# BALANCE OF PAYMENTS DEVELOPMENTS JANUARY-JULY 2002

*10/24/2002 12:10 PM*

## ➢ Overall Position

*The BOP reverses to a surplus due mainly to the robust performance of the current account.*

The country's balance of payments (BOP) in the first seven months of 2002 yielded a $1,084 million surplus, a reversal of the $917 million deficit posted in the same period last year. This favorable development was realized on account mainly of the robust performance of the current account (Table 1).

**Balance of Payments (US$ m)**

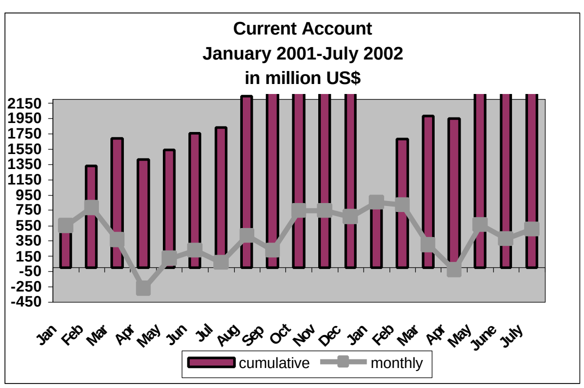
| | Jan-July 2002 | Jan-July 2001 | Growth Rate (%) |
|---|---|---|---|
| I. Current Account | 3396 | 1422 | 138.8 |
| II. Capital & Fin'l. | -2576 | -2446 | -5.3 |
| III. Net Unclassified | 264 | 107 | 146.7 |
| **IV. Overall BOP *** | **1084** | **-917** | **218.2** |

* Totals may not add up due to rounding.

## ➢ Current Account

*The current account gains strength on the back of improved balances in trade-in-goods and services as well as higher income receipts.*

The surplus in the current account yielded a more than twofold increase to $3,396 million in January-July 2002. Largely contributing to this positive development was the higher surplus in the trade-in-goods account, and the lower net outflow in the services account. This resulted in the turnaround in the trade-in-goods and services balance to a surplus of $564 million, which compared favorably with the $357 million deficit in 2001. The substantial increase in the net income account surplus to $2,564 million also helped prop up the current account performance.

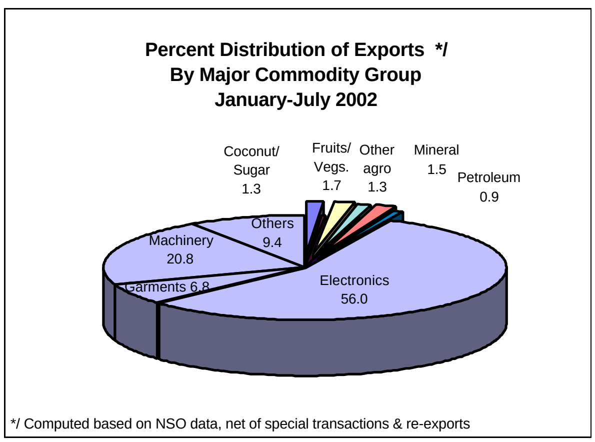


## ➢ Trade in Goods

*Exports of goods post four straight months of double-digit growth since April, after more than a year of decline.*

The upturn in exports of goods continued following the improvement in global demand, particularly from non-traditional markets, and the implementation of the two-pronged strategy in the new export plan, i.e, industry clustering to enhance competitive advantage and an aggressive marketing program in both old and new markets. Exports posted double-digit growth for four straight months of 2002 after fourteen months of lackluster performance.[1] Exports expanded by 23.6 percent in July to reach $3,134 million, the highest level in 18 months. This favorable development brought the year-to-date exports to $19,394 million or 7.5 percent higher than last year's level.[2] Higher demand for Philippine goods from the Netherlands and some East Asian countries such as Singapore, Taiwan, Hong Kong, Malaysia and China made up for the slack in exports to the U.S. and Japan.

