

## ***Philippines***

Philippine GDP growth increased to 7.3 percent in the first half of 2007, highest among the middle-income countries of Southeast Asia, while GNP growth reached 8 percent. This performance indicates that growth for the year could reach or exceed the 6.7 percent upper end of the Government's original target range for 2007. Growth performance and prospects have improved following the substantial fiscal adjustment, public debt reduction and balance of payments surpluses of recent years. By October 2007, financial markets had largely recovered from the US sub-prime crisis-induced volatility, notwithstanding a spate of corruption scandals featuring prominently on the political landscape. A shortfall in targeted tax revenue in 2007, unless rectified, could undermine official aspirations to strengthen infrastructure and eliminate the National Government deficit in 2008.

Stronger first half growth was driven by 8.6 percent growth in the services sector, which accounts for more than half of GDP. Industry expanded by 7.2 percent, but this was due to strong growth in mining and construction whereas expansion in manufacturing slowed to 3.8 percent. The agriculture and fishery sector also slowed to 3.9 percent. Investment began to pick up, albeit unevenly: both private and public investment in construction increased significantly, but investment in durable equipment remained lackluster. Meanwhile, personal consumption expanded by 6 percent, benefiting from large and growing remittances.

Unemployment fell to 7.8 percent from 8.1 percent in 2006 according to the July round of the labor force survey. Underemployment also fell marginally from 23.4 percent to 22 percent. The share of wage and salaried workers increased slightly to 53 percent while the share of unpaid family workers diminished somewhat, suggesting some improvement in the quality of employment. Within wage and salaried workers, the largest increase was in the public sector, where election related hiring might have been a factor.

The consolidated public sector deficit was eliminated in 2006, and a P32 billion consolidated public sector surplus recorded in the first half of 2007, about 1 percent of GDP, driven in large part by higher surpluses of the social security funds and local government units. The National Government (NG) deficit of P40 billion through September 2007 was smaller than targeted, aided by P42 billion of privatization receipts, and despite lower-than-targeted tax revenue. Following a significant policy induced increase in 2006, the tax effort fell in the first half of the year relative to target, recovering only partially in the third quarter. Through September, tax revenue had grown by 7.8 percent, notwithstanding growth of over 15 percent in the third quarter. Non-interest NG spending increased significantly thus far in 2007, reversing the trend of past years, but overall growth in government spending was moderated by lower interest payments that reflected both a declining debt ratio and lower interest rates for government borrowing. Non-financial public sector debt fell to 74 percent of GDP in 2006 and this ratio is expected to fall further in 2007 given strong economic growth and an appreciating currency.

Philippine financial markets were significantly impacted by the sub-prime crisis, with the stock market index losing 24 percent of its value by mid-August from its peak in early July. Even though local banks have minimal direct exposure to US sub-prime-linked assets, bank balance sheets were impacted by the falling prices of foreign exchange denominated government bonds (ROPs) during July-August, in which the banks are significant investors. By early October, however, financial markets had largely recovered from the sub-prime-induced volatility. Equity prices reached a new record high in the following week. The peso resumed its appreciation in September and has appreciated the most against the US dollar through early November among East Asian currencies this year (nearly 15 percent). Recovering ROP prices have also benefited the banks in recent months, although bond spreads remain higher than prior to the onset of the sub-prime crisis. The 91 day T-bill rate averaged 3.3 percent in September, 2 percentage points

lower than September 2006. Following the U.S. rate cut in September, the BSP reduced policy rates by 25 basis points in October to 5.75 percent for its overnight deposit rate, facilitated by declining inflation through much of 2007. The consumer price index increased by an average of 2.6 percent in the first nine months of the year, versus 6.8 percent in during the same period in 2006. Finally, bank lending which has consistently lagged GDP growth, expanded by 7.5 percent in August, the highest monthly growth this year, and the central bank forecasted a further increase to about 10 percent growth by year end.

Gross international reserves reached \$32.4 billion in October 2007, up from \$23 billion at the end of 2006, reflecting rising surpluses on both current and capital accounts. The current account surplus rose sharply on account of large remittance inflows and a smaller trade deficit. Remittances increased by 15 percent to \$9.3 billion through August. By contrast, export growth slowed to 6.6 percent in the first half and decelerated further in July and August. Import growth has also slowed, which, coupled with the appreciation of the peso and the prospect of slower OECD growth, has raised some concern about prospective export growth. Strong inflows were also recorded in the capital account. Net foreign direct investment reached \$1.6 billion through July 2007, up 70 percent from 2006. Net portfolio inflows jumped 143 percent to \$3.4 billion through September despite a substantial outflow in August.