets; Fund staff estimates.
2/ Includes private sector inter-company accounts, loans without BSP approval, and obligations under capital lease.

Figure 3. Fiscal Sector

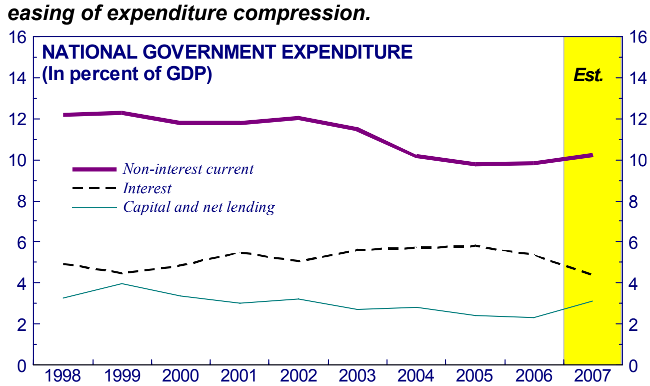
After years of adjustment, the deficit has leveled off...



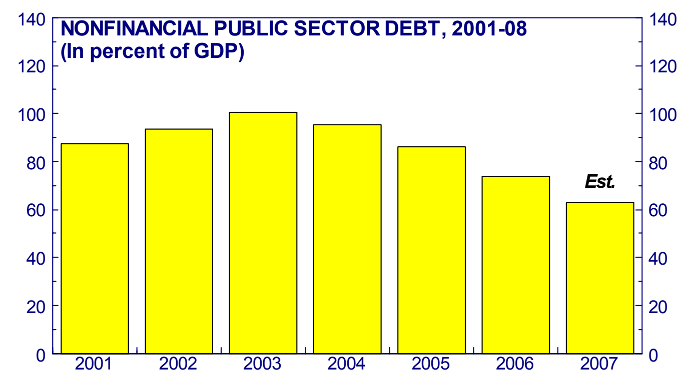
...as revenue collections momentum subsided...



...but there was a welcome pickup in capital spending and easing of expenditure compression.



Public sector debt continues to trend down from high levels.

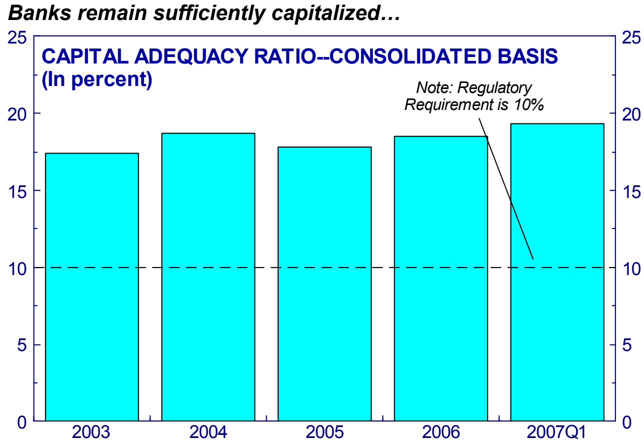


Source: Data provided by the Philippine authorities; and Fund staff estimates and projections.

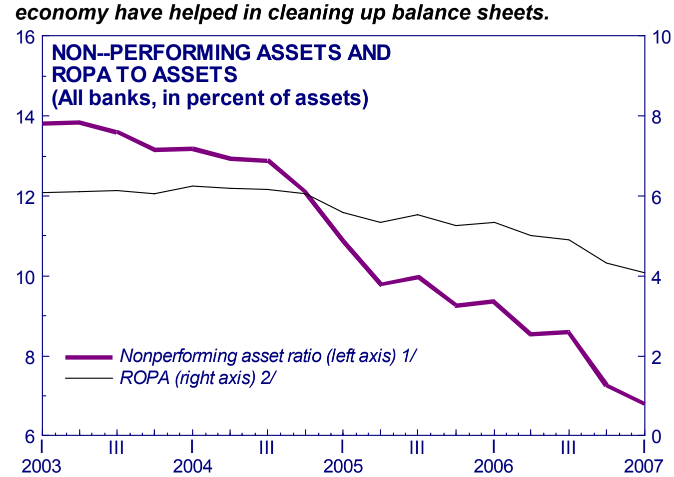
1/ Fund staff definition. Excludes privatization receipts of the national government and includes operations of the Central Bank-Board of Liquidators.

Figure 4. Banking Sector

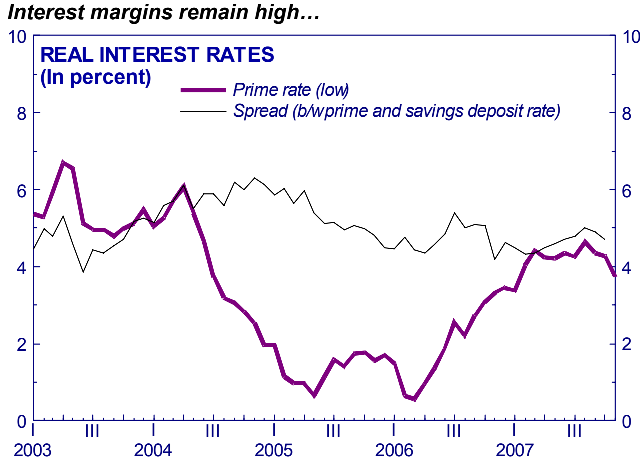
Banks remain sufficiently capitalized…



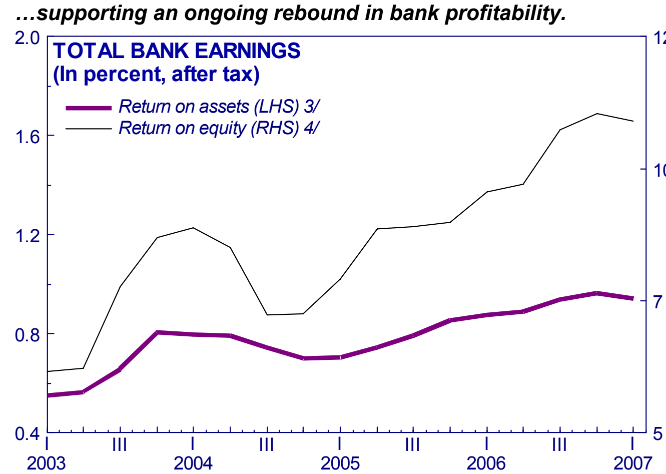
…new standards, an improved regulatory framework, and strong economy have helped in cleaning up balance sheets.



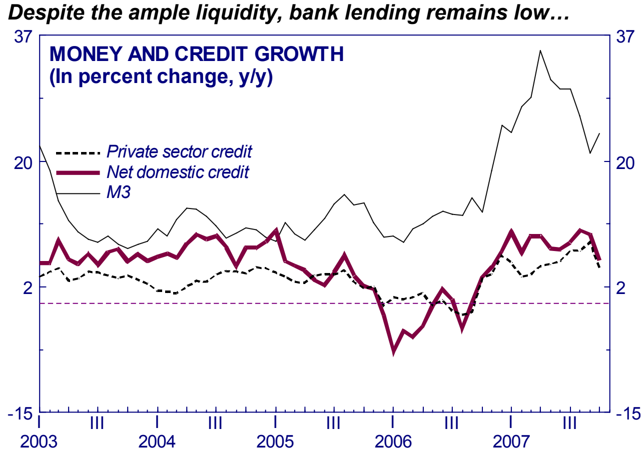
Interest margins remain high…



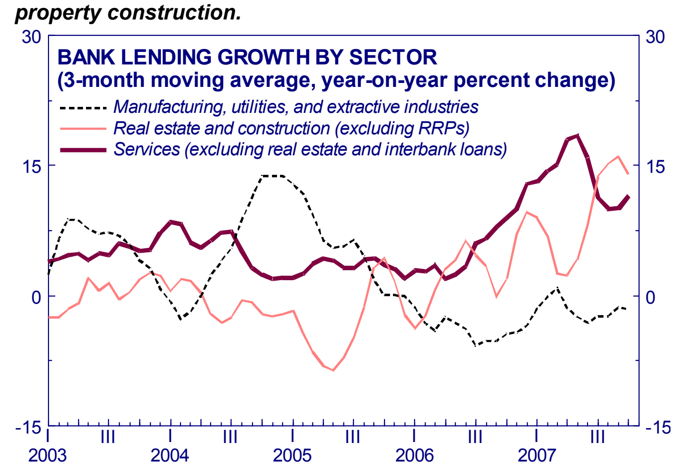
…supporting an ongoing rebound in bank profitability.



Despite the ample liquidity, bank lending remains low…



…except to the service sector and, more recently, to finance property construction.



Sources: Data provided by the Philippine authorities; CEIC; and Fund staff estimates.

1/ Nonperforming loans plus ROPA (see below) over gross assets.

2/ Real and other properties owned or acquired in settlement of loans and receivables, including real properties, shares of stock, and chattels formerly constituting collaterals for secured loans.

3/ Return on assets for all banks is defined as net income before taxes as a share of domestic assets (assets less net claims due to headquarters' branches or agencies.

4/ Return on equity refers to the ratio of net income after taxes to average capital.

Table 1. Philippines: Selected Economic Indicators, 2003–08

Nominal GDP (2006): P6,033 billion ($117.6 billion)
Population (2006): 87.0 million
GDP per capita (2006): $1,352
Poverty headcount ratio at $2 a day at PPP (2003): 43 percent
IMF quota: SDR 879.9 million
Main products and exports: Electronics and agricultural products
Unemployment rate (2006): 7.9 percent

	2003	2004	2005	2006	2007 Staff. Est.	2008 Staff Proj.
GDP and prices (percent change)						
Real GDP	4.9	6.4	4.9	5.4	7.3	6.0
CPI (annual average)	3.5	6.0	7.7	6.2	2.8	4.4
CPI (end year)	3.9	8.6	6.7	4.3	3.9	3.4
Investment and saving (in percent of GDP)						
Gross investment	16.8	16.7	14.6	14.3	14.7	15.4
National saving 1/	17.2	18.6	16.6	19.3	19.9	18.1
Public finances (in percent of GDP)						
National government balance (authorities' definition)	-4.6	-3.8	-2.7	-0.9	-0.1	0.0
National government balance (authorities' definition, excl. privatization receipts)	-4.9	-4.2	-3.0	-1.0	-1.4	-0.6
National government balance 2/	-4.9	-4.2	-3.0	-1.2	-1.6	-0.7
Nonfinancial public sector balance 3/	-5.6	-5.0	-2.1	0.2	-0.1	0.6
Revenue and grants 4/	20.9	20.6	22.1	23.2	23.1	23.0
Expenditure 5/	26.4	25.6	24.2	22.9	23.2	22.4
Nonfinancial public sector debt 6/	100.8	95.2	86.0	73.9	62.3	59.0
Monetary sector (percent change, end of period)						
Broad money (M3)	4.2	10.2	10.3	22.7	9.1 8/	...
Interest rate (91-day Treasury bill, end of period, in percent) 7/	6.5	8.4	6.4	5.1	4.2	...
Credit to the private sector	2.8	4.9	-0.3	6.7	8.5 9/	...
External sector						
Export value (percent change)	2.7	9.8	3.8	15.6	5.0	8.1
Import value (percent change)	3.1	8.0	8.0	11.0	5.5	13.9
Current account (in percent of GDP)	0.4	1.9	2.0	5.0	5.2	2.7
Capital and financial account (in billions of U.S. dollars, excluding errors and omissions)	0.8	-1.6	2.3	-1.3	2.3	0.8
Foreign direct investment (net)	0.2	0.1	1.7	2.0	0.5	1.9
Other	0.6	-1.7	0.6	-3.3	1.9	-1.2
Errors and omissions (in billions of U.S. dollars)	-0.9	-0.3	-1.8	-0.7	-0.7	-0.7
Overall balance (in billions of U.S. dollars)	0.2	-0.2	2.5	3.9	9.2	4.7
Total external debt (in percent of GDP) 10/	78.8	70.3	62.4	51.4	43.3	36.8
Debt-service ratio (percent of exports)	20.6	19.7	18.5	18.6	18.3	19.0
Reserves, adjusted (in billions of U.S. dollars) 11/	14.9	15.2	18.0	23.0	33.8	38.8
Reserves/Short-term liabilities, adjusted 12/	124.2	125.8	120.1	166.6	222.5	249.4
Exchange rate (period averages)						
Pesos per U.S. dollar	54.2	56.0	55.1	51.3	46.1	...
Nominal effective exchange rate (1990 =100)	81.3	75.7	76.9	82.0	88.7 8/	...
Real effective exchange rate (1990 =100)	89.1	86.2	92.3	102.5	111.4 8/	...

Sources: Philippine authorities; and Fund staff estimates and projections.

1/ Defined as difference between gross investment and current account. There is a statistical break in national saving and balance of payments data in 2003.
2/ Fund definition. Excludes privatization receipts of the national government, and includes net deficit from restructuring the central bank.
3/ Includes the national government, Central Bank-Board of Liquidators, 14 monitored government-owned enterprises, social security institutions, and local governments.
4/ The sum of all nonfinancial public sector revenue net of intra-public sector payments. It is assumed that 80 percent of Bureau of Treasury revenue represents interest and dividends from other parts of the nonfinancial public sector. Privatization receipts are excluded.
5/ Defined as difference between nonfinancial public sector revenue and balance.
6/ Debt is consolidated (net of intra-nonfinancial public sector holdings of debt). Data on local government debt are not available for 2001; it is assumed that these debts were the same as a share of GDP as in 2002.
7/ Secondary market rate.
8/ November 2007.
9/ September 2007.
10/ Defined as external debt plus liabilities of foreign banks in the Philippines to their headquarters, branches and agencies, some external debt not registered with the central bank and private capital lease agreements.
11/ Gross reserves less gold and securities pledged as collateral against short-term liabilities.
12/ Reserves as a percent of short-term debt (including medium- and long-term debt due in the following year). Both reserves and debt were adjusted for pledged assets.