The recovery in exports has boosted domestic manufacturing activities, which explained in part the increase in the volume of production index of key manufacturing enterprises for the first seven months of 2002. In January-July 2002, the country's major export earners remained to be electronics, machinery and transport equipment, and garments (Table 2.1).




*Rebound in electronics exports continues in July, while exports of machinery and transport*

a) *Electronics.* Electronic exports for the first seven months of 2002 rose by 9.2 percent to $10,596 million following successive year-on-year increases since April 2002, with the highest growth posted in July at 39.4 percent. The strong recovery in electronics exports was expected as the book-to-bill ratio continued to breach the demand-supply unity mark since March 2002, to reach 1.22 in July.[3] The growing intra-Asian trade and the continued rebuilding of inventory for semi-conductors and electronic circuits as well as micro-assemblies compensated for the slowdown in demand from the U.S. To

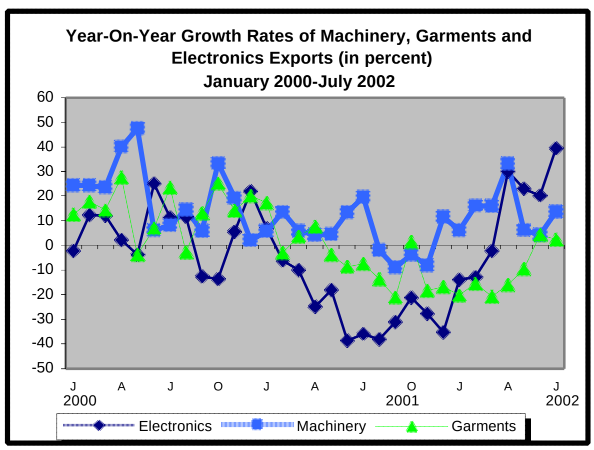
[1] Industry clustering is a strategy aimed at strengthening the domestic base of an industry by putting and linking together similar businesses so as to ensure a steady supply chain. Industry clusters are usually privately-led initiative but the Government extends support to enhance the trade and investments environment.
[2] Per BPM5 concept
[3] The book-to-bill ratio is the ratio of three-month moving average bookings (a measure of demand) to three-month moving average shipments (a measure of supply). A ratio of one or more indicates that demand exceeds supply.

*equipment boost further export earnings.*

improve competitiveness and brace for stiffer market competition abroad, the leading electronic exporters groups, with the aid of the government, are hammering out a survival blueprint that will set the Philippines as a regional center for production design and as a transshipment point for testing and quality check for mass-assembled electronic goods from China in transit to the Western markets.

b) *Machinery and Transport Equipment*. Exports of machinery and transport equipment, the only major export commodity group that has showed consistent strength during the year, grew by 13.1 percent to $3,931 million. Major contributory factors were the increased exports of input/output peripheral units, parts/accessories of automatic data processing and machineries and units as well as other parts and accessories of motor vehicles.

c) *Garments.* After rebounding in June, exports of garments continued to post a modest growth of 2.4 percent in July. This tempered the year-to-date decline of garment exports to 10.1 percent to reach $1,291 million. The twin strategies to tap the high-end segment in traditional quota-driven markets and the increased penetration of non-quota markets of Japan, United Arab Emirates, Hong Kong, Mexico and South Korea have appeared to be paying off. The garments industry is gearing up for the worldwide full phase out of the quota system in 2004.




*Higher import of raw materials and capital goods propel the growth in total imports.*

Imports of goods climbed for the sixth consecutive month since February following the increased purchases of raw materials and capital goods, which combined, comprise more than four-fifths of total imports. Consequently, imports for January-July were 5.8 percent higher at $18,242 million. This was a reversal of the 0.9 percent decline registered in 2001.[4] The import growth reflected the robust domestic demand and rebound in export amid strong demand from other Asian countries. As a leading indicator, the positive import growth augurs well for the

[4] Per BPM5 concept

manufacturing sector in the remaining months of 2002 (Table 2.2).

