# BALANCE OF PAYMENTS DEVELOPMENTS
# JANUARY-MAY 2003

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## ➢ Overall Position

*BOP continues to post a lower deficit in May as war-related uncertainties diminish.*

The swift resolution to the conflict in Iraq resulted in a positive development in the country's external transactions account, as the BOP posted a lower deficit of $15 million in May 2003. This developed despite the continuing concern over the extent of the effects of Severe Acute Respiratory Syndrome (SARS) in Asia and other major economies. With the dramatic decline in the BOP deficits in April and May, the cumulative balance of payments (BOP) deficit for the first five months of the year ended at $534 million. This, however, was a reversal from the $1,889 million surplus registered in the comparable period last year. Both the current and the capital and financial accounts showed lackluster performance from their year-ago levels (Table 1).

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

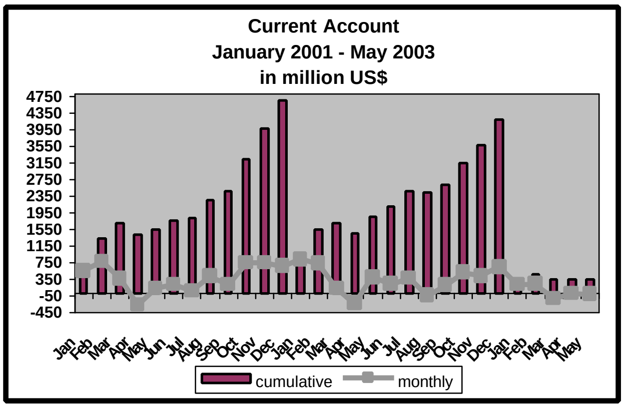
| | January-May | | |
|---|---|---|---|
| | **2003** | **2002** | **Growth Rate (%)** |
| I. Current Account | 330 | 1851 | -82.2 |
| II. Capital & Fin'l. | -1581 | 1763 | -189.7 |
| III. Net Unclassified | 717 | -1725 | 141.6 |
| **IV. Overall BOP *** | **-534** | **1889** | **-128.3** |

* Totals may not add up due to rounding.

## ➢ Current Account

*The current account remains in surplus.*

The continued strength of the income account was the main driver of the surplus in the current account of $330 million in January-May 2003, albeit, lower compared to the $1,851 million surplus posted in the comparable period last year. The trade-in-goods account reversed to a deficit from a surplus, influenced largely by the frontloading of raw materials and crude oil in the first quarter of the year. The services account was also weaker due to the increase in import-related freight expenditures and lower income from travel.



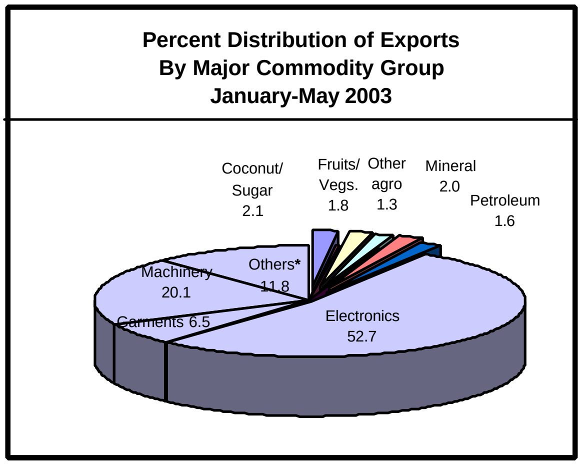

## ➢ Trade-in-Goods

*The tension in the Middle East triggers the surge in imports and the deficit in the trade-in- goods balance.*

The trade-in-goods balance for the first five months reversed to a deficit of $1,477 million from a surplus of $154 million in the same period last year, on account mainly of the surge in imports in the first three months of the year when the tension in Iraq was at its peak. Total imports of goods at $15,156 million expanded by 14.2 percent surpassing the 1.9 percent growth of exports at $13,679 million.[1]

*Export growth tapers off.*

Exports of goods dropped in April and May, after a year of continuous upturn, to post a modest cumulative growth of 1.9 percent during the first five months at $13,679 million.