Table 2. Philippines: National Government Cash Accounts, 2003-10

(In percent of GDP; unless otherwise indicated)

	2003	2004	2005	2006	2007			2008		2009	2010
					Budget	Sept.	Staff Est.	Budget	Staff Proj.	Staff Proj.	Staff Proj.
Revenue and grants	14.9	14.6	15.0	16.3	16.7	11.8	16.2	16.6	16.3	15.8	15.9
Tax revenue	12.8	12.4	13.0	14.4	15.3	10.5	14.4	15.2	14.3	13.9	14.0
Net Income and Profits	5.6	5.7	5.9	6.2	6.8	4.6	6.3	6.6	6.6	6.2	6.3
Excises	1.6	1.6	1.4	1.1	1.1	0.7	1.1	1.0	1.1	1.1	1.1
VAT	3.1	2.9	2.9	4.3	4.6	3.1	4.1	5.2	4.1	4.1	4.0
Tariffs	1.0	0.9	1.1	1.1	1.2	0.8	1.1	1.0	1.0	0.9	0.9
Other 1/	1.4	1.3	1.7	1.6	1.7	1.3	1.7	1.5	1.6	1.6	1.6
Nontax revenue	2.1	2.1	2.0	1.9	1.3	1.3	1.9	1.4	1.9	1.9	1.9
Expenditure and net lending	19.8	18.7	18.0	17.5	17.9	12.9	17.8	17.1	17.0	16.5	16.9
Current expenditures	17.1	15.9	15.6	15.2	15.1	10.8	14.7	14.2	14.1	14.0	14.0
Personnel services	6.4	5.8	5.4	5.4	5.6	3.7	5.4	5.5	5.4	5.4	5.4
Maintenance and operations	1.8	1.7	1.6	1.7	1.9	1.4	1.9	1.9	1.9	1.9	2.0
Allotments to local government units	2.7	2.3	2.2	2.3	2.2	1.7	2.3	2.3	2.3	2.5	2.5
Subsidies	0.3	0.1	0.1	0.2	0.1	0.2	0.3	0.1	0.1	0.2	0.2
Tax expenditure	0.3	0.1	0.4	0.3	0.2	0.4	0.4	0.2	0.2	0.2	0.2
Interest	5.6	5.7	5.8	5.4	5.1	3.5	4.4	4.2	4.2	3.9	3.7
National government	5.2	5.4	5.5	5.1	4.7	3.3	4.2	4.1	4.0	3.7	3.4
Central Bank-Board of Liquidators	0.4	0.4	0.3	0.2	0.3	0.1	0.1	0.2	0.2	0.2	0.3
Capital and equity expenditure 2/	2.6	2.7	2.4	2.3	2.7	2.0	3.0	2.8	2.8	2.5	2.9
Net lending	0.1	0.1	0.0	0.0	0.1	0.1	0.2	0.2	0.2	0.0	0.0
Balance	-4.9	-4.2	-3.0	-1.2	-1.3	-1.1	-1.6	-0.6	-0.7	-0.7	-1.0
On the authorities' presentation 3/	-4.6	-3.8	-2.7	-0.9	-0.9	-0.4	-0.1	0.0	0.0	0.0	-0.3
Financing	4.9	4.2	3.0	1.2	1.3	1.1	1.6	0.6	0.7	0.7	1.0
Net external financing	3.3	1.7	1.7	2.0	0.9	0.8	0.8	0.5	0.5	0.4	0.1
Net domestic financing	1.6	2.5	1.3	-0.8	0.4	0.3	0.8	0.0	0.3	0.4	0.8
Privatization	...	...	0.0	0.1	0.0	0.6	1.4	0.4	0.6	...	...
Memorandum Items:											
Nonfinancial public sector balance 4/	-5.6	-5.0	-2.1	0.0	…	…	-0.1	…	0.6	0.4	0.0
Consolidated public sector balance 4/	-5.2	-4.8	-1.9	0.1	…	…	0.0	…	0.7	0.5	0.1
Primary national government balance	0.7	1.6	2.8	4.2	3.8	…	2.8	3.7	3.5	3.2	2.7
National government debt 5/	71.4	69.7	62.9	55.4	…	…	47.8	…	45.2	43.3	39.4
(Percent of NG revenues)	480.1	479.2	419.4	339.1	…	…	294.6	…	277.6	274.8	247.5
Nonfinancial public sector debt 6/	100.8	95.2	86.0	73.9	…	…	62.3	…	59.0	57.0	51.0
(Percent of NFPS revenues)	484.5	463.6	389.5	319.0	…	…	269.8	…	256.8	253.6	226.4
National government gross financing requirements 7/	23.6	24.3	21.2	21.8	…	…	18.6	…	16.6	14.0	14.7
Health and education spending (current and capital)	2.7	2.4	2.2	2.2	2.2	…	2.2	2.2	2.2	…	…
GDP (in billions of pesos) 8/	4,316	4,872	5,438	6,033	6,713	6,651	6,651	7,285	7,349	8,066	8,849

Sources: Philippine authorities; and Fund staff projections.

1/ Includes other percentage taxes, documentary stamp tax, and noncash collections. Noncash collections are also reflected as tax expenditures under current expenditures.

2/ Excludes purchase of NPC securities and other onlending; includes capital transfers to LGUs. May exceed public investment in years when capital transfers to LGUs exceed their reported capital spending.

3/ Includes privatization receipts as revenue and excludes the operations of the Central Bank-Board of Liquidators (CB-BOL).

4/ Excludes privatization receipts from revenue.

5/ Consolidated (net of national government debt held by the sinking fund) and excluding contingent/guaranteed debt.

6/ Nonfinancial public sector includes the national government, CB-BOL, 14 monitored government-owned enterprises, social security institutions, and local governments. Debt is consolidated (net of intra-nonfinancial public sector holdings of debt).

7/ Defined as the deficit, plus amortization of medium- and long-term debt, plus the stock of short-term debt at the end of the last period, plus market financing on behalf of NPC.

8/ For the budget, the lower bound of the range of GDP estimates.

Table 3. Philippines: Balance of Payments, 2003–08

(In billions of U.S. dollars)

	2003	2004	2005	2006	2007	2008
					Staff Est.	Staff Proj.
CURRENT ACCOUNT BALANCE	0.3	1.6	2.0	5.9	7.5	4.6
Trade balance	-5.9	-5.7	-7.8	-6.8	-7.4	-11.3
Exports, f.o.b.	35.3	38.8	40.3	46.5	48.8	52.8
Imports, f.o.b.	41.2	44.5	48.0	53.3	56.3	64.1
Of which: Oil and related products	3.8	4.7	6.3	8.1	9.3	12.3
Services (net)	-2.0	-1.8	-1.3	0.3	0.3	0.1
Receipts	3.4	4.0	4.5	6.5	7.4	8.2
Payments	5.4	5.8	5.9	6.1	7.1	8.2
Income	-0.3	-0.1	-0.3	-0.8	-0.1	0.1
Receipts	3.3	3.7	3.9	4.4	5.0	5.5
Of which: Remittances of resident workers abroad 1/	2.6	2.9	2.9	2.8	2.9	3.0
Payments	3.6	3.8	4.2	5.2	5.1	5.4
Interest payments	2.5	2.4	2.7	3.3	3.6	3.8
Transfers (net)	8.4	9.2	11.4	13.2	14.7	15.7
Receipts	8.6	9.4	11.7	13.5	15.1	16.2
Of which: Nonresident workers remittances 1/	7.7	8.6	10.7	12.3	13.2	13.5
Payments	0.2	0.3	0.3	0.3	0.4	0.5
CAPITAL AND FINANCIAL ACCOUNT	0.8	-1.6	2.3	-1.3	2.3	0.8
Capital account	0.1	0.0	0.0	0.1	0.1	0.1
Financial account	0.7	-1.6	2.2	-1.5	2.2	0.7
Direct investment	0.2	0.1	1.7	2.0	0.5	1.9
Portfolio investment	0.6	-1.7	3.5	2.4	4.4	3.0
Equity	0.5	0.5	1.5	2.4	4.0	2.8
Debt	0.1	-2.2	2.0	0.0	0.3	0.2
Other investment	0.0	0.0	-2.9	-5.8	-2.6	-4.3
ERRORS AND OMISSIONS	-0.9	-0.3	-1.8	-0.7	-0.7	-0.7
OVERALL BALANCE	0.2	-0.2	2.5	3.9	9.2	4.7
OVERALL FINANCING	-0.2	0.2	-2.5	-3.9	-9.2	-4.7
Monetization of gold and revaluation	0.5	1.0	1.4	0.5	1.3	0.6
Change in net international reserves (increase =-)	-0.6	-0.7	-3.9	-4.4	-10.5	-5.3
BSP gross reserves (increase =-)	0.3	1.3	-3.0	-4.0	-10.5	-5.3
Fund credit (net)	-0.5	-0.5	-0.3	-0.4	0.0	0.0
Change in other BSP liabilities	-0.4	-1.6	-0.5	0.0	0.0	0.0
Memorandum items:						
Current account/GDP	0.4	1.9	2.0	5.0	5.2	2.7
Short-term debt (original maturity)	8.2	7.6	9.4	8.2	8.5	8.8
Short-term debt (residual maturity)	14.1	13.1	15.5	13.8	15.0	15.6
Gross reserves	17.1	16.2	18.5	23.0	33.8	38.8
Adjusted gross reserves 2/	14.9	15.2	18.0	23.0	33.8	38.8
(In percent of st. debt by res. maturity) 3/	124.2	125.8	120.1	166.6	222.5	249.4
Net international reserves	14.1	14.6	17.7	23.0	33.7	38.8
Total external debt (in billions) 4/	62.8	61.2	61.6	60.5	62.3	64.0
(In percent of GDP)	78.8	70.3	62.4	51.4	43.3	36.8
Debt service ratio 5/	20.6	19.7	18.5	18.6	18.3	19.0
Export value (percent change)	2.7	9.8	3.8	15.6	5.0	8.1
Import value (percent change)	3.1	8.0	8.0	11.0	5.5	13.9
Gross external financing needs 6/	13.1	12.5	11.1	9.6	6.3	10.4
GDP (in billions)	79.6	86.9	98.7	117.6	144.1	173.7

Sources: Philippine authorities and Fund staff projections.

1/ The 2003–04 revisions to the data separate remittances made by Filipino residents working abroad (income), and nonresident workers' remittances (transfers).
2/ Gross reserves less gold and securities pledged as collateral against short-term liabilities.
3/ As a percent of short-term debt excluding pledged assets of the central bank.
4/ Monitored external liabilities are defined as external debt plus liabilities of foreign banks in the Philippines to their headquarters, branches, and agencies; some external debt not registered with the central bank and private capital lease agreements.
5/ In percent of goods and nonfactor services.
6/ Defined as the current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at the end of the previous period.

Table 4. Philippines: Depository Corporations Survey, 2003-07

	2003	2004	2005	2006	2007		
	Dec.	Dec.	Dec.	Dec.	Jun.	Sep.	Nov.
			(In billions of pesos)				
Net foreign assets	598	678	912	1,366	1,573	1,663	1,672
Central bank	637	689	846	1,077	1,186	1,356	1,365
Net international reserves	782	819	937	1,128	1,222	1,392	1,399
Medium and long-term foreign liabilities	145	130	91	51	36	36	34
Other depository corporations	-39	-12	66	289	388	308	307
Net domestic assets	2,120	2,307	2,300	2,445	2,359	2,163	2,238
Net domestic credit	2,625	2,849	2,804	3,007	3,028	3,048	3,129
Public sector credit	862	1,000	960	1,040	1,073	1,074	1,070
National government	660	799	719	762	824	828	811
Credits	844	963	913	986	1,047	1,060	1,092
Foreign exchange receivables	15	15	18	4	0	0	0
Treasury IMF accounts	-66	-70	-60	-58	-55	-54	-53
Deposits	-137	-109	-152	-170	-168	-178	-228
Local government and others	202	201	241	278	249	246	259
Claims on CB-BOL 1/	4	1	0	0	0	0	0
Private sector credit	1,763	1,849	1,844	1,967	1,955	1,974	2,059
Other items (net)	-505	-543	-505	-562	-670	-885	-891
Total liquidity	2,718	2,984	3,211	3,811	3,932	3,827	3,910
M4	2,619	2,908	3,127	3,722	3,850	3,700	3,725
M3 (peso liquidity)	1,924	2,121	2,339	2,870	3,024	2,886	2,977
Foreign currency deposits, residents	695	787	788	853	826	814	748
Other liabilities	99	76	85	89	82	126	185
			(12-month percent change)				
Net foreign assets	21.2	13.4	34.5	49.9	31.1	32.2	25.6
Net domestic assets	2.5	8.8	-0.3	6.3	3.8	-5.1	-4.7
Net domestic credit	5.9	8.5	-1.6	7.2	7.5	9.6	5.1
Public sector	12.9	16.0	-4.0	8.3	10.5	11.6	4.0
Private sector	2.8	4.9	-0.3	6.7	6.0	8.5	5.7
M4	5.2	11.0	7.5	19.0	13.8	7.8	4.1
M3	4.2	10.2	10.3	22.7	19.4	11.4	9.1
Memorandum items:			(In billions of pesos; unless otherwise indicated)				
Gross domestic credit from other dep. corp.	2,608	2,841	2,843	2,855	2,865	2,860	…
Private sector	1,763	1,849	1,844	1,950	1,962	1,974	…
(12-month percent change)	2.8	4.9	-0.3	5.7	6.3	8.5	…
Public sector	846	992	999	906	904	886	…
(In percent of total gross credit)	32.4	34.9	35.1	31.7	31.5	31.0	…
			(In billions of U.S. dollars; unless otherwise indicated)				
Net foreign assets	10.8	12.0	17.2	27.8	34.0	36.9	39.1
Central bank	11.5	12.2	15.9	21.9	25.6	30.1	31.9
Other depository corporations	-0.7	-0.2	1.2	5.9	8.4	6.8	7.2
Foreign currency deposits residents	12.5	14.0	14.8	17.4	17.8	18.1	17.5
Exchange rate (peso per dollar; end-period)	55.6	56.3	53.1	49.1	46.3	45.1	42.8

Sources: Philippine authorities, CEIC, and Fund staff estimates.