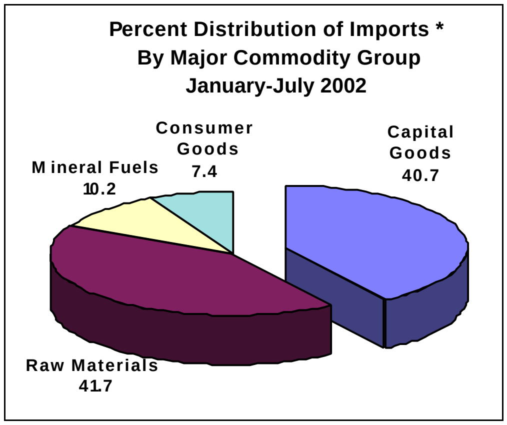
Capital goods imports grew by 8.4 percent to reach $7,469 million, following increased imports of telecommunication equipment? mainly inputs to electronics production? and office and EDP machines. The positive growth in capital goods imports was a reversal of the 2.9 percent decline in 2001.

Likewise, imports of raw materials and intermediate goods—which accounted for more than two-fifths of total imports—expanded by 9.3 percent to $7,647 million. Double-digit year-on-year growths ranging from 32 to 49 percent were noted in the imports of materials/accessories for the manufacture of electrical equipment from February-July 2002.[5] The increase in imported inputs for electronics exports and the growth in imports of capital goods for electronics production confirmed market expectations of an upturn in the electronics industry.

Meanwhile, mineral fuels and lubricants posted the highest decline of 9.5 percent to reach $1,870 million during the period in review amid lower imports particularly of petroleum crude which more than offset the higher purchases of other mineral fuels and lubricants such as gas oil, motor and aviation gasoline. This developed on account of the twin effect of the decline in the volume of imports and lower price of petroleum crude. The average price of petroleum crude for the first seven months of 2002 dropped to $22.96 per barrel from $24.67 per barrel last year. On the other hand, the decline in the volume of oil imports was most apparent in the first quarter due to shutdown of some refinery units for maintenance check-up, excess capacity, and high oil stockpile in 2001.

According to the Department of Energy, the country is committed under the term contract with the oil suppliers to purchase 111 million barrels of crude petroleum for the full year 2002. This approximates the full year 2001 crude oil imports of 114 million barrels. In the event of Iraq crisis, the National Security Council assured that there would be no major disruption in oil deliveries since Iraq is not a source of Philippine crude oil.

[5] About half of the imported raw materials needed for electronics production are lodged in the capital goods commodity group, particularly under telecommunication equipment and electrical machinery. Only consigned materials/accessories for the manufacture of electrical equipment are classified as raw materials and intermediate goods. Other electronics parts are classified as capital goods. The combined total of imported inputs to electronics lodged in the capital goods and raw materials categories increased by 24.2 percent during the review period as against the 7.7 percent decline in January-July 2001.




* Computed based on NSO data, net of special transactions

## ➢ Trade In Services

*The deficit in the trade-in-services account narrows due to lower net payments for transportation services, and miscellaneous business, professional and technical services coupled with higher net travel receipts.*

The trade-in-services account in January-July 2002 posted a lower net outflow of $588 million (Table 3). The 49.4 percent narrowing of the deficit was traced to lower net payments for transportation services and for miscellaneous business, professional and technical services. Increased net receipts from travel services, which rose by 75.0 percent to $581 million, owing to the higher rate of decline in travel payments relative to that of travel receipts also contributed to the narrower net outflow in the trade-in-services account. The lower travel payments reflected in part the weaker peso and the government program to promote domestic tourism among local residents. The government continues to pursue an aggressive promotion blitz through new international marketing campaigns to showcase the country's tourism attractions. The government will also launch soon the "Visit Philippines 2003" in selected markets abroad.  The programs are intended to target tourists from Japan, Taiwan, the U.S., Singapore, Australia, People's Republic of China, the United Kingdom, Hong Kong, South Korea and Germany. The recent agreement between Thailand and the Philippines on tourism marketing strategies is likewise expected to translate to a 25 percent increase in tourist traffic between the two countries in the next two years.