* Includes special transactions & re-exports net of returned goods and temporary exports

[1] Based on BPM5

*Electronics exports decline.*

a) *Electronics.* With the SARS outbreak posing a new threat to global economic recovery, exports of electronics registered a double-digit decline of 13.6 percent in May 2003 after turning in double-digit expansion rates in most months of the last three quarters of 2002. Consequently, the electronics exports contracted by 2.0 percent for the first five months of the year compared to same period last year to $7,215 million (Table 2.1). The weakening of the electronics exports was likewise reflected in the May book-to-bill ratio of less than unity (0.90).[2] However, the electronics industry remains optimistic that the growth of electronics exports will stabilize towards the year-end with the expected resurgence in business and consumer confidence. Exports of electronics comprised 52.7 percent of total exports for the first five months of 2003.

*Machinery and transport equipment exports decline.*

b) *Machinery and Transport Equipment*. Exports of machinery and transport equipment—the second largest export earner next to electronics—registered a slight decline to reach $2,749 million in the first five months of 2003 from $2,771 million last year. After recording robust growth in 2002, this industry weakened in February to start off a four-month run of negative growths. This was influenced in part by the softening demand for electronics exports since nearly 60 percent of exports from this commodity group consisted of input/output peripheral units of computers. Other major product lines of machinery transport and equipment included other parts and accessories of motor vehicles.

*Garments exports rebound.*

c) *Garments.* Exports of garments, representing 6.5 percent of total exports for the first five months of 2003, recorded a modest rebound in May 2003 with a 1.1 percent growth (from 8.8 percent decline in April), resulting in a cumulative growth of 9.0 percent in the first five months of the year. This compared favorably with last year's contraction of 16.5 percent. The strong performance of this sector was due mainly to the almost full use of the annual quota (largely to the U.S. market) in the initial months, signaling a decline in shipments in the latter part of the year. However, the implementation of the twin strategies of tapping the high-end segment in traditional quota-driven markets and increasing access to non-quota markets such as Japan, United Arab Emirates, Hong Kong and Mexico should provide a better long-term outlook for the industry. It should be noted that these strategies form part of the aggressive market and product development and promotion schemes set in the Garments Industry Transformation Plan (GITP) aimed at re-establishing the backbone of the garments export sector. Developed in January 2001, the GITP is a comprehensive program that focuses on cost reduction, productivity enhancement, market and product development, trade facilitation and the re-engineering of the garments industry to meet the challenges of the quota phase-out in 2005 and achieve

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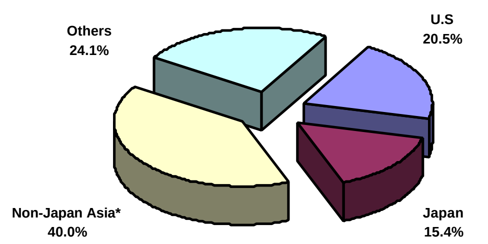
[2] The book-to bill ratio is the ratio of three-month moving average bookings (demand) to three-month moving average shipments (supply). A ratio of less than one indicates that demand is lower than supply. Conversely, a ratio of one or more indicates that demand exceeds supply.

competitiveness in a quota-free environment.

*Intra-Asian trade continues to dominate the export market.*

The increasing intra-regional trade in Asia has made non-Japan Asia as the Philippines' main trading bloc, which was traditionally a spot for the U.S. market. Since 1998, non-Japan Asian economies' share of Philippine exports has been on the rise, garnering 40.0 percent in the first five months of the year, compared to only 25.6 percent share posted five years ago. It has overtaken the share of the U.S. which has declined to 20.5 percent from 34.2 percent in 1998. Among the non-Japan Asian countries, Hongkong, Malaysia, Singapore and Taiwan remained the top export markets but the fastest growing trade was with China, which overtook Thailand's market share in 2002. Behind this development was the relocation to Asia of some electronics manufacturing firms affiliated with local electronics producers to take advantage of the region's potentially large consumer market. Moreover, this move was undertaken to reduce manufacturing costs as production processes and marketing systems that have become increasingly integrated became geographically closer to one another.