1/ The Central Bank-Board of Liquidators was established in 1993 to absorb the debts of the old central bank.

Table 5. Philippines: Medium-Term Outlook, 2005-13
(Baseline scenario)

	2005	2006	2007	2008	2009	2010	2011	2012	2013
		Staff Est.		Staff Proj.					
	(Percent change; unless otherwise indicated)								
GDP and prices									
Real GDP	4.9	5.4	7.3	6.0	6.0	6.0	6.1	6.2	6.2
GDP per capita (in U.S. dollars)	1,158	1,352	1,625	1,919	2,031	2,154	2,287	2,431	2,583
CPI (average)	7.7	6.2	2.8	4.4	3.8	3.5	3.5	3.5	3.5
Labor									
Employment (average, million)	32.3	33.0	33.9	34.9	35.9	37.0	38.2	39.4	40.7
Employment (average, percent chage)	2.2	2.0	2.9	2.9	3.0	3.1	3.1	3.2	3.2
	(In percent of GDP, unless otherwise indicated)								
Investment and saving									
Gross investment	14.6	14.3	14.7	15.4	15.4	16.0	16.7	17.5	17.7
Private	12.4	12.2	12.0	13.0	13.3	13.4	13.9	14.3	14.3
Public	2.2	2.1	2.7	2.4	2.1	2.6	2.8	3.2	3.4
National saving 1/	16.6	19.3	19.9	18.1	17.3	17.3	17.3	17.9	17.9
Private	16.2	16.9	17.2	14.9	14.6	14.5	14.3	14.7	14.5
Public	0.4	2.5	2.7	3.2	2.6	2.7	3.0	3.2	3.4
Foreign saving	-2.0	-5.0	-5.2	-2.7	-1.9	-1.3	-0.6	-0.4	-0.2
Public finances									
Nonfinancial public sector balance 2/	-2.1	0.2	-0.1	0.6	0.4	0.0	0.0	-0.2	-0.2
Primary balance	4.3	6.0	4.6	5.1	4.5	3.9	3.6	3.2	2.9
Revenue and grants 3/	22.1	23.2	23.1	23.0	22.5	22.5	22.7	22.8	22.8
Expenditure (primary) 4/	17.8	17.2	18.5	17.9	17.9	18.6	19.1	19.6	19.9
Interest	6.4	5.8	4.7	4.5	4.2	3.9	3.5	3.3	3.1
Nonfinancial public sector gross financing	24.3	24.0	19.6	17.3	14.8	15.7	13.1	12.9	12.5
Domestic	19.2	18.7	16.3	14.7	11.8	13.2	10.8	10.8	10.5
Foreign currency	5.1	5.3	3.3	2.7	3.0	2.5	2.3	2.2	2.0
National government balance (authorities' definition)	-2.7	-0.9	-0.1	0.0	0.0	-0.3	-0.4	-0.5	-0.5
National government balance 5/	-3.0	-1.2	-1.6	-0.7	-0.7	-1.0	-0.9	-0.9	-0.9
Nonfinancial public sector debt 6/	86.0	73.9	62.3	59.0	57.0	51.0	48.1	45.5	43.1
External sector									
Export value (percent change)	3.8	15.6	5.0	8.1	7.4	7.9	8.2	8.4	9.2
Import value (percent change)	8.0	11.0	5.5	13.9	8.7	9.2	9.2	9.0	8.3
Trade balance	-7.9	-5.8	-5.2	-6.5	-6.9	-7.4	-7.7	-7.9	-7.6
Current account	2.0	5.0	5.2	2.7	1.9	1.3	0.6	0.4	0.2
FDI (net, in billions of U.S. dollars)	1.7	2.0	0.5	1.9	2.1	2.2	2.4	2.6	2.9
Reserves, adjusted (in billions of U.S. dollars) 7/	18.0	23.0	33.8	38.8	42.0	44.2	44.3	44.2	43.9
Reserves / Short-term liabilities, adjusted 8/	120.1	166.6	222.5	249.4	257.4	271.0	248.8	241.2	237.0
Gross external financing requirements (in billions of U.S. dollars) 9/	11.1	9.6	6.3	10.4	12.0	13.7	15.9	16.8	17.7
Total external debt (in percent of GDP) 10/	62.4	51.4	43.3	36.8	35.0	33.7	32.1	30.5	28.1
Debt service ratio (in percent of exports of goods and services)	18.5	18.6	18.3	19.0	18.3	17.6	18.1	16.6	15.0

Sources: Philippine authorities; and Fund staff estimates and projections.

1/ Defined as difference between gross investment and current account.
2/ Nonfinancial public sector includes the national government, CB-BOL, 14 monitored government-owned enterprises, social security institutions, and local governments.
3/ The sum of all nonfinancial public sector revenue net of intra-public sector payments. It is assumed that 80 percent of Bureau of Treasury revenue represents interest and dividends from other parts of the nonfinancial public sector. Privatization receipts are excluded.
4/ Defined as difference between nonfinancial public sector revenue and primary balance.
5/ Fund definition. Excludes privatization receipts of the national government, and includes net deficit from restructuring the central bank.
6/ Debt is consolidated (net of intra-nonfinancial public sector holdings of debt).
7/ Gross reserves less gold and securities pledged as collateral against short-term liabilities.
8/ Reserves as a percent of short-term debt (including medium and long-term debt due in the following year). Both reserves and debt were adjusted for gold-backed loans.
9/ Defined as the current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at the end of the previous period.
10/ Defined as external debt plus liabilities of foreign banks in the Philippines to their headquarters, branches, and agencies; some external debt not registered with the central bank and private capital lease agreements.

Table 6. Philippines: Medium-Term Outlook, 2005-13
(Reform scenario)

	2005	2006	2007	2008	2009	2010	2011	2012	2013
			Staff Est.			Staff Proj.			
	(Percent change; unless otherwise indicated)								
GDP and prices									
Real GDP	4.9	5.4	7.3	6.3	6.5	6.5	6.7	7.0	7.0
GDP per capita (in U.S. dollars)	1,158	1,352	1,625	1,925	2,047	2,181	2,329	2,494	2,671
CPI (average)	7.7	6.2	2.8	4.4	3.8	3.5	3.5	3.5	3.5
Labor									
Employment (average, million)	32.3	33.0	34.0	35.1	36.2	37.4	38.7	40.1	41.5
Employment (average, percent chage)	2.2	2.0	3.1	3.2	3.3	3.3	3.4	3.6	3.6
	(In percent of GDP, unless otherwise indicated)								
Investment and saving									
Gross investment	14.6	14.3	14.7	16.0	17.2	18.5	19.3	20.2	20.5
Private	12.4	12.2	12.0	13.1	14.1	15.0	15.5	15.8	15.7
Public	2.2	2.1	2.7	2.9	3.1	3.5	3.8	4.4	4.8
National saving 1/	16.6	19.3	19.9	18.6	18.5	18.8	19.0	19.6	19.6
Private	16.2	16.9	17.2	14.8	14.6	14.5	14.2	14.4	14.1
Public	0.4	2.5	2.7	3.8	3.9	4.3	4.8	5.2	5.5
Foreign saving	-2.0	-5.0	-5.2	-2.6	-1.3	-0.3	0.3	0.6	0.9
Public finances									
Nonfinancial public sector balance 2/	-2.1	0.2	-0.1	0.7	0.7	0.6	0.8	0.7	0.6
Primary balance	4.3	6.0	4.6	5.2	4.8	4.5	4.2	3.8	3.5
Revenue and grants 3/	22.1	23.2	23.1	23.5	23.5	23.8	24.2	24.5	24.7
Expenditure (primary) 4/	17.8	17.2	18.5	18.2	18.7	19.3	19.9	20.7	21.2
Interest	6.4	5.8	4.7	4.5	4.1	3.9	3.4	3.2	2.9
Nonfinancial public sector gross financing	24.3	24.0	19.6	17.1	14.4	14.9	11.9	11.3	10.7
Domestic	19.2	18.7	16.3	14.5	11.4	12.3	9.6	9.2	8.8
Foreign currency	5.1	5.3	3.3	2.7	2.9	2.5	2.3	2.1	1.9
National government balance (authorities' definition)	-2.7	-0.9	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
National government balance 5/	-3.0	-1.2	-1.6	-0.7	-0.7	-0.7	-0.5	-0.4	-0.4
Nonfinancial public sector debt 6/	86.0	73.9	62.3	58.8	56.3	49.7	46.0	42.5	39.2
External sector									
Export value (percent change)	3.8	15.6	5.0	8.1	7.5	8.2	8.5	8.8	9.6
Import value (percent change)	8.0	11.0	5.5	14.1	9.0	9.4	9.5	9.4	8.8
Trade balance	-7.9	-5.8	-5.2	-6.6	-7.0	-7.4	-7.7	-7.8	-7.6
Current account	2.0	5.0	5.2	2.6	1.3	0.3	-0.3	-0.6	-0.9
FDI (net, in billions of U.S. dollars)	1.7	2.0	0.5	2.0	2.9	4.2	4.5	5.0	5.4
Reserves, adjusted (in billions of U.S. dollars) 7/	18.0	23.0	33.8	38.7	42.4	46.5	48.6	50.5	52.2
Reserves/short-term liabilities, adjusted 8/	120.1	166.6	222.5	248.8	260.0	285.1	272.7	275.2	281.6
Gross external financing requirements (in billions of U.S. dollars) 9/	11.1	9.6	6.3	10.5	13.1	15.7	18.0	19.3	20.6
Total external debt (in percent of GDP) 10/	62.4	51.4	43.3	36.7	34.7	33.3	31.5	29.7	27.2
Debt-service ratio (in percent of exports of goods and services)	18.5	18.6	18.3	19.0	18.3	17.5	18.0	16.4	14.8

Sources: Philippine authorities; and Fund staff estimates and projections.

1/ Defined as difference between gross investment and current account.
2/ Nonfinancial public sector includes the national government, CB-BOL, 14 monitored government-owned enterprises, social security institutions, and local governments.
3/ The sum of all nonfinancial public sector revenue net of intra-public sector payments. It is assumed that 80 percent of Bureau of Treasury revenue represents interest and dividends from other parts of the nonfinancial public sector. Privatization receipts are excluded.
4/ Defined as difference between nonfinancial public sector revenue and primary balance.
5/ Fund definition. Excludes privatization receipts of the national government, and includes net deficit from restructuring the central bank.
6/ Debt is consolidated (net of intra-nonfinancial public sector holdings of debt).
7/ Gross reserves less gold and securities pledged as collateral against short-term liabilities.
8/ Reserves as a percent of short-term debt (including medium and long-term debt due in the following year). Both reserves and debt were adjusted for gold-backed loans.
9/ Defined as the current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at the end of the previous period.
10/ Defined as external debt plus liabilities of foreign banks in the Philippines to their headquarters, branches, and agencies; some external debt not registered with the central bank and private capital lease agreements.

Table 7. Philippines: Medium-Term Balance of Payments Outlook, 2005–13
(In billions of U.S. dollars)