## ➢ Income

*Higher OFW remittances and lower interest payments contribute to the income account surplus.*

Remittances from overseas Filipino workers (OFWs), consistently a major source of foreign exchange earnings, expanded by 24.8 percent in January-July 2002 from the level a year-ago to reach $4.264 billion.[6] This brought the income account to a surplus of $2.564 billion, or an increase of 69.7 percent from the year-ago level. Behind this positive development was the 4.3 percent rise in the number of deployed new hires and rehires OFWs during the review period. The growth in OFW deployment was noted in the Middle East, Europe, and Asia. The bulk of remittances from OFWs, which comprised about 91 percent of gross income receipts, came from the U.S., Saudi Arabia, Japan, Hong Kong and Singapore.[7] With the emerging trend towards "localization" and the economic slowdown experienced in some of the countries where Filipino workers are deployed, the government continues to intensify its marketing efforts to augment the hiring of Filipino skills abroad.[8] In the next three years, higher remittances are anticipated with the expanded hiring of OFWs in the medical field.

Meanwhile, the net outflow in the investment income account was lower by 10.9 percent relative to the level last year as interest payments on portfolio and other investments fell with the continued drop in global interest rates (Table 4).

## ➢ Current Transfers

*The surplus in current transfers remains unchanged.*

The net inflow from the current transfers account for January-July 2002 was steady at $268 million (Table 5).

## ➢ Capital and Financial Account

*The capital and financial account posts a higher net outflow even as portfolio investment account reverses to a net inflow.*

The net outflow in the capital and financial account widened marginally by 5.3 percent to $2,576 million during the period in review. This developed on account of higher net outflow of other investments and lower net inflows of direct investments despite the reversal of the portfolio investment account to a net inflow of $1,301 million from a net outflow of $182 million last year.

## ➢ Capital Account

[6] Data for OFW remittances for the period January to July 2002 reflected amendments arising from erroneous bank reports discovered after BSP audit. Previously reported amount of $4.142 billion OFW remittances for the period January to June 2002 was revised to $3.591 billion, or a reduction of $551 million.

[7] Data may not reflect truly the actual country-source of OFW remittances due to the common practice of remittance centers in various cities abroad to course their remittances through correspondent banks, which are located mostly in the United States. Since banks attribute the origin of funds to the most immediate source, the U.S., therefore, would appear to be the major source of remittances.

[8] Localization means the preferential hiring by a country of its own residents.

*The capital account yields a deficit.*

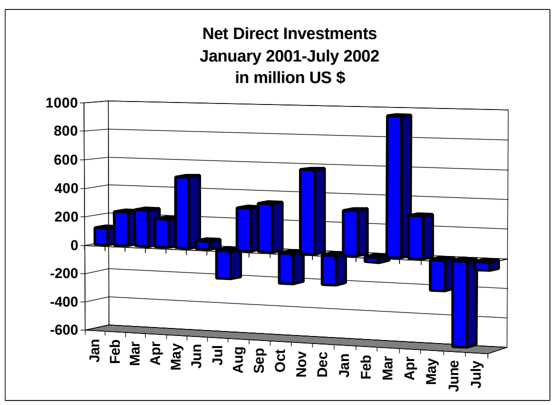
The capital account for January-July 2002 posted a higher net outflow of $9 million compared to the level last year of only $1 million, owing mainly to increased net outflow of migrants' transfers (Table 6).[9]

## ➢ Direct Investments

*Higher direct equity investments by non-residents result in a surplus in the direct investment account.*

Non-residents' investments in equity capital increased by almost threefold to $760 million during the period in review. The bulk of non-residents' equity investments came from Japan following the investment of $544 million worth of shares by a Japanese firm in a local brewery company in March 2002. The rest was directed to other manufacturing companies, financial institutions and transport and storage services. Other major sources of direct investments were the U.S., Singapore, U.K and Netherlands. (Table 7).