**Major Export Destinations**
**January-May 2003**
**(Percent Share %)**




' Comprised of China, Hong Kong, South Korea, Singapore, Taiwan, Malaysia and Thailand.

*Imports continue to expand.*

Imports of goods in May 2003 posted a year-on-year expansion rate of 12.9 percent, or a cumulative five-month growth of 14.2 percent, a turnaround from the 5.9 percent contraction last year. This reinstated imports to the double-digit growth path after the momentary decline in April. Imports for the first five months of 2003 reached $15,156 million, with the growth notably broad-based across major commodities (Table 2.2).[3]

Imports of raw materials and intermediate goods—which comprised almost 41 percent of total imports—grew by 3.1 percent to $6,193 million. This was a reversal from the 13.3 percent contraction last year. The commodities that primarily contributed to growth of this group were chemicals, particularly chemical compounds and artificial resins and manufactured goods such as iron and steel, non-ferrous metals and

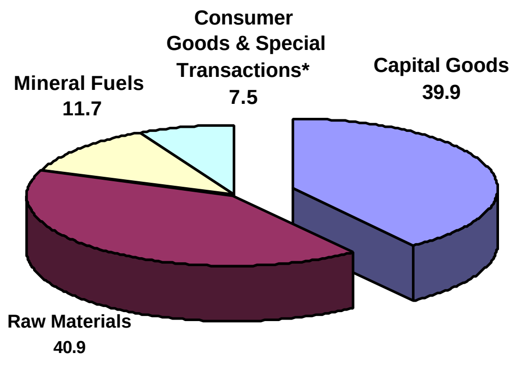
[3] Based on BPM5 concept

paper and paper products.

Imports of capital goods, comprising about 40 percent of total imports, climbed by 16.6 percent (from only 7.1 percent last year) during the first five months of 2003 to reach $6,049 million. The expansion was influenced largely by imports of telecommunications equipment and land transport equipment excluding passenger cars and motorized cycles.

Imported mineral fuels and lubricants, comprising 11.7 percent of total imports, posted a robust expansion rate of 42.2 percent to reach $1,770 million during the period in review, due to the combined effects of the increase in both the volume and price of petroleum crude. The volume of petroleum crude imports grew by 21.6 percent to 44.6 million barrels in January-May 2003 from 36.7 million barrels in the comparable period last year. These were mostly stock build-up in the first quarter when the government directed oil companies to maintain at least a 30-day oil inventory for big oil players and 15 days for small oil players to ensure continued domestic oil supply.[4] Meanwhile, the average price of petroleum crude during the review period rose sharply to $27.94 per barrel from $22.06 per barrel during the same period last year, but has significantly eased in April and May as the 'war premium' on oil prices started to fade.

**Percent Distribution of Imports**
**By Major Commodity Group**
**January-May 2003**




* Special transactions are net of returned goods and temporary imports

## ➢ Trade-In-Services

*The deficit in the trade-in-services account widens.*

The trade-in-services account for January-May 2003 posted a net outflow of $722 million, 60.8 percent higher compared to the level in the comparable period in 2002. The deterioration was due largely to the combined effects of the decline in travel receipts and the rise in import-related freight payments. Net inflows from travel dropped by 37.6 percent to $257 million following geo-political concerns and the fear of the SARS

[4] On 7 April 2003, the government announced the reduction of the minimum oil inventory to 7-15 days following the easing of hostilities in the Middle East.

epidemic. Tourist arrivals posted double-digit declines of 24.4 percent and 33.0 percent in April and May, respectively, consequently bringing down travel receipts by 25.5 percent to $609 million for the first five months of 2003. The drop in the number of tourist arrivals was most evident in countries such as the U.S., Japan, Korea, Hong Kong, Taiwan, Singapore and Australia.