	2005	2006	2007	2008	2009	2010	2011	2012	2013
			Staff Est.			Staff Proj.			
CURRENT ACCOUNT BALANCE	2.0	5.9	7.5	4.6	3.5	2.6	1.4	1.0	0.6
Trade balance	-7.8	-6.8	-7.4	-11.3	-13.0	-14.9	-16.9	-18.8	-19.7
Exports, f.o.b.	40.3	46.5	48.8	52.8	56.7	61.2	66.2	71.7	78.4
Imports, f.o.b.	48.0	53.3	56.3	64.1	69.7	76.1	83.1	90.5	98.0
Services (net)	-1.3	0.3	0.3	0.1	0.2	0.2	0.0	0.0	0.1
Receipts	4.5	6.5	7.4	8.2	9.1	10.0	10.9	12.0	13.4
Payments	5.9	6.1	7.1	8.2	8.9	9.9	10.9	12.0	13.2
Income	-0.3	-0.8	-0.1	0.1	0.2	0.4	0.7	1.1	1.4
Receipts,	3.9	4.4	5.0	5.5	5.9	6.4	6.8	7.3	7.8
Of which: Remittances of resident workers abroac	2.9	2.8	2.9	4.0	4.5	5.1	5.8	6.8	6.8
Payments	4.2	5.2	5.1	5.4	5.8	6.0	6.2	6.2	6.4
Interest payments	2.7	3.3	3.6	3.8	3.8	3.8	3.9	3.9	3.9
Transfers (net)	11.4	13.2	14.7	15.7	16.2	16.9	17.6	18.7	18.7
Receipts,	11.7	13.5	15.1	16.2	16.7	17.5	18.2	19.4	19.4
Of which: Non-resident workers remittances 1/	10.7	12.3	13.2	13.5	13.8	14.0	14.2	15.2	15.2
Payments	0.3	0.3	0.4	0.5	0.5	0.6	0.6	0.7	0.7
CAPITAL AND FINANCIAL ACCOUNT	2.3	-1.3	2.3	0.8	-0.3	-0.3	-1.3	-1.1	-0.8
Capital account	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Financial account	2.2	-1.5	2.2	0.7	-0.4	-0.4	-1.4	-1.2	-1.0
Direct investment	1.7	2.0	0.5	1.9	2.1	2.2	2.4	2.6	2.9
Portfolio investment	3.5	2.4	4.4	3.0	2.8	2.4	2.3	2.7	3.0
Equity	1.5	2.4	4.0	2.8	2.8	2.8	2.8	3.4	4.1
Debt	2.0	0.0	0.3	0.2	0.0	-0.3	-0.5	-0.7	-1.0
Other Investment,	-2.9	-5.8	-2.6	-4.3	-5.3	-5.1	-6.2	-6.5	-6.9
Of which: Currency and deposits	-3.2	-2.5	-2.0	-2.3	-3.0	-3.7	-4.0	-4.4	-4.7
New lending (net)	-1.9	-3.1	-1.2	-1.2	-1.2	-1.2	-1.2	-1.2	-1.2
New borrowing	3.6	3.1	4.6	3.2	3.2	3.2	2.8	2.8	2.8
Public	1.8	1.3	2.2	1.5	1.7	1.7	1.3	1.3	1.3
Private	1.8	1.8	2.4	1.8	1.5	1.5	1.5	1.5	1.5
Amortization	-4.3	-3.4	-4.4	-4.2	-4.5	-3.6	-4.1	-4.1	-4.1
Public	-2.0	-2.0	-2.6	-2.4	-3.1	-2.4	-2.9	-2.9	-2.9
Private	-2.3	-1.4	-1.7	-1.8	-1.5	-1.2	-1.2	-1.2	-1.2
ERRORS AND OMISSIONS	-1.8	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7
OVERALL BALANCE	2.5	3.9	9.2	4.7	2.6	1.6	-0.6	-0.7	-0.9
OVERALL FINANCING	-2.5	-3.9	-9.2	-4.7	-2.6	-1.6	0.6	0.7	0.9
Monetization of gold and revaluation	1.4	0.5	1.3	0.6	0.6	0.6	0.6	0.6	0.6
Change in net international reserves (increase =-)	-3.9	-4.4	-10.5	-5.3	-3.2	-2.3	-0.1	0.1	0.3
BSP gross reserves (increase =-)	-3.0	-4.0	-10.5	-5.3	-3.2	-2.3	-0.1	0.1	0.3
Fund credit (net)	-0.3	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Change in other BSP liabilities	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Current account/GDP	2.0	5.0	5.2	2.7	1.9	1.3	0.6	0.4	0.2
Short-term debt (original maturity)	9.4	8.2	8.5	8.8	9.2	9.8	10.3	10.8	11.0
Short-term debt (residual maturity)	15.5	13.8	15.0	15.6	16.3	16.3	17.8	18.3	18.5
Gross reserves	18.5	23.0	33.8	38.8	42.0	44.2	44.3	44.2	43.9
Adjusted gross reserves 2/	18.0	23.0	33.8	38.8	42.0	44.2	44.3	44.2	43.9
(In percent of st. debt by res. maturity) 3/	120.1	166.6	222.5	249.4	257.4	271.0	248.8	241.2	237.0
Net international reserves	17.7	23.0	33.7	38.8	42.0	44.2	44.3	44.2	43.9
Total external debt (in billions) 4/	61.6	60.5	62.3	64.0	65.6	68.4	70.4	72.6	72.6
(In percent of GDP)	62.4	51.4	43.3	36.8	35.0	33.7	32.1	30.5	28.1
Debt service ratio 5/	18.5	18.6	18.3	19.0	18.3	17.6	18.1	16.6	15.0
Export value (percent change)	3.8	15.6	5.0	8.1	7.4	7.9	8.2	8.4	9.2
Import value (percent change)	8.0	11.0	5.5	13.9	8.7	9.2	9.2	9.0	8.3
Gross external financing needs 6/	11.1	9.6	6.3	10.4	12.0	13.7	15.9	16.8	17.7
GDP (in billions)	98.7	117.6	144.1	173.7	187.4	202.8	219.6	238.1	258.1

Sources: Philippine authorities and Fund staff projections.

1/ The 2003–04 revisions to the data separate remittances made by Filipino residents working abroad (income), and nonresident workers' remittances (transfers).
2/ Gross reserves less gold and securities pledged as collateral against short-term liabilities.
3/ As a percent of short-term debt excluding pledged assets of the central bank.
4/ Monitored external liabilities are defined as external debt plus liabilities of foreign banks in the Philippines to their headquarters, branches, and agencies; some external debt not registered with the central bank and private capital lease agreements.
5/ In percent of goods and nonfactor services.
6/ Defined as the current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at the end of the previous period.

Table 8. Philippines: Banking Sector Indicators, 2003–07

(End of year; unless otherwise indicated)

	2003	2004	2005	2006	2007 Q2
Capital adequacy					
Total capital accounts to total assets	13.1	12.6	12.0	11.7	11.5
Capital adequacy ratio (consolidated basis)	17.4	18.7	17.8	18.5	19.3
Asset quality					
NPL ratio 1/	16.1	14.4	10.3	7.5	7.0
NPA ratio 2/	13.2	11.8	9.1	6.9	6.4
Distressed asset ratio 3/	27.0	25.3	20.0	15.8	15.1
NPL coverage ratio 4/	51.5	58.0	73.8	75.0	74.8
NPA coverage ratio 5/	30.9	33.2	39.2	37.3	36.5
Profitability					
Return on assets 8/	0.8	0.7	0.9	1.0	0.9
Return on equity	8.5	7.1	8.7	10.6	11.6
Cost-to-income ratio 9/	68.9	69.8	67.3	66.5	65.5
Liquidity					
Liquid assets to deposits	47.9	53.2	53.0	52.0	54.4
Loans (gross) to deposits	80.3	73.4	72.5	69.4	65.1

Sources: Philippine authorities; and Fund staff calculations.

Note: ROPA = Real and Other Property Acquired. ROPA is a measure of the stock of foreclosed properties held by a bank.

1/ Nonperforming Loans (NPL) Ratio (excluding IBL).

2/ (Nonperforming loans + ROPA) over total gross assets.

3/ Ratio of (NPLs + Gross ROPA + current restructed loans) to (Gross total loan portfolio + Gross ROPA).

4/ Ratio of loan loss reserves to NPLs.

5/ Ratio of valuation reserves (for loans and ROPA) to NPAs.

6/ NPL minus loan loss reserves over capital.

7/ NPA minus allowances for probable loss on NPAs over capital.

8/ Average net income before taxes over average assets.

9/ Operating expenses (net of bad debts and provisions) to total operating income.

Table 9. Philippines: Indicators of External Vulnerability, 2003–08 1/
(In percent of GDP; unless otherwise indicated)

	2003	2004	2005	2006	2007	2008
					Staff Est.	Staff proj.
External indicators (including external liquidity):						
Gross international reserves, adjusted (in billions U.S. dollars) 2/	14.9	15.2	18.0	23.0	33.8	38.8
Short-term debt (original maturity, in billions U.S. dollars)	8.2	7.6	9.4	8.2	8.5	8.8
Amortization of medium and long-term debt (in billions U.S. dollars)	5.9	5.4	6.0	5.6	6.6	6.7
Net FDI inflows (in billions of U.S. dollars)	0.2	0.1	1.7	2.0	0.5	1.9
FX deposits residents (in billions of U.S. dollars)	12.5	14.0	14.8	17.4	17.5 3/	...
Total gross external debt	78.8	70.3	62.4	51.4	43.3	36.8
Public sector indicators:						
Overall balance	-5.6	-5.0	-2.1	0.2	-0.1	0.6
Primary balance	0.7	1.6	4.3	6.0	4.6	5.1
Nonfinancial public sector debt (NFPSD)	100.8	95.2	86.0	73.9	62.3	59.0
NFPSD denominated in FX or linked to the exchange rate (in percent of NFPS	67.8	65.9	60.9	61.2	58.4	61.2
Short-term general government debt (original maturity, in percent of NFPSD)	14.5	15.4	16.6	17.7	16.4	16.4
Average effective interest rate of government debt (in percent)	6.3	6.9	7.4	7.8	7.6	7.6
Amortization of total debt	23.2	23.1	22.2	24.2	19.5	17.9

Sources: Philippine authorities; and Fund staff estimates and projections.

1/ Includes estimates of nonmonitored debt stock.

2/ Gross reserves less gold and securities pledged as collateral against short-term liabilities.

3/ As of November 2007.

APPENDIX I. DEBT SUSTAINABILITY ANALYSIS

The sustainability of the Philippines' public sector debt depends largely on the strength of future reforms. In the baseline scenario, recent fiscal gains are assumed to be sustained, but no new measures are introduced over the medium term apart from the planned reduction in the corporate income tax (CIT) rate in 2009. In this scenario, the nonfinancial public sector (NFPS) debt will decline, but will remain high at 43 percent of GDP in 2013. While the debt dynamics are favorable overall, they remain vulnerable to shocks, especially to the exchange rate and, to a lesser extent, growth.

Projected external debt dynamics are generally benign. In recent years, external debt has steadily declined—from nearly 80 percent of GDP in 2003 to just over 40 percent in 2007, with the appreciated peso and stronger growth each responsible for about half of the change. Under the staff's baseline scenario, the external debt ratio would fall gradually over the medium term to just below 30 percent in 2013. Such a level of external indebtedness compares favorably with other emerging market economies, and past empirical work suggests that it entails limited vulnerabilities.

- *Continued vulnerability to the exchange rate:* A one-time real depreciation of 30 percent is estimated to entail a 15-percentage point jump in the external debt ratio from its 2008 level and would remain above 50 percent in the medium term.

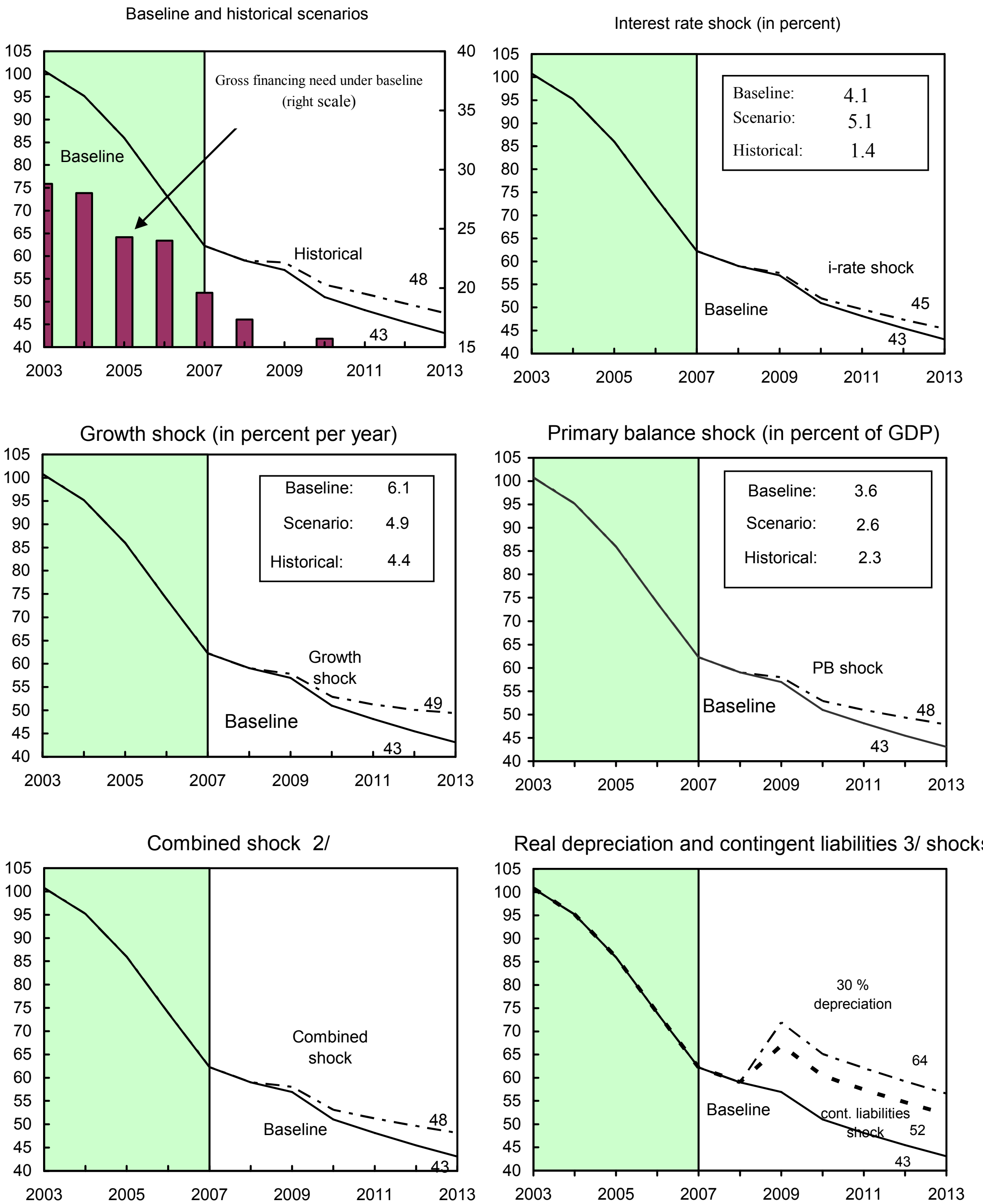
- *Rising resilience to interest rate and growth shocks:* Given the lengthening of maturities and tilt toward domestic financing, external debt is essentially unaffected by world interest rate and domestic growth shocks. It is only moderately affected (ending up some 5 percentage points higher by 2013) by non-interest shocks to the current account.