These notwithstanding, direct investments for January-July 2002 registered a lower net inflow of $669 million compared with the year-ago level. The 42.4 percent drop was due mainly to repayments on intercompany loans, particularly in June, and lower investments in the form of reinvested earnings.[10]



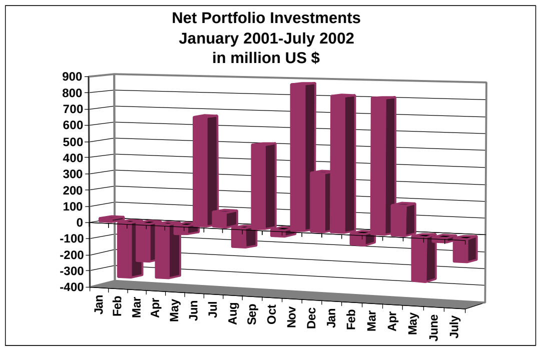

## ➢ Portfolio Investments

[9] The capital account consists largely of capital transfers. Capital transfers are transactions that involve a change in the stocks of assets of one or both parties and therefore relate to investments. By contrast, current transfers involve transactions that affect the level of disposable income and should therefore influence consumption of goods and services.

[10] Reinvested earnings refer to earnings that are not distributed as dividends but instead plowed back to the direct investment enterprise as additional investment.

*Higher non-residents' investments in equity and debt securities turn the portfolio investment account to a net inflow …*

Portfolio investments for the first seven months of 2002 reversed to a net inflow of $1.301 billion from a net outflow of $182 million in 2001 following increased non-residents' investments in resident-issued foreign denominated debt securities, particularly government-issued medium-term bonds.[11] Non-residents' investments in equity securities also rose by 13.0 percent to $356 million, indicating resurgence of investor confidence in the local equities market and as investors shifted investments to equity securities following relatively lower yield on bonds and other domestic financial instruments (Table 8).




## ➢ Other Investments

*…while net outflow of other investments increases.*

The net outflow in the other investment account expanded by 32.5 percent to $4.537 billion during the review period. This developed on account mainly of the higher net deposits abroad by resident non-banks, majority of which were corporations involved in build-operate-transfer scheme, to cover foreign-related obligations.[12] Payments arising from maturing non-residents' placements to local banks also contributed to the net outflow in other investments (Table 9).

## ➢ Reserve Assets

[11] The government issued $2.04 billion worth of foreign currency-denominated bonds in January, March and June while the BSP issued $250 million worth of fixed rate notes in January. Proceeds are earmarked for budgetary support and international reserve management.

[12] Under the BOT arrangement, a number of BOT companies are required by their foreign creditors to place/deposit in trust accounts certain amount of their income/fees received from their local operations to cover future payment of the companies' foreign loans, profit/dividend repatriation, payments for imports and other debt service requirements.

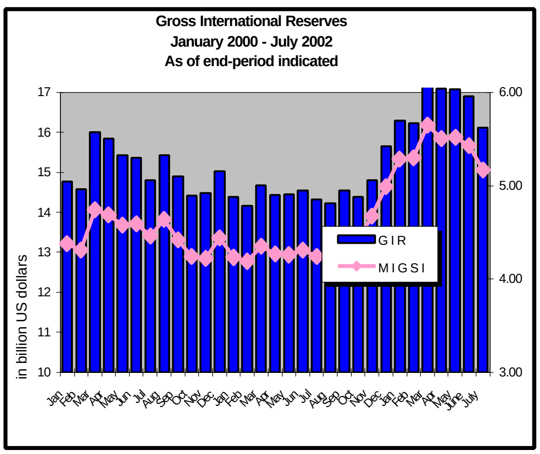
*BSP's GIR increase following higher NG deposits.*

As of end-July 2002, the BSP's GIR rose to $16.1 billion, 2.9 percent higher vis-à-vis the end-December level of $15.7 billion (Table 11).

