

Philippines

Market sentiment towards the Philippines improved during 2006, aided by the major fiscal adjustment during 2005-06 and abundant global liquidity. Equity prices and the peso rose significantly (until the global correction in late February 2007), as did foreign direct investment, portfolio inflows and international reserves, while interest rates and inflation fell. Real GDP grew by 5.4 percent in 2006 and real GNP by 6.2 percent, marking the first time that three consecutive years of growth of 5 or more percent was recorded since the 1970s. Higher growth was underpinned by strong growth in business process outsourcing, electronics exports, remittances and consumption.

Public consumption also expanded in 2006, despite a reenacted budget, due mainly to first quarter pump priming and fourth quarter supplemental budget spending. Investment grew marginally in 2006, but continued its decline as a share of GDP to below 15 percent. Moreover the slight increase in investment was tilted towards public construction, while private construction and acquisition of durable equipment contracted. On the supply side, agriculture grew by 4.1 percent in spite of two severe typhoons in the fourth quarter of 2006. Service sector growth of 6.3 percent was led by the financial sector and private services. Manufacturing output continued to grow on pace with GDP but, in contrast to recent years, mining witnessed a contraction.

Inflation fell to 4.3 percent by end-2006 and to 2.6 percent by February 2007, aided by the stronger peso and relatively stable food and oil prices. Average inflation in 2006 fell to 6.2 percent from 7.6 percent in 2005. The central bank (BSP) did not explicitly lower its overnight rates but instead reintroduced a “tiering scheme” in November, whereby bank deposits placed at the BSP receive progressively lower rates on balances above P5 billion and P10 billion than the 7½ basic rate.

Employment growth in 2006 slowed to 2 percent, less than growth of the working age population. The growth of wage and salaried workers was higher, at 2.9 percent, but their share of total employment is still only about 50 percent, and fell relative to 2004. By contrast, the proportion of unpaid family workers, prevalent in agriculture and private households, increased. Under the old definition, unemployment had dropped slightly to 11 percent as of October 2006, in part due to a decline in the labor force participation rate. Underemployment, however, grew to 22.7 percent from 17.6 percent two years ago. About 1.1 million Filipino workers are estimated to have left the country in 2006 for employment overseas, which in part reflects the lack of domestic employment opportunities, as well as higher wages abroad.

The consolidated public sector deficit (CPSD) is estimated to have fallen to about 0.7 percent of GDP in 2006 from 1.8 percent in 2005 and 4.9 percent in 2005, implying a primary public sector surplus in 2006 of over 5 percent of GDP. The reduction of the CPSD was essentially due to a larger cut in the National Government deficit. The NG deficit, targeted for balance by 2008, was reduced to 1 percent of GDP in 2006 from 2.7 percent in 2005. In contrast to the 2002-05 period, when NG deficit reduction was driven primarily by expenditure compression, in 2006, the bulk of the adjustment was due to implementation of the VAT reforms which raised tax revenue by 22 percent, increasing the tax/GDP ratio from 13 percent in 2005 to about 14.3 percent in 2006—marking the first significant increase in tax effort since the post-Asian crisis collapse of tax revenue. In the first two months of 2007, the budget deficit fell to P18.6 billion, versus P40.4 billion through February 2006. Revenue in February was boosted by proceeds from the P25.2 billion sale of the Government’s stake in Philippines Telecommunications Investment Corp. However, tax revenue through February was 0.5 percent below collections in 2006 as opposed to the targeted 14 percent increase. With Congressional approval in January of the 2007 budget, non-interest spending is slated to increase as a share of GDP after continuous compression since 2002.

Falling GOCC (Government Owned and Controlled Corporations) deficits, continued surpluses in the two major pension funds, and a rising surplus for local governments also contributed to the consolidated deficit reduction. In particular, the deficit of the National Power Corporation, traditionally the largest GOCC deficit contributor was held in check, reflecting tariff increases in 2004-05 and aided by recent peso appreciation (given its large external debt). By contrast, the National Food Authority’s deficit increased to be the largest single contributor to the GOCC deficit (about 0.4 percent of GDP). The non-financial public debt/GDP ratio fell from 87 percent in 2005 to an estimated 77 percent in 2006 reflecting both real growth and real appreciation of the peso.

The strong performance of electronics exports and remittances far outweighed the impact of higher imported oil prices on the current account—the current account surplus in 2006 jumped to \$5 billion from \$2 billion in 2005—while rising foreign direct and equity investment also contributed to gross reserve accumulation to \$24.4 billion by February 2007, from \$18.5 billion in 2005. Net FDI inflow rose to \$2.35 billion in 2006, nearly double the 2005 level, and net portfolio inflows also accelerated following the May-June sell-off. A 20 percent increase in remittances to \$12.8 billion in 2006 underscores the vital role of remittances and transfers for the balance of payments: through these flows, which together account for over 13 percent of GDP, large trade deficits have been transformed into current account surpluses, which in 2006 grew to over 4 percent of GDP.

Boosted by foreign capital inflow, the Philippine stock market was among the top East Asian performers in 2006, and continued to ascend towards pre-Asian crisis highs—prior to the global correction of equity prices that began in the last week of February 2007 which saw the stock market index lose more than 12 percent of its value in one week. However equities had recovered 6-7 percent of their post-correction losses by the latter part of March. The peso appreciated by about 7½ percent against the U.S. dollar in 2006, and strengthened further in early 2007 even as the BSP continued to build reserves as a net buyer of foreign currency. Interest rates in the peso market and Philippine spreads in the global market fell substantially, with the former prompting more investment into equities. The benchmark 91-day Treasury bill averaged 5.4 percent in 2006 and fell below 3 percent in February 2007. Sovereign spreads declined by 100 basis points in 2006 reflecting both lower public deficits and the falling spreads for emerging markets in general. In January 2007, the national government issued a \$1 billion 25-year bond at a yield of 6.55 percent. This completed the national government's intended commercial borrowing for 2007.

Gradual strengthening of the banking sector has continued. Regulations are in closer alignment with international standards and regulatory policies are more responsive to the growing sophistication and globalization of the banking industry. The extension of the Special Purpose Vehicle Act enabled universal and commercial banks to reduce their stock of NPLs by another 18 percent in 2006. BSP expects an additional P100 billion worth of NPLs/NPAs would be taken out from bank balance sheets during 2007. Capital adequacy requirements are also being brought in line with international norms.