Table A.1. Philippines: Public Sector Debt Sustainability Framework, 2003-2013
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	**Debt-stabilizing primary balance 10/**
Baseline scenario: Public sector debt 1/	100.8	95.2	86.0	73.9	62.3	**59.0**	**57.0**	**51.0**	**48.1**	**45.5**	**43.1**	**-0.6**
o/w foreign-currency denominated	68.3	62.7	52.4	45.2	36.4	36.1	36.8	32.4	30.9	29.0	27.0	
Change in public sector debt	7.1	-5.6	-9.2	-12.1	-11.7	-3.2	-2.1	-6.0	-2.9	-2.6	-2.4	
Identified debt-creating flows (4+7+12)	1.2	-6.1	-10.8	-12.2	-13.8	-6.9	-6.0	-5.3	-4.6	-4.2	-3.9	
Primary deficit	-0.7	-1.6	-4.3	-6.0	-4.6	-5.1	-4.5	-3.9	-3.6	-3.2	-2.9	
Revenue and grants 2/	20.8	20.5	22.1	23.2	23.1	23.0	22.5	22.5	22.7	22.8	22.8	
Primary (noninterest) expenditure	20.1	19.0	17.8	17.2	18.5	17.9	17.9	18.6	19.1	19.6	19.9	
Automatic debt dynamics 3/	1.4	-4.2	-6.9	-6.4	-8.9	-1.4	-1.1	-1.1	-1.0	-1.0	-1.0	
Contribution from interest rate/growth differential 4/	-1.3	-5.0	-3.5	-2.7	-2.2	-1.4	-1.1	-1.1	-1.0	-1.0	-1.0	
Of which contribution from real interest rate	2.9	0.7	0.6	1.5	2.8	2.0	2.1	2.0	1.8	1.7	1.6	
Of which contribution from real GDP growth	-4.2	-5.7	-4.2	-4.2	-4.9	-3.4	-3.2	-3.1	-2.8	-2.7	-2.6	
Contribution from exchange rate depreciation 5/	2.7	0.8	-3.3	-3.7	-6.8	...	...	...	...	...	...	
Other identified debt-creating flows	0.6	-0.4	0.4	0.2	-0.3	-0.4	-0.4	-0.2	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	-0.1	-1.4	-0.6	-0.6	-0.4	-0.2	-0.2	-0.2	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.6	-0.4	0.4	0.3	1.1	0.2	0.2	0.2	0.2	0.2	0.2	
Residual, including asset changes (2-3) 6/	5.8	0.6	1.6	0.1	2.1	3.6	3.9	-0.7	1.8	1.6	1.5	
Public sector debt-to-revenue ratio 1/	484.5	463.6	389.5	319.3	269.8	256.8	253.6	226.4	212.4	199.7	188.9	
Gross financing need 7/	28.8	28.0	24.3	24.0	19.6	17.3	14.8	15.7	13.1	12.9	12.5	
in billions of U.S. dollars	22.9	24.4	24.0	28.2	28.2	30.1	27.7	31.9	28.9	30.8	32.3	
Scenario with key variables at their historical averages 8/						**59.0**	**58.6**	**53.7**	**51.7**	**49.6**	**47.5**	**-1.0**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	4.9	6.4	4.9	5.4	7.3	6.0	6.0	6.0	6.1	6.2	6.2	6.1
Average nominal interest rate on public debt (in percent) 9/	7.3	7.3	7.5	7.5	7.0	8.0	7.7	7.6	7.6	7.6	7.5	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	3.6	1.2	1.1	2.2	4.3	3.8	4.1	4.1	4.1	4.1	4.0	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-4.5	-1.2	6.0	8.0	18.7	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	3.8	6.1	6.4	5.2	2.7	4.2	3.6	3.5	3.5	3.5	3.5	
Growth of real primary spending (deflated by GDP deflator, in percent)	1.3	0.6	-1.7	1.7	15.5	2.8	6.1	10.0	8.8	9.2	7.5	
Primary deficit	-0.7	-1.6	-4.3	-6.0	-4.6	-5.1	-4.5	-3.9	-3.6	-3.2	-2.9	

1/ Nonfinancial public sector includes the national government, CB-BOL, 14 monitored government-owned enterprises, social security institutions, and local governments. Debt is gross and consolidated (net of intra-nonfinancial public sector holdings of debt).
2/ Revenue is the sum of all nonfinancial public sector revenue net of intra-public sector payments. It is assumed that 80 percent of Bureau of Treasury revenue represents interest and dividends from other parts of the nonfinancial public sector.
3/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
4/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.
5/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
6/ For projections, this line includes exchange rate changes.
7/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
8/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
9/ Derived as nominal interest expenditure divided by previous period debt stock.
10/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure A.1. Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline scenario and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

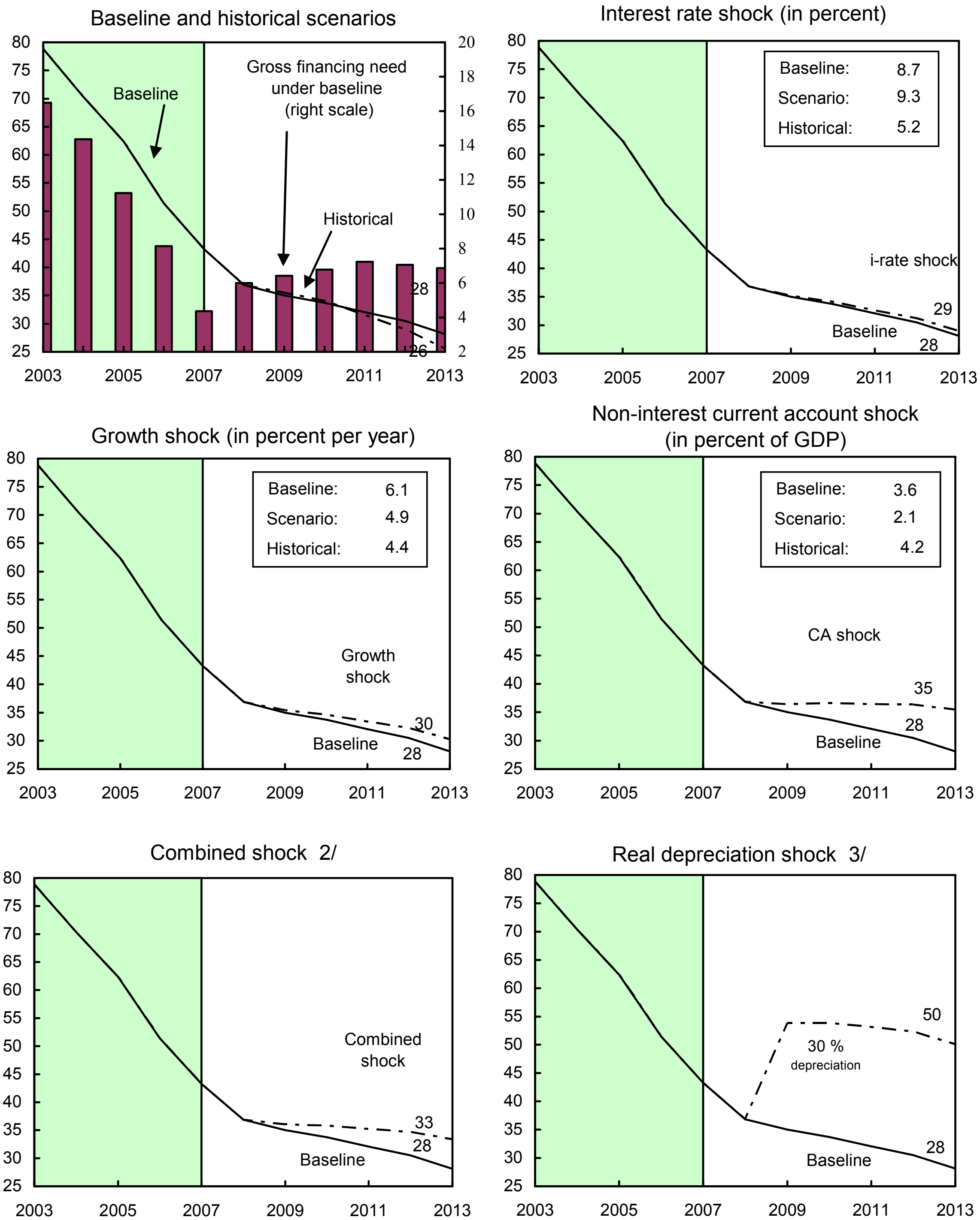
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2007, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table A.2. Philippines: External Debt Sustainability Framework, 2003-2013
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	78.8	70.3	62.4	51.4	43.3	**36.8**	**35.0**	**33.7**	**32.1**	**30.5**	**28.1**	**-2.6**
Change in external debt	1.1	-8.5	-8.0	-10.9	-8.2	-6.4	-1.8	-1.3	-1.7	-1.6	-2.4	
Identified external debt-creating flows (4+8+9)	-3.9	-9.2	-13.6	-18.7	-17.8	-7.6	-6.5	-5.7	-4.9	-4.8	-4.7	
Current account deficit, excluding interest payments	-3.6	-4.8	-5.3	-8.3	-8.5	-5.6	-4.7	-3.9	-3.6	-3.1	-2.6	
Deficit in balance of goods and services	9.8	8.6	9.2	5.5	4.9	6.5	6.9	7.3	7.7	7.9	7.6	
Exports	48.6	49.3	45.4	45.1	39.0	35.1	35.1	35.1	35.1	35.2	35.5	
Imports	58.4	57.9	54.6	50.6	44.0	41.6	41.9	42.4	42.8	43.1	43.1	
Net non-debt creating capital inflows (negative)	-0.8	-0.7	-3.2	-3.7	-3.1	-2.7	-2.6	-2.5	-2.4	-2.5	-2.7	
Automatic debt dynamics 1/	0.5	-3.7	-5.1	-6.7	-6.2	0.7	0.8	0.7	1.0	0.9	0.7	
Contribution from nominal interest rate	3.2	2.9	3.3	3.3	3.3	2.9	2.8	2.7	2.9	2.7	2.4	
Contribution from real GDP growth	-3.7	-4.6	-3.0	-2.9	-3.1	-2.2	-2.0	-1.9	-1.9	-1.8	-1.7	
Contribution from price and exchange rate changes 2/	0.9	-2.0	-5.4	-7.1	-6.4	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	5.1	0.7	5.6	7.8	9.6	1.2	4.7	4.4	3.3	3.2	2.3	
External debt-to-exports ratio (in percent)	162.1	142.8	137.5	114.1	110.8	104.9	99.7	96.1	91.4	86.7	79.1	
Gross external financing need (in billions of US dollars) 4/	13.1	12.5	11.1	9.6	6.3	10.4	12.0	13.7	15.9	16.8	17.7	
in percent of GDP	16.5	14.4	11.2	8.2	4.4	6.0	6.4	6.8	7.2	7.1	6.9	
Scenario with key variables at their historical averages 5/						**36.8**	**35.5**	**34.1**	**31.6**	**29.0**	**25.5**	**-2.5**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	4.9	6.4	4.9	5.4	7.3	6.0	6.0	6.0	6.1	6.2	6.2	
GDP deflator in US dollars (change in percent)	-1.2	2.6	8.3	12.9	14.2	13.6	1.9	2.1	2.1	2.1	2.1	
Nominal external interest rate (in percent)	4.3	4.1	5.3	6.2	7.8	8.1	8.2	8.3	9.4	9.1	8.6	
Growth of exports (US dollar terms, in percent)	2.4	10.6	4.6	18.3	6.2	8.4	7.8	8.2	8.3	8.7	9.5	
Growth of imports (US dollar terms, in percent)	2.6	8.1	7.2	10.3	6.6	14.0	8.8	9.3	9.3	9.1	8.5	
Current account balance, excluding interest payments	3.6	4.8	5.3	8.3	8.5	5.6	4.7	3.9	3.6	3.1	2.6	
Net non-debt creating capital inflows	0.8	0.7	3.2	3.7	3.1	2.7	2.6	2.5	2.4	2.5	2.7	

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate,
ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.
2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).
3/ For projection, line includes the impact of price and exchange rate changes.
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure A.2. Philippines: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2008.

I. Philippines: Fund Relations

(As of December 31, 2007)

I. **Membership Status:** Joined: December 27, 1945; Article VIII

II. **General Resources Account:**

	SDR Million	% Quota
Quota	879.90	100.00
Fund holdings of currency	792.31	90.05
Reserve position in Fund	87.60	9.96

III. **SDR Department:**

	SDR Million	% Allocation
Net cumulative allocation	116.60	100.00
Holdings	0.47	0.40

IV. **Outstanding Purchases and Loans:** None

V. **Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-by	04/01/1998	12/31/2000	1,020.79	783.23
EFF	06/24/1994	03/31/1998	791.20	791.20
Stand-by	02/20/1991	03/31/1993	334.20	334.20

Post-program monitoring ended following the advance repurchase made by the Philippines on December 29, 2006.

VI. **Projected Obligations to Fund:** SDR Million; based on existing use of resources and present holdings of SDRs:

	Forthcoming			
	2008	2009	2010	2011
Principal	...	...	...	...
Charges/Interest	4.08	4.07	4.07	4.07
Total	4.08	4.07	4.07	4.07

VII. **Exchange Arrangement:**

The exchange arrangement is classified as an independent float. The value of the Philippine peso is determined in the interbank foreign exchange market; the Bangko Sentral intervenes in the spot and forward markets in order to smooth undue short-term fluctuations in the exchange rate and to strategically build reserves.

VIII. **Article IV Consultation:**

The Philippines is on the standard 12-month cycle. The 2006 Article IV Consultation was discussed by the Executive Board on January 19, 2007. At that time, Directors commended the authorities for substantial further strengthening of macroeconomic performance in 2006—as evidenced by a rebound in growth with declining inflation; a boost to market confidence from the positive results of fiscal reform; and a steady uptick in capital inflows and reserves. Given this progress, Directors welcomed the early repayment by the Philippines of its outstanding obligations to the IMF, which triggered the exit from Post-Program Monitoring (PPM) at end-2006.

IX. **FSAP and ROSC Participation:**

MCM: The Philippines' FSAP was conducted during the fourth quarter of 2001; FSAP missions visited Manila in October and November–December 2001. The final version of the report was discussed with the authorities in June 2002. The associated FSSA was discussed by the Executive Board together with the Article IV staff report in September 2002.

FAD: Discussions on fiscal transparency were held in Manila in September 2001. The ROSC report was discussed by the Executive Board in September 2002 together with the Article IV staff report, and published in October 2002. The update to the ROSC report was published in June 2004. FAD adviser has visited Manila six times (June and September 2006, January, March, May, and July 2007). (Funding is available for a further three visits, if warranted by an improvement in reform progress).