The increase in GIR during the period was due mainly to foreign exchange inflows mainly in the form of net deposits by the Treasurer of the Philippines.[13] However, these were partly offset by outflows to meet the foreign exchange requirements of the BSP and the National Government to service in part the obligations of the National Power Corporation.

The BSP's GIR was adequate to cover 5.1 months' worth of imports of goods and payment of services and income. Using other reserve coverage measures, the level of reserves was 3.1 times the amount of the country's short-term external debt based on original maturity or, alternatively, 1.4 times the amount of short-term external debt based on residual maturity.[14]

During the review period, the bulk of reserves consisted of foreign investments (80.6 percent), while the rest were in gold (15.7 percent), foreign exchange (2.8 percent), and combined SDRs and reserve position in the Fund (0.9 percent). In terms of the currency composition of reserves excluding gold, 93.5 percent were in US dollars, 2.5 percent in Japanese yen, 1.6 percent in pound sterling and the balance of 2.4 percent in other foreign currencies.




## ➢ Exchange Rate

[13] Sources of deposit were mainly from government borrowings, i.e., net proceeds of the RP-US Securities Registered Global Bond ($2.042 billion) and JBIC Co-Financing of the Power Sector Loan ($100 million)

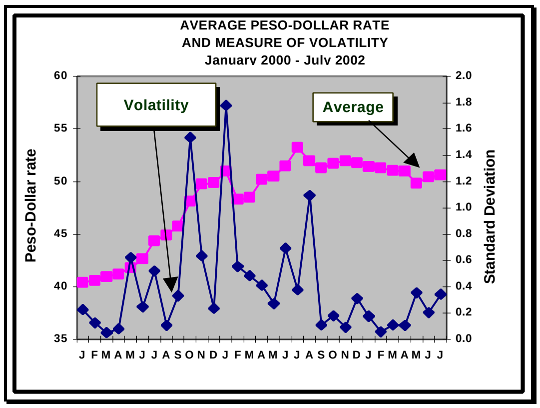
[14] Refers to outstanding short-term external debt on original maturity basis plus principal payments on medium- and long-term loans of the public and private sectors falling due in the next 12 months.

*The peso depreciates compared to the level last year...*

The peso-dollar exchange rate averaged ₱50.80:US$1 from January to July 2002, depreciating by 0.7 percent from the ₱50.45:US$1 average exchange rate for the same period in 2001. The year-on-year depreciation of the peso reflected partly, swings in sentiment on regional currencies and steady corporate demand for dollars in tandem with the rise in imports.

*...but the peso shows continued stability.*

Notwithstanding the weaker peso, exchange rate movements were less volatile as indicated by the declining standard deviation of the daily peso-dollar exchange rate since September last year. In January-July 2002, the standard deviation at ₱0.57 was substantially lower than the ₱1.81 registered for the same period in 2001. The peso-dollar exchange rate ranged from ₱49.336 to ₱51.730 during the period under review.




*Higher nominal depreciation and relatively lower domestic inflation strengthen the peso's external competitiveness against currencies of some competitor countries.*

Relative to its level in the comparable period last year, the peso's average nominal effective exchange rate index (NEERI)[15] in January-July 2002 appreciated slightly by 0.4 percent against the currency basket of the country's major trading partners. However, the peso's NEERI depreciated by 4.4 percent against the currency basket of a broad group of competitor countries,[16] and by 7.4 percent against the currency basket of a narrow group of competitor countries.[17] The drop in the peso's NEERI against the currency baskets of both the broad and narrow groups of competitor countries resulted from the larger depreciation of the peso against the US dollar compared to the depreciation of the exchange rates of other currencies in these baskets. In terms of the real effective exchange rate index (REERI),[18] the peso appreciated by 3.2 percent against the currency basket of the country's major trading partners, reflecting the weakened external competitiveness of Philippine goods against those countries in the basket due in part to the negative impact of the lower nominal peso depreciation. However, in the case of countries in both the broad and narrow baskets, the peso's external competitiveness strengthened as the REERI depreciated by 3.1 percent and 10.0 percent, respectively. This developed on account of the higher nominal