Meanwhile, the increase in the net outflow of transportation services was due to higher freight expenditures following the increase in imports of goods. Moreover, with some domestic shipping companies having pulled out of international routes due to high maintenance costs, importers have increased their reliance on foreign carriers for shipment of their goods. (Table 3).

## ➢ Income

*OFW remittances remain the driver behind the strength of the income account.*

Backed by higher inflows from OFW remittances, the income account continued to perform strongly during the review period to reach $2,270 million, or a growth of 15.8 percent. Despite the 3.2 percent drop in deployment, OFW remittances for January-May 2003 rose by 9.7 percent to $3,289 million due to the increase in the number of deployed higher-paid professionals such as engineers, caregivers, performing artists, clerks and sales workers. It was noted that the number of OFWs deployed declined from 404,251 to 391,246 during the review period due to the combined effects of SARS-related travel risks, the temporary suspension of deployment in Hong Kong because of the minimum wage cut issue and the first quarter threat of war.[5] Notably affected by these developments were the land-based workers whose number decreased by 5.6 percent. Meanwhile, deployment of sea-based workers increased by 5.2 percent.

The investment income account continued to register a net outflow that reached $1,019 million in January to May, slightly lower by 1.6 percent compared to past year's level. Lower income received from both direct and portfolio investments were largely influenced by the global decline in interest rates while higher interest payments were due in turn to higher external debt level (Table 4).

Considered to be one of the drivers of economic growth, the government continues to pursue programs that will enhance the competitiveness of OFWs. In line with this, the government is promoting technical education and training programs for OFWs such as foreign language instruction for Filipino nurses; specialized training for household workers and performing artists; and skills proficiency schemes for information technology (IT) professionals. Furthermore, government initiatives/efforts are underway to improve/facilitate overseas remittances particularly from the United States.

[5] Of the total number of Filipino workers deployed abroad for the period January-May 2003, 298,181 were land-based workers and 93,065 were sea-based workers.

Meanwhile, the government addresses the emerging trend towards "localization" and the economic slowdown in host economies by exploring and expanding access by Filipino overseas workers to other economies.[6]

## ➢ Current Transfers

*The surplus in current transfers increases.*

Net current transfers for January-May 2003 amounted to $259 million, 40.0 percent higher than the level posted in the same period last year (Table 5). The improvement was accounted for by the transfer of income by migrant workers as well as receipts in the form of gifts, grants and donations from individuals and non-governmental institutions.

## ➢ Capital and Financial Account

*The capital and financial account reverses to a deficit.*

The capital and financial account reversed to a net outflow of $1,581 million for the first five months of the year from a net inflow of $1,763 million posted in the same period in 2002. Investors' continued to be prudent in their investment plans amid weak global demand. During the review period, the direct investment account reversed to a net outflow from a net inflow while the portfolio investment account posted a significantly lower net inflow.

## ➢ Capital Account

*The capital account posts a higher deficit.*

The capital account for January-May 2003 posted a higher net outflow of $10 million relative to a net outflow of $6 million in the comparable period last year owing to the increase in the net outflow of migrant's transfers (Table 6).[7]

[6] Localization means the preferential hiring by a country of its own residents.
[7] 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 influence consumption of goods and services.