STA: ROSC Data Module mission was conducted in September 2003, and the report was published in August 2004.

X. **Technical Assistance:**

An MCM resident banking supervision advisor has been stationed in Manila since May 2003, to assist the BSP in the implementation of a new supervisory model. An MCM mission visited Manila in February 2005 to review the payment systems, central bank accounting, and government bond market development. An MCM mission took place in July 2006 to review the regulation and infrastructure of the domestic debt market. Another MCM visited Manila in November 2006 to advise on liberalization of the foreign exchange market.

An STA peripatetic mission visited Manila in July–August 2003, January–February 2004, and February–March 2005 to provide technical assistance in balance of payments and international investment position statistics and in implementing the recommendations made by the ROSC Data Module mission. An STA mission took place in March-April 2006 to assist the authorities in compiling and disseminating government finance statistics in accordance with GFSM 2001.

An FAD mission to provide a briefing to the new tax commissioner took place in April–May 2001. An FAD mission reviewed VAT and excise administration in December 2001. An FAD staff member participated in the July 2004 PPM mission to evaluate and advice on tax measures. An FAD mission visited Manila in November-December 2005 to provide assistance in the areas of tax and customs administration and another mission was fielded in March 2006 to reach agreement with the authorities on the priorities of the BIR reform agenda. An FAD tax administration advisor visited Manila in June-July 2006, the first in a program of 8 or 9 visits to help the Tax Reform Administration Group to implement the reform agenda.

An LEG legal expert visited Manila to discuss anti-money laundering initiatives in March 2002.

XI. **Resident Representative:**

A Resident Representative has been stationed in Manila since January 1984. Mr. Reza Baqir assumed the post of Resident Representative in July 2005.

XII. **Fourth Amendment to the Articles of Agreement:**

The authorities have formally communicated to the Fund their acceptance of the Fourth Amendment, which was ratified by the Upper House of Parliament (Senate) in August 2001.

II. PHILIPPINES: STATISTICAL ISSUES

While data provision for surveillance purposes is adequate overall, shortcomings remain in certain areas. The Report on the Observance of Standards and Codes (ROSC)—Data Module, a Response by the Authorities, and a Detailed Assessment Using the Data Quality Assessment Framework (DQAF) were published on the IMF website in August 2004. The ROSC identified the national accounts and balance of payments statistics as needing particular attention.

The country subscribed to the Special Data Dissemination Standards (SDDS) in August 1996 and its metadata are posted on the Dissemination Standards Bulletin Board (DSBB).

A. National Accounts

Despite the authorities' efforts to improve quality, weaknesses remain in the national accounts. These include large discrepancies in GDP estimates between the expenditure and production sides (the official GDP estimates), with consequent differences in estimates of GDP growth.

The data ROSC identified a number of causes for these problems.[4]

- **Deaths and births of establishments are not adequately captured.** This gap is of growing importance given the rapid structural change in the economy in recent years, with a large number of new establishments, in particular in the electronics and information technology industries.

- **Compilation relies on an outdated benchmark year and fixed input-output ratios.** Estimates are derived by extrapolation of the 1988 benchmark year using fixed input-output ratios. For example, GDP statistics for the electronic sector suggest that value added remained at 10 percent of exports over the past years in spite of industry evidence that the domestic component of exports has been rising sharply.[5]

- **Statistical techniques in estimating GDP at constant prices are inadequate.** For most activities, not all components of the production accounts are compiled, instead only value added is estimated. Value added at current prices is calculated by extrapolating the benchmark year value with an indicator for the value of output; data in constant prices are estimated using a price deflator for output. In addition, the national accounts constant price estimates for merchandise exports and imports are constructed by multiplying 1985

[4] Currently, the authorities are compiling new national accounts series based on the *1993 SNA* guidelines.

[5] Industry representatives indicate that the domestic component has increased significantly, to around 30 percent in recent years.

values by quantity data (weights) from the foreign trade statistics for current years. Because of this inappropriate method, implicit deflators for electric machinery products appear high compared with developments in world market prices.

The consumer price index (CPI) has been compiled since February 2004 using weights based on the 2000 Family Income and Expenditures (FIES) survey. A notable change was that the weight given to the group comprising food, beverages, and tobacco (FBT) decreased to 50 percent in 2000 from 55 percent in 1994, the previous weight reference year.

B. Balance of Payments

Steps have been taken to improve the quality of the balance of payments. The Fund has fielded several technical assistance missions since 1995, including the assignment of a peripatetic advisor in 2003. In 2005, Bangko Sentral ng Pilipinas (BSP) created a new Department of Economic Statistics, with one of its units to concentrate on compiling, analyzing, and publishing the balance of payments and the international investment position. Progress since 2004, has included a significant improvement in the measurement of imports to correct an underestimation of imports of electronic goods on a consignment basis, improvements in the classification and recording of remittances, the introduction of a new methodology for measuring trade credits, and progress in the direct investment survey. Major revisions to the 2003-04 accounts were made in March 2005 and work to backtrack the series to 1999 was completed in the first quarter of 2006. Data for external debt and reserves are generally of good quality, although the data ROSC mission identified scope for improvement.

The revisions to imports have narrowed the gap between national trade data and those of partner countries on a net basis. An interagency task force on import statistics was established in July 2002 to improve the measurement of activity in the electronics sector, which accounts for about 43 percent of trade flows. Results of surveys covering electronics sector raw material imports confirmed that imports were routinely underestimated in reports to the National Statistics Office. Import figures have therefore been revised substantially, back to 2000.[6] As a result, the estimated trade balance for 2001 changed from a surplus of 3.8 percent of GDP to a deficit of 8.8 percent of GDP. A comparison of the revised figures with trade data of partner countries suggests that the revised trade balances for 2001–02 are reasonably well measured. However, substantial differences remain with partner country data on gross flows of exports and imports, with the latter about 15 percent higher than the corresponding national data. The BSP is continuing research on the factors behind discrepancies in data related to trade in processed goods, such as electronics and textiles.

[6] Data from 1996–99 have not been revised and remain underestimated.

Challenges remain for addressing certain compilation issues. Since deregulation in the early 1990s, international transactions have increasingly flowed through nontraditional channels that are not adequately covered by the statistical reporting system. The Foreign Currency Deposit Units (FCDUs), which account for about 70–75 percent of foreign exchange settlements, are exempt from reporting requirements because of strict secrecy banking rules. Steps have been taken to measure cross-border transactions that skirt the domestic banking system, such as flows through inter-company accounts.[7] Enterprise surveys, for example, have been introduced, although these are conducted on a voluntary basis and will take time to implement fully. Unless modifications are made to secrecy rules associated with FCDU accounts to facilitate the collection of data for statistical purposes, compilers of the balance of payments will continue to face challenges in securing adequate source data.

C. Monetary Accounts

Compilation of monetary and financial statistics (MFS) largely conforms to the Fund's methodology, although there is some scope for improvement. The authorities have recently made progress in implementing some of the recommendations of the data ROSC. They have introduced the Depository Corporations Survey, which now includes operations of thrift and rural banks. They have also introduced uniform procedures for converting foreign currency denominated accounts to local currency in the monetary aggregates. However, some weaknesses remain, including in the treatment of non-operational banks, valuation of securities, and treatment of accrued interest. The October 2007 MFS mission introduced the standardized report forms (SRFs) for reporting monetary statistics to the IMF and an integrated monetary database (IMD) that will meet the data needs of the BSP, APD, and STA. The IMD will become operational when the BSP submits data in the SRFs in early 2008.

D. Fiscal Data

While the Philippines meets the requirements of fiscal transparency in many important respects, the fiscal and data ROSCs found areas that require strengthening. An important problem is that the budget is presented on an obligations basis, while the deficit is reported on a cash basis, complicating comparisons of budgets and outcomes. In addition, for levels of the public sector beyond the budgetary central (national) government, consolidated fiscal outturns for items other than the fiscal balance are generally unavailable. The August 2004 GFS mission addressed shortcomings in the reconciliation of debt stocks and financing flows and advised on improving the consolidation of debt data for the public sector

[7] According to recent household surveys, typically about 30 percent of remittances of Overseas Filipino Workers were not channeled through the banking system, suggesting that remittances may have been underestimated by about US$3 billion (3.8 percent of GDP) in 2002.

(and its subsectors). This has allowed publication of revised nonfinancial public sector debt data since early 2005. The discrepancy between stocks and flows was further investigated during a follow-up mission in April 2006. It was established that the problems with reconciliation result from differences in time of recording and inconsistency in the coverage and classification of some transactions related to debt guarantees and assumed debt. The authorities agreed to compare the coverage of data in the two debt recording systems, standardize the classifications of these transactions, and improve the recording of debt transactions according to international best practice.

The introduction of a standardized chart of accounts, and the electronic New Government Accounting System has facilitated the compilation of annual financial statements for all the levels of the public sector. The accounting system allows for the compilation of accrual based accounts and also provides for the compilation of a statement of cash flows. These statements become available six months after the end of a reference period. In addition, the mission worked with the authorities to revise classifications in the chart of accounts, in order to allow for the consolidation of data for the nonfinancial public sector as a whole. Also, it recommended separating the market and non-market activities of the government-owned-and-controlled-corporations, so that consolidated data for the general government sector could be compiled.

Annual data covering only the budgetary central government are reported for publication in the *GFSY*, and monthly budgetary central government data are published in the *IFS*. A dedicated unit in Department of Finance was created to compile government finance statistics in accordance with *GFSM 2001* framework.

PHILIPPINES: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(As of January 23, 2008)

	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]	Memo Items: Data Quality – Methodological Soundness[7]	Memo Items: Data Quality – Accuracy and Reliability[8]
Exchange Rates	Dec. 07	Jan 7/08	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Nov 07	Jan 3/08	D	D	M		
Reserve/Base Money	Oct 15/07	Oct 21/07	D	W	W	O, LO, LO, LNO	LO, O, O, O, LO
Broad Money	Oct 15/07	Oct 21/07	M	M	M		
Central Bank Balance Sheet	Sep/07	Oct 26/07	M	M	M		
Consolidated Balance Sheet of the Banking System	Sep/07	Nov/07	M	M	M		
Interest Rates[2]	Dec/07	Jan 16/08	D	D	D		
Consumer Price Index	Dec/07	Jan 16/08	M	M	M	O, O, O, O	O, LO, O, LO, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q2/07	Jul/07	Q	Q	Q	LO, LO, O, O	LO, LO, LO, LO, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Sep/07	Oct 26/07	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Q2/07	Oct 26/07	Q	Q	Q		
External Current Account Balance	Q2/07	Oct 26/07	Q	Q	Q	O, LO, LO, LO	LNO, LO, O, LO, LO
Exports and Imports of Goods and Services	Q3/07	Jan 16/08	Q	Q	Q		
GDP/GNP	Q3/07	Jan 16/08	Q	Q	Q	LO, LO, O, LO	LNO, LNO, O, LO, O
Gross External Debt	Q2/07	Oct 26/07	Q	Q	Q		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).
[7] Reflects the assessment provided in the data ROSC or the Substantive Update (published on August 25, 2004, and based on the findings of the mission that took place during September 1–16, 2003) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[8] Same as footnote 8, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

III. Relations with the World Bank Group

A. World Bank Lending and Nonlending Activities

Since the World Bank started operations in the Philippines, it has committed approximately $12 billion under IBRD loans and $239 million under IDA credits (less cancellations). As of September 30, 2007, the Philippines portfolio consisted of 22 projects, amounting to $1.13 billion with an undisbursed balance of $854.0 million. As a result of the improved fiscal situation and demand from the government, lending rose from around $100 million to $200 million a year from FY03 to FY05, to $410 million in FY06 and $395 million in FY07. The figure in FY07 includes a first Development Policy Loan ($250 million), after an 8-year lull in policy based lending and three investment operations. Three investment operations were approved in FY06 and another three are scheduled for Board deliberations before the end of FY08. Based on net commitments and by sector, the current portfolio can be broken down as follows: infrastructure ($334 million, 30 percent); human development ($326 million, 29 percent); rural development and environment ($338 million, 30 percent); social development ($100 million, 9 percent); and governance and economic management ($32.9 million, 3 percent).

The overarching objective of the Bank's Country Assistance Strategy (CAS) for the Philippines is to improve the lives of Filipinos through sustainable economic growth and greater social inclusion. Fiscal stability and public institutions that serve the common good are critical to these objectives. The strategy supports "Islands of Good Governance" in those government agencies, local governments, and dynamic sectors in the Philippines that demonstrate how improved accountability and service delivery will lead to better economic and social outcomes. The CAS seeks to align Bank lending more closely with the government's own investment priorities, *within* the existing national budget, implying a shift away from financing discrete projects toward programmatic engagement. The approach also encourages local government units to pursue and finance their own priorities and to foster a better partnership with the national government.

The CAS originally set forth a conservative lending program of up to $1.8 billion for the entire FY06–08 period. As a result of the increased fiscal space, the pressing need for increased public investment to stimulate growth, especially in infrastructure, and strong demand from the government, the CAS period has been extended by one year to June 2009 and the envisaged lending envelope for the remaining two years of the CAS scaled up to between $0.8 billion to $2.2 billion. The actual lending level will continue to be tied to fiscal performance, while the composition of new investments will be determined by reform intensity in different policy areas. Only operations with adequate governance and anti corruption safeguards will be considered under the program.

An important aspect of World Bank support to the Philippines is in the form of analytical and advisory activities leveraged through partnerships with other organizations, administration of trust funds, policy dialogue and involvement in the Philippines Development Forum working groups. Strategic partnerships, supported by large bilateral and multi donor trust funds administered by the World Bank, are beginning to form a growing line of business in the Philippines, as the Government and its development partners move toward coordinated sector wide approaches in delivering development assistance to various sectors, in line with the Paris Declaration.