[15] The NEER index represents the weighted average exchange rate of the peso vis-à-vis a basket of foreign currencies such as the US dollar, the Japanese yen, the Deutsche mark and the British pound. Major trading partners include the U.S., Japan, Germany and the U.K.
[16] The broad basket is composed of the currencies of Singapore, South Korea, Taiwan, Malaysia, Thailand, Indonesia and Hong Kong.
[17] The narrow basket is composed of the currencies of Indonesia, Malaysia and Thailand.
[18] The REER index is derived from the NEER index by adjusting for inflation differentials.

depreciation of the peso and the relatively lower domestic inflation vis-a-vis those of the countries in the broad and narrow baskets.

| EFFECTIVE EXCHANGE RATE INDICES OF THE PESO For periods indicated | | | | | | | |
|---|---|---|---|---|---|---|---|
| | | NEER | | | REER | | |
| | | MIC 1/ | CC | | MIC 1/ | CC | |
| | | | Broad[2] | Narrow[3] | | Broad[2] | Narrow[3] |
| 2001 | Jan | 12.80 | 32.59 | 65.44 | 60.39 | 109.90 | 171.93 |
| | Feb | 13.53 | 34.46 | 69.71 | 63.98 | 114.69 | 181.88 |
| | Mar | 13.65 | 35.38 | 72.46 | 64.63 | 117.75 | 188.96 |
| | Apr | 13.29 | 35.60 | 74.44 | 63.04 | 118.19 | 192.04 |
| | May | 13.17 | 35.54 | 74.71 | 62.41 | 118.52 | 195.38 |
| | Jun | 12.99 | 35.00 | 73.47 | 61.88 | 118.10 | 193.65 |
| | Jul | 12.61 | 33.53 | 69.64 | 60.89 | 114.36 | 183.81 |
| | Aug | 12.76 | 31.77 | 62.56 | 61.70 | 108.47 | 166.15 |
| | Sep | 12.82 | 32.50 | 64.53 | 61.61 | 109.93 | 169.75 |
| | Oct | 12.79 | 33.29 | 67.42 | 61.57 | 111.59 | 176.25 |
| | Nov | 12.79 | 33.66 | 69.33 | 61.84 | 114.49 | 179.90 |
| | Dec | 12.95 | 31.04 | 67.95 | 63.06 | 110.46 | 175.70 |
| Ave. | Jan-July | 13.15 | 34.58 | 71.41 | 62.46 | 115.93 | 186.81 |
| Ave. | Jan-Dec | 13.01 | 33.70 | 69.31 | 62.25 | 113.87 | 181.28 |
| 2002 | Jan | 13.23 | 34.05 | 69.37 | 64.50 | 117.01 | 177.14 |
| | Feb | 13.31 | 33.92 | 68.75 | 64.90 | 113.96 | 173.53 |
| | March | 13.29 | 33.68 | 67.61 | 64.74 | 113.53 | 170.88 |
| | April | 13.28 | 33.21 | 65.91 | 64.73 | 111.99 | 165.41 |
| | May | 13.40 | 33.08 | 65.30 | 65.43 | 112.12 | 166.68 |
| | June | 13.10 | 31.87 | 62.60 | 64.03 | 108.93 | 161.06 |
| | July | 12.81 | 31.68 | 63.09 | 62.97 e/ | 109.24 e/ | 162.79 e/ |
| Ave. | Jan-July | 13.20 | 33.07 | 66.09 | 64.46 | 112.38 | 168.21 |

1/ Major trading countries: USA, Japan, Germany and United Kingdom
2/ Competing countries (broad basket): Hong Kong, Singapore, South Korea, Taiwan, Malaysia, Thailand and Indonesia
3/ Competing countries (narrow basket): Indonesia, Malaysia and Thailand
e/ Estimates using the average inflation rate of the previous two months.

:\eden\BOP-REP\2002\July02BOP.doc