## ➢ Direct Investments

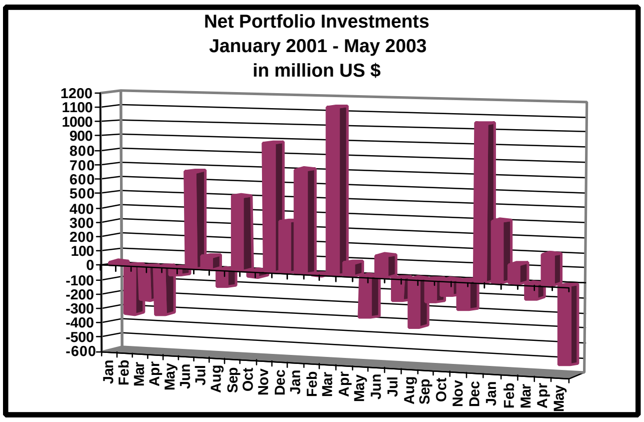
*Direct investments reverse to a net outflow due to fragile global economic outlook.*

The direct investment account posted a net outflow of $56 million during the first five months of 2003, a reversal from last year's surplus of $828 million as investors remained cautious due to fragile global economic outlook despite the quick end to the conflict in Iraq. Non-residents' investments in equity capital in the first five months of the year dipped to $37 million compared to $704 million in the same period last year, with the biggest drop in investments posted in the manufacturing sector. The bulk of these investments were mainly channeled to the manufacturing and construction industries as well as financial intermediation services and real estate. Another contributory factor to the weakening of the direct investment account was the $49 million net outflow in other capital representing net repayment of intra-company loans (Table 7).

## ➢ Portfolio Investments

*The portfolio investment account declines but remains in surplus.*

The portfolio investment account in the five-month review period managed to post a $114 million surplus despite the persistently subdued investment climate. However, this was substantially below the $1,640 million surplus realized in the same period last year. The lower surplus was due mainly to the combined impact of the substantial increase in residents' investments abroad and the 29.5 percent contraction in non-residents' investments in both equity and debt securities during the review period. The drop was noted largely in the national government account on debt securities traceable to lower bond availments. The below par performance could also be attributed to the concerns on fiscal position and weak corporate profit (Table 8).



## ➢ Other Investments

*The net outflow of other investments increases.*

During the review period, the net outflow in the other investment account at $1,629 million was higher by more than half of the level posted in the comparable period last year. Largely accounting for the increase in net outflow was the net repayment of loans and withdrawal by non-residents of their foreign currency deposits with local banks (Table 9).

## ➢ Reserve Assets

*International reserves remain adequate at $16 billion.*

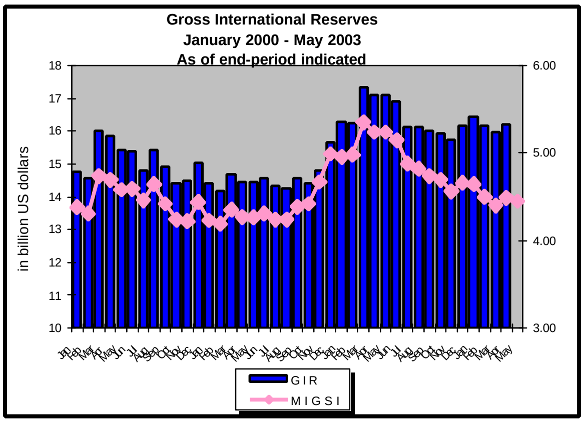
The BSP's gross international reserves (GIR) reached $16.1 billion as of end-May 2003. This was slightly lower than the end-December 2002 level of $16.2 billion.

The slight decline in reserves during the period was due mainly to the repayments of the debt service requirements of the National Government and the BSP.

The BSP's GIR were adequate to cover 4.4 months' worth of imports of goods and payment of services and income. Using other reserve coverage measures, the level of reserves was 2.5 times the amount of the country's short-term external debt based on original maturity or, alternatively, 1.3 times the amount of short-term external debt based on residual maturity.[8]

During the quarter in review, the bulk of reserves consisted of foreign investments (76.2 percent), while the balance was in the form of gold (20.1 percent), foreign exchange (2.9 percent), and combined SDRs and reserve position in the Fund (0.8 percent). In terms of the currency composition of reserves excluding gold, 84.8 percent were in US dollars, 8.4 percent in Euros, 3.8 percent in Japanese yen, 1.7 percent in pound sterling and the balance of 1.3 percent in other foreign currencies.