Significant analytical effort is currently being focused around the theme of achieving shared growth, in addition to the six thematic programs of fiscal reform; growth and the investment climate; social development and inclusion, social protection, and poverty; governance, political economy reform, and anti-corruption; local government, municipal finance, and fiscal decentralization; and meeting infrastructure needs. Four major pieces of analytical were delivered in FY07, including an Agricultural Public Expenditure Review, an Environment Monitor focused on Environmental Health, a report on the Investment Climate, and a Development Policy Review for the Philippines Development Forum.

The Bank has an extensive outreach program in the Philippines to promote knowledge sharing. Currently there are ten Knowledge for Development Centers (KDCs) around the country that make available Bank publications and development literature either through on-line access or through hard copies. The Bank has also partnered with the Asian Institute of Management (AIM) to create a Global Distance Learning Network that offers distance learning sessions for a broad national, regional, and international audience. In addition, the Bank also maintains an external country website (**www.worldbank.org.ph**).

B. Partnership

The Philippines Development Forum (PDF), formerly called the Consultative Group (CG), is the primary mechanism of the Government for facilitating substantive policy dialogue among stakeholders on the country's development agenda. The main event is held in country every twelve months, and the next PDF is scheduled to convene in March 2008. As in the past three years, the Bank will co-chair the meeting with the Philippine Government, represented by the Department of Finance. The PDF has seven working groups in the following areas to facilitate the policy dialogue throughout the year related to their specific themes: MDGs and social progress; growth and investment climate; economic and fiscal reforms; governance and anti-corruption; Mindanao, sustainable rural development; and decentralization and local government.

Table 1. Board Approvals for Loans between July 1, 2000 and September 30, 2007
(In millions of U.S. dollars)

Name	IBRD Amount	Effective Date
Land Administration Management Project (LIL)	4.79	1/9/01
Metro Manila Urban Integration Project	60.00	12/6/01
LGU Urban Water and Sanitation Project 2	30.00	5/16/02
Social Expenditure Management-2	100.00	12/11/02
Kalahi Community Development Project	100.00	12/16/02
Second Agrarian Reform Communities Project	50.00	6/4/03
ARMM Social Fund	33.6	5/19/03
Judicial Reform	21.9	12/04/03
Rural Power	10.00	05/06/04
Laguna de Bay Institutional Strengthening and Community Participation	5.00	04/02/04
Diversified Farm Income and Market Development	60.00	10/29/04
Second Women's Health and Nutrition Project	16.0	12/28/05
Second Land Administration and Management Project	19.0	10/11/05
Third Manila Sewerage Project	64.0	03/06/06
National Program Support for Basic Education	200.0	01/01/07
National Program Support for Health	110.0	03/27/07
Support for Strategic Local Development and Investment	100.0	02/28/07
Development Policy Loan	250.0	12/21/06
National Program Support for Tax Administration Reforms	11.0	06/25/07
Mindanao Rural Development Project 2	83.8	07/03/07
National Program Support for Environment and Nat. Resources Mgmt.	50.0	NYE

NYE: not yet effective.

Table 2. IBRD/IDA Lending Operations as of September 30, 2007
(In millions of U.S. dollars)

	IBRD	IDA	TOTAL
Total disbursed[1/]	9,695	244	9,939
Total commitments[1/]	12,308	294	12,602
Total undisbursed	854	0	854
Total repaid	8,021	63	8,084

[1/] Net of cancellations

IFC investments as of September 30, 2007
(In millions of U.S. dollars)

Total commitments held by IFC and participants	519.77
Total commitments held by IFC alone	512.55
Approvals pending commitments:	
IFC	0
Participants	0

IV. Relations with the Asian Development Bank

Reflecting the improved public budget situation and progress with sector reforms, in 2006 ADB approved new loans for $650 million, the highest since 1998, and disbursed $750 million, the highest ever, while the net resource transfer was positive ($269 million) for the first time since 1997. In 2007, ADB expects to approve new commitments of about the same amount, with increasing opportunities for investment project lending and more private sector operations. Financial support is augmented by non-lending activities, which significantly enhance the impact of the ADB-Philippines partnership

Since joining the Asian Development Bank (ADB) in 1966, the Philippines has received 199 loans for a total of $9.53 billion, and 322 technical assistance grants amounting to $147 million. Energy and agriculture account for the largest proportion of lending (Table 1). Since 1998, 72% of lending has been for policy-based operations and 28 percent for investment projects.

AsDB's private sector operations, which are made without government guarantee, amounted to $429.7 million, including 16 loans of $275.3 million and 20 equity investments of $36.8 million. The Philippines is one of the largest clients for such activities.

Table 1. Philippines: Cumulative AsDB Lending to the Philippines
(As of 30 September 2007)

	No. of Loans	Amount of Loans (In millions of US $)	Percent (by amount)
Energy	25	2,657.1	27.9
Agriculture	47	1,572.3	16.5
Multisector	28	1,175.8	12.3
Transport and Communication	23	996.8	10.5
Finance	19	1,128.0	11.8
Water	20	731.1	7.7
Health	6	317.4	3.3
Education	8	252.0	2.6
Industry and Trade	5	174.0	1.8
Law	2	253.0	2.7
Private Sector	16	275.3	2.9
Total	199	9,532.8	100.0

The ADB Philippines Country Strategy and Program 2005–2007 (CSP) provides the framework for the alignment of ADB's activities with Philippine priorities. ADB's engagement focuses on support for fiscal consolidation, improving the investment climate, and faster achievement of the Millennium Development Goals. A recent assessment concluded that the CSP strategic framework remains relevant and robust, allowing it to be extended by one year to end 2008. Under the extended CSP, ADB expects to continue to provide most of its financial support using the policy-based lending modality, calibrating its high case lending scenario against progress on fiscal consolidation and sector reforms. ADB works with the IMF and other development partners, in collaboration with Government, to build a common understanding of economic issues and prospects, and to determine the best timing for policy-based support.

Fiscal and macroeconomic stability. In 2007 ADB supported the Government's broad policy reform agenda with the Development Policy Support Program loan ($250 million). ADB expects to provide a series of such loans over the medium term, supporting fiscal consolidation, governance and anti-corruption, the investment climate, and social sector service delivery.

Power Sector. In recent years support has been provided to restructure the sector and reduce its drain on the national budget. The policy-based Power Sector Development Program loan ($450 million), approved in December 2006, provides the anchor for many of AsDB's activities. Further financial support is being contemplated to facilitate privatization and more effective competition at the wholesale and retail levels.

Local Government. ADB supports a wide range of activities at the sub-national government level to improve governance, own-resource mobilization, planning and budgeting, and service delivery. In 2007 ADB plans a policy-based loan for the Local Government Financing and Budget Reform Program ($300 million).

Other sectors. ADB is engaged in policy dialogue, lending and technical assistance for justice reform, urban services for the poor, agrarian reform, coastal resources, upland agriculture, and supporting government's customizing the Paris Declaration on Aid Effectiveness for Philippine circumstances. The Philippines participates in ADB's regional economic cooperation and integration initiatives.

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International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2007 Article IV Consultation with the Philippines

On March 12, 2008, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Philippines.[1]

Background

Economic performance has improved markedly over the past few years. Founded on impressive fiscal consolidation, investor confidence has revived, and sovereign spreads have tightened. A substantial improvement in banking supervision has gone in hand with a marked improvement in banks' balance sheets.

GDP growth accelerated to 7.3 percent (annual average) in 2007 in a low inflation environment. Private consumption firmed as remittances remained strong, part of which financed home purchases. Fiscal impetus from government spending, including on infrastructure, provided an added push to growth. Private investment remained low by regional standards, but there are tentative signs of a revival. Headline inflation was only 2.8 percent (annual average) in 2007, primarily from higher food and oil prices.

These developments and favorable global conditions led to a surge in foreign exchange inflows and the external value of the peso. The current account surplus reached 5.7 percent of GDP in the first half of 2007 on high levels of transfers from overseas workers. Heightened investor interest in Philippine securities helped to turn the financial account into a small surplus. Intervention helped smooth fluctuations in the foreign exchange market and scale up

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

buffers for increased capital flows. Despite a large buildup of reserves, the currency appreciated 19 percent against the U.S. dollar during 2007.

The momentum in stepped-up collection from the 2006 VAT reform slowed. The government deficit (excluding privatization receipts) widened to about 1½ percent of GDP as expected improvements in tax administration did not materialize. Yet there was a welcomed pickup in public investment. While the deficit is likely to be mitigated by privatization receipts, the debt-to-revenue ratio remained high relative to other countries. Privatization has attracted large interest from investors. Around 40 percent of power generating capacity has been sold to date.

Inflation remained low because of an appreciating peso and prudent monetary policy. The Bangko Sentral ng Pilipinas (BSP) successfully sterilized the jump in liquidity from foreign exchange intervention, including through broader access to the Special Deposit Account facility. At the same time, the benign inflation outlook permitted the BSP to cut interest rates in the second half of 2007 and in the process moderate inflows and support growth. Outflows were also encouraged through prepayment of external debt and foreign exchange liberalization.

The health of the financial sector has improved substantially. Non-performing assets of banks were reduced without government support; risk management facilities were upgraded as Basel II was phased in. Corporations also found alternative sources of funding, as equity and bond placements helped to supplement bank lending in 2007.

Executive Board Assessment

Executive Directors commended the authorities for the economy's impressive performance—strong growth, low inflation, sustained fiscal consolidation, and improved investor confidence. Directors also welcomed the improvement in the health of the banking system and the strengthening of bank supervision. Against this background, they encouraged the authorities to address the remaining challenges and vulnerabilities, including infrastructure bottlenecks, social needs, and further strengthening of the financial sector, which would help the Philippines weather the ongoing global financial turmoil.

Directors praised the authorities for their strong efforts in fiscal adjustment. They welcomed the 2005 and 2006 tax reforms, and commended the authorities' efforts to control spending. Better performance of non-financial public enterprises has slashed the public sector deficit and further improved the Philippines' debt dynamics. Directors viewed the government's plan to attain a balanced budget in 2008 within a firm medium-term framework as an important demonstration of fiscal prudence.

Directors encouraged the authorities to strengthen the tax effort and place priority spending on a sustainable footing. In addition to administrative reforms, they considered that legislation is needed to restore the tax base by rationalizing fiscal incentives and adjusting excise taxes. Directors noted that Public-Private Partnerships can be useful but require close monitoring, particularly of projects that extend guarantees to private investors. They also congratulated the authorities for a sustained effort at privatizing power sector assets, which has generated more income than expected and helped to support the government's plan to ensure that growth is not impeded by power shortages.

Directors commended the authorities for managing foreign exchange inflows well, while maintaining price stability. They highlighted, in particular, the successful smoothing of peso fluctuations while taking a strategic opportunity to build reserves. Directors noted that wider access to the Special Deposit Account, together with operations through the Reverse Repurchase facility and greater use of swaps, have successfully sterilized the reserves buildup and reduced liquidity growth. Well-anchored inflation expectations and an appreciating peso have helped counter the effects of sharply higher commodity prices in 2007. Directors were reassured by the authorities' commitment to remain vigilant, given the recent increase in inflation provoked by higher global food and oil prices.

Noting that the underlying current account balance is only slightly higher than its long-run average, Directors considered the exchange rate to be broadly in equilibrium. They recommended continuation of the current policy of limiting intervention to smooth erratic movements of the currency in the context of the flexible exchange rate regime. They also welcomed the recent two-step liberalization of the foreign exchange regulatory regime, which should help moderate net capital inflows. The government's decision to tilt its borrowing mix more heavily toward domestic sources should further reduce vulnerabilities and potentially ease pressure on the peso.

Directors welcomed the improvement in the health of the financial system. They also encouraged the authorities to further strengthen the financial sector, particularly in light of slow domestic credit growth and the possible effects of a serious turn in the credit cycle. While welcoming the progress in disposing of non-performing assets and in implementing international accounting standards and Basel II, Directors pointed to the need to reduce the remaining large stock of non-performing assets. They also noted that banks hold a significant amount of government debt that is sensitive to changes in sovereign spreads. Directors acknowledged that bank monitoring had improved, but encouraged the authorities to work for the passage of the BSP Charter Amendment, which is essential to lift the threat of legal action against supervisors, facilitate the operation of monetary policy, and improve economic surveillance of the non-bank sector. Directors also called for the adoption of legislation such as the Corporate Recovery Act and the Credit Information Systems Act, to help improve bank profitability and lending.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Philippines: Selected Economic Indicators, 2003–2008

	2003	2004	2005	2006	2007 Staff Est.	2008 Staff Proj. [1/]
Growth and prices (in percent change)						
GDP growth	4.9	6.4	4.9	5.4	7.3	6.0
CPI inflation (average)	3.5	6.0	7.7	6.2	2.8	4.4
Public finances (in percent of GDP)						
National government balance (authorities' definition)	-4.6	-3.8	-2.7	-0.9	-0.1	0.0
National government balance [2/]	-4.9	-4.2	-3.0	-1.2	-1.6	-0.7
Nonfinancial public sector balance [3/]	-5.6	-5.0	-2.1	0.2	-0.1	0.6
Revenue and grants [4/]	20.8	20.5	22.1	23.2	23.1	23.0
Expenditure [5/]	26.4	25.5	24.2	22.9	23.2	22.4
Money and credit (in percent change)						
Broad money (M3) [6/]	4.2	10.2	10.3	22.7	9.1 [7/]	...
Interest rate (91-day Treasury bill, secondary market, end period, in percent)	6.5	8.4	6.4	5.1	4.2	...
Credit to the private sector (net)	1.9	4.6	-1.5	6.0	6.8 [8/]	...
Balance of payments (in percent of GDP)						
Trade balance	-7.3	-6.5	-7.9	-5.8	-5.2	-6.5
Current account balance	0.4	1.9	2.0	5.0	5.2	2.7
Gross international reserves						
In billions of U.S. dollars	17.1	16.2	18.5	23.0	33.8	...
Adjusted, in billions of U.S. dollars [9/]	14.9	15.2	18.0	23.0	33.8	...
Adjusted, in percent of short-term liabilities [10/]	124.2	125.8	120.1	166.6	222.5	...