[8] 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.



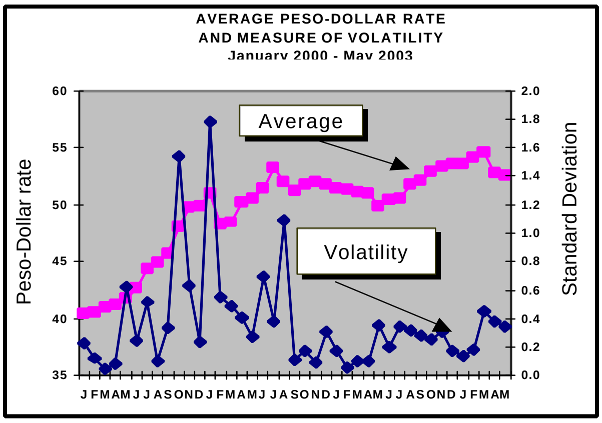

## ➢ Exchange Rate

*The peso depreciates relative to the previous year's level.*

The nominal peso-dollar exchange rate averaged ₱53.51/US$1 in January-May 2003, depreciating by 5.1 percent from the ₱50.92/US$1 average exchange rate in January-May 2002. The depreciation of the peso was due mainly to the rise in corporate demand on account of the surge in import bill in the first quarter. Other factors such as the tension in the Middle East, the spread of the SARS virus in Asia as well as the concern over the ballooning budget deficit and the isolated bombings in the southern part of the country weighed heavily on the peso.

*The peso is more volatile.*

The peso was more volatile in the first five months of 2003, as indicated by the standard deviation of ₱0.84 compared with the year-ago standard deviation of only ₱0.61. To address the excessive peso volatility arising from speculative demand particularly in March and avoid the effect on inflationary expectation, the BSP introduced a number of measures.[9] The peso-dollar exchange rate ranged from ₱52.021/US$1 to ₱55.075/US$1 during the period.




[9] Among the measures implemented by the BSP were: a) the reduction of the allowable overbought position of banks to 2.5 percent of unimpaired capital or US$5 million, whichever is lower, b) limiting the tenor of contracts to a maximum of 6 months, c) imposing appropriate sanctions against banks violating BSP foreign exchange regulations, d) raising the liquidity reserve requirement by one percentage point from 7 percent to 8 percent, and e) removing the tiering scheme for banks' short-term deposits under BSP's Reverse Repurchase Facility and Special Deposit Accounts.

*Higher nominal depreciation and relatively lower domestic inflation strengthen the peso's external competitiveness.*

In comparison with the previous year's level, the peso's average nominal effective exchange rate (NEER) index[10] for the first five months of 2003 depreciated by 12.7 percent against the currency basket of the country's major trading partners, 10.0 percent against the currency basket of a broad group of competitor countries,[11] and by 11.6 percent against the currency basket of a narrow group of competitor countries.[12] This was due to 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 (REER) index,[13] the peso gained external price competitiveness as the REER depreciated by 11.9 percent against the currency basket of the country's major trading partners. Relative to the currencies of countries in both the broad and narrow baskets, the peso's external competitiveness improved as the REER depreciated by 9.2 percent and 12.7 percent, respectively, due mainly to the higher nominal depreciation of the peso and the relatively lower domestic inflation vis-à-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 | |
| | | | Broad2 | Narrow3 | | Broad2 | Narrow3 |
| **2001** | Jan | 114.35 | 32.59 | 64.78 | 62.13 | 109.90 | 171.13 |
| | Feb | 15.24 | 34.46 | 69.00 | 65.96 | 114.69 | 181.02 |
| | Mar | 15.37 | 35.38 | 71.71 | 66.42 | 117.75 | 187.98 |
| | Apr | 15.01 | 35.60 | 73.65 | 64.74 | 118.19 | 191.46 |
| | May | 14.95 | 35.54 | 73.91 | 64.38 | 118.