Sources: The Philippine authorities; IMF staff estimates and projections.
1/ Projections are based on baseline scenario.
2/ IMF definition. Excludes privatization receipts of the national government, and includes net deficit from restructuring the central bank.
3/ Includes the national government, Central Bank-Board of Liquidators, 14 monitored government-owned enterprises, social security institutions, and local governments.
4/ The sum of all nonfinancial public sector revenue net of intra-public sector payments. It is assumed that 80 percent of Bureau of Treasury revenue represents interest and dividends from other parts of the nonfinancial public sector. Privatization receipts are excluded.
5/ Defined as difference between nonfinancial public sector revenue and balance.
6/ Based on the regular monetary survey data.
7/ As of November 2007.
8/ As of September 2007.
9/ In addition to monitoring the level of gross international reserves (GIR), the IMF also monitors Adjusted Reserves, which are calculated by subtracting from GIR the value of the BSP's foreign assets that have been pledged as collateral for short-term liabilities. These pledged assets (gold and other securities) remain foreign reserve assets of the BSP and so are considered part of GIR. However, they are not as readily usable as other components of GIR since pledged assets must be set aside while the short-term liabilities they secure remain outstanding.
10/ Short-term liabilities include medium- and long-term debt due in the following year, and exclude loans backed by gold and securities pledged as collateral.

Statement by Richard Murray, Executive Director for the Philippines and Wilhelmina Mañalac, Alternate Executive Director
March 12, 2008

Key Points

- Continued implementation of prudent macroeconomic policies and structural reforms bolstered confidence in the economy and paved the way for milestone achievements, notwithstanding the external and internal shocks experienced during the year. The Philippine economy grew by 7.3 percent in 2007, the highest in more than three decades. Inflation averaged 2.8 percent, its lowest in 21 years. The budget deficit was reduced to 0.1 percent of GDP, the lowest in 10 years. Foreign exchange reserves stood at an unprecedented level of $33.8 billion, with the exchange rate recovering from previous bouts of undervaluation. The Philippine Stock Exchange Index (PSEI) reached an all-time high of 3873.5 index points in October 2007.

- Faced with the near-term challenges brought about by the recent volatility in financial markets and the slowdown in the US economy, coupled with the long-term objective of achieving sustained macroeconomic stability, the authorities are determined to implement additional necessary reforms, particularly in the fiscal and financial sectors. The government will pursue its priority to enhance governance practices to further improve the business environment.

Introduction

1. The Philippine authorities welcome the productive exchange of views with the Fund staff and their candid assessment of the key developments in the economy and the policy responses by the authorities in the year just passed, as well as discussions on future challenges. The authorities also thank the staff for the papers on selected issues, which support proposed policy measures particularly in the fiscal sector, and provide inputs for future decisions. The authorities also value staff advice, which benefited from staff's knowledge on a wide range of cross-country experiences.

The Philippine economy takes a significant leap forward

2. The economy grew by 7.3 percent in 2007, the highest in 31 years. Growth was broad-based, led by the fast expanding services sector. Inflation was on a downtrend while the fiscal deficit was significantly lower than program level. The external payments position considerably improved due to substantial inflows of foreign exchange (FX) from exports, remittances and foreign investments, while the exchange rate recovered from previous undervaluation. The authorities took advantage of the favorable conditions to build up reserves and further improve the debt structure. With the rise in

the level of investor confidence, the stock market maintained its bullishness and the PSEI reached its highest level since 1997.

3. The country's milestone achievements demonstrate the authorities' commitment to implement sound macroeconomic policies and to pursue additional reforms, in the face of record high global oil and non-oil commodity prices and the recent domestic political incidents. Going forward, the authorities are well aware of the remaining challenges they continue to face. While the current global financial turmoil stemming from the subprime mortgage crisis in the US has had little impact on the Philippine financial system which has remained stable, the resulting slowdown in economic activity in the US (a major trading partner of the Philippines) and the rest of the world may dampen export growth and remittances by overseas Filipinos (OF). The continued high and volatile prices of global oil and non-oil commodities, including food, might put some pressure on domestic inflation. The authorities continue to monitor developments in these and other areas even as they pursue further reforms to sustain the gains achieved so far.

Sustaining the gains require continued implementation of prudent monetary and external sector policies

4. Inflation at 2.8 percent was well below the target range for 2007 and the lowest annual average in 21 years. From the supply side, low inflation was maintained as a result of favorable agricultural production, the firm peso, and the subsiding base effects of the reformed value added tax (RVAT) implemented in November 2005 and February 2006. However, headline inflation increased in the last two months of 2007 with pressures coming from global supply shocks mainly coming from oil and non-oil commodities, particularly food, and strengthening demand conditions. Headline inflation is expected to be within target of 4 ± 1 percentage point in 2008.

5. Earlier in 2007, the Bangko Sentral ng Pilipinas (BSP) implemented liquidity management measures to help prevent potential inflationary pressures that could build up over the medium term as a result of rapid money supply growth driven mainly by FX inflows. The widening of the access to its Special Deposit Account (SDA) facility which now included trust offices of financial institutions supervised by the BSP, helped sterilize liquidity resulting from strong FX inflows and reduced liquidity growth from a peak of 26.1 percent year-on-year in April 2007 to 9.0 percent in December of the same year, the slowest pace in nearly two years. Since the implementation of the twin monetary policy moves which lifted the tiering scheme and adjusted the policy rates in July 2007, the BSP considered the benign inflation outlook as well as the favorable balance of risks and reduced its key policy rates by 25 basis points four times for a total of 100 basis points. The latest reduction was implemented in January 2008. However, with the rise in headline inflation to 4.9 percent in January 2008 and 5.4 percent in February as a result of elevated prices of food items, fuel, transportation and

communication services, the BSP will continue to be attentive to inflationary risks with a view to calibrating its monetary policy stance that would maintain price stability as the economy sustains its strong growth momentum.

6. Enabled by a favorable external environment, the country's gross international reserves reached a historic level of $33.8 billion at end-December 2007, overshooting the 2007 target, in the face of sustained inflows of remittances, foreign portfolio and direct investments, and export earnings. Foreign exchange reserves further rose to $34.8 billion in January 2008 due mainly to inflows from the BSP's net FX operations on the back of sustained FX inflows as well as income from the BSP's investments abroad. A modest expansion in exports occurred in spite of the peso appreciation recorded at 18.8 percent for the year. Assessed against international benchmarks, the reserves level at end-December 2007 could adequately cover 5.9 months of imports of goods and payments of services and income and is equivalent to 4.9 times the country's short-term external debt based on original maturity and 3.0 times based on residual maturity.

7. Staff's assessment that the Philippines' exchange rate is in line with fundamentals is welcome. Consistent with the country's market-determined exchange rate policy, the authorities have allowed the peso to be market-determined while smoothing observed volatilities and seizing the opportunity to increase reserves as a precautionary measure in case any possible reversal of market sentiment occurs. Amidst calls from the export and services sectors for more actions from the BSP to moderate the peso appreciation, the BSP continues to adhere to a market-determined exchange rate.

8. At the same time, the BSP has promoted the use of hedging products offered by banks to reduce FX risk for dollar earners. A hedging program for exporters was offered by the Development Bank of the Philippines (DBP) which provides options for exporters to hedge themselves against potential FX rate losses through FX insurance and forward FX rate protection products. Other commercial banks have initiated public information campaigns to popularize the use of hedging facilities.

9. As with other Asian countries, the authorities had to face the difficult task of managing the substantial flows of FX, considering the associated rise in liquidity and the appreciation of the exchange rate. In response to this challenge, the authorities took the opportunity to prepay some of its external debt, including obligations to the Fund, resulting in the improvement of the country's debt structure. In 2007, the country prepaid $2.8 billion of the medium and long term external debt of both the public and private sectors. Two phases of FX liberalization measures were also implemented which allow the freer flow of FX both in the current and capital accounts. The BSP will continue its review of the FX regulatory framework to further relax existing rules particularly on registration requirements and offshore investments. The idea is to make the market supportive of a more dynamic, expanding and increasingly globally integrated economy. On the fiscal side, the authorities will source their financing

requirements largely from domestic sources to lessen the impact of the strengthening of the currency as well as reduce the public sector's vulnerability to exchange rate movements.

Fiscal consolidation and sustainability depend on continued fiscal reforms

10. Consistent with its goal of achieving a balanced budget by 2008, the National Government (NG) deficit was recorded at 0.1 percent of GDP in 2007 (see Table 1). This outcome was as a result of increased revenues, savings in interest payments due to lower interest rates, and prepayment of debt. Prompted by the progress in stabilizing public sector finances and an easing in government's dependence on external financing, Moody's Investor Service upgraded its outlook of the country's capacity to pay its obligations to "positive" from "stable." Meanwhile, the consolidated public sector financial position recorded a surplus of P52.8 billion as of end-September 2007, almost six times the P8.9 billion surplus for the same period in 2006. This was largely due to the substantial improvement in the performance of government-owned and controlled corporations (GOCCs), in particular, the power sector.

11. The government's successful privatization program which attracted strong investor interest primarily contributed to the rise in revenue. Tax revenues, while recording an increase, fell below the target as interest rates declined and the peso appreciated affecting export and import transactions. Tax revenues increased by 13 percent on an annual basis, as improvements in the management revenue collection office, helped increase tax revenues during the second half of 2007. The authorities expect the ongoing tax administration reforms to start reaping dividends this year. Meanwhile, the tax effort slightly declined to 14 percent against last year's 14.3 percent. The government's goal is to return to an upward trajectory and achieve a 16 percent tax effort by 2010 or close to pre-crisis (1996) levels of 16.9 percent.

12. With the majority of the high-ticketed assets privatized in 2007, the government is keenly aware of the need to achieve a sustained tax revenue base in order to meet its goal of a balanced budget this year. In addition to further enhancing tax administration, among the authorities' priorities are streamlining fiscal incentives, particularly phasing out the income tax holiday, and simplifying the system of excise taxes on tobacco products specifically the proposed application of a uniform tax rate, by product, on sin taxes. In particular, the National Government proposes to phase out the income tax holiday within three years from the effectivity of the proposed regulation. In lieu of the income tax holiday, eligible enterprises will be given a choice of either a reduced income tax rate (partial income tax holiday) or a gross income tax package. The proposed tax incentive package is to run for 20 years. Meanwhile, the proposed simplification of the excise tax system on tobacco entails the reduction in the number of tax brackets being applied to both tobacco and alcohol products. Specific provisions will be introduced to simplify excise tax administration. In addition, a number of

governance measures in the government's agenda are to be intensified including the Revenue Protection Integrity Service (RIPS) where 82 cases have been filed to date, Run After Tax Evaders (RATE) and Run After the Smugglers (RATS) with 87 and 60 cases filed, respectively.

13. In last year's meeting, Directors expressed concern that expenditure compression as a means to fiscal consolidation is not sustainable. In full agreement with this statement, the expenditure compression which was observed in previous years was reversed in 2007 as the authorities implemented various projects aimed at improving infrastructure and social spending. This year's budget, which is up by 8 percent from 2007, places strong emphasis on upgrading the country's infrastructure facilities. In response to the slowdown in the US, the authorities intend to frontload expenditures particularly for infrastructure. The measure is viewed as appropriately addressing the twin objectives of alleviating the impact of the global situation and the government's goal of reducing its deficit.

14. Meanwhile, the National Government debt as percent to GDP dropped to 59.4 percent in 2007 from 66.9 percent in 2006. It is expected to go down further to 54 percent in 2008 as a result of lower interest cost, which, together with the peso appreciation also helped reduce the National Government's financing requirement.

Sustained economic growth will be facilitated by further implementation of the structural reform agenda

15. While the financial sector has shown considerable improvement, the BSP is well aware of the remaining vulnerabilities faced by the sector. The BSP's medium-term strategic plan thus establishes a four-pronged approach towards developing a stronger and more efficient banking system that is prepared to meet the needs of the country's medium-term economic development program. In particular, the approach entails further enhancing the existing regulatory framework, promoting corporate governance, fully implementing a consolidated and risk-based supervision approach consistent with modern banking and finance standards, and advancing capital market reform initiatives. A notable achievement in July 2007 was the full implementation of Basel II for the standardized approach. The advanced internal ratings based approach is targeted for full implementation after 2010. The BSP also sustains its advocacy efforts for the passage of vital legislation that affect the BSP and the financial system, such as the amendments to the Central Bank Act that would strengthen its supervisory and regulatory powers, help develop the capital market, allow the monetary policy stance under the inflation targeting framework to determine the limits on the growth of monetary and price indicators, remove the restrictions on the BSP's issuance of its own securities, and expand its authority to obtain data from the non-bank sector.

16. On the power sector, the Wholesale Electricity Spot Market (WESM) has started to bring down power cost. In January 2008, the WESM rate was at an all-time low of P3.38/kwh since the spot market started in July 2006.

17. The Power Sector Assets and Liabilities Management Corporation or PSALM advanced the privatization efforts of government in the power sector when it sold at least 10 plants equivalent to 42 percent of the generating assets of the National Power Corporation in 2007. This year, PSALM has lined up the sale of 10 more plants to reach 70 percent of its privatization target, the trigger level for the open access system to be implemented. Open access will allow power users to choose their power suppliers. A pending bill in Congress seeks to lower the trigger level to 50 percent, to speed up the implementation of the open access system for all residential and industrial users in the country. Meanwhile, efforts are underway towards the reduction of power rates in ecozones to make electricity rates more competitive.

Concluding Remarks

18. After a long series of critical setbacks, the Philippine economy has finally taken off. To maintain this upward course, the authorities are keenly aware of the need for further reform efforts and continued policy discipline. Mindful of the headwinds ahead, in conjunction with a less friendly external environment, the authorities are determined and committed to carry out the needed measures to steer the economy towards a higher growth path. In doing so, the authorities intend to continue working closely with the Fund through the regular Article IV consultations and through its technical assistance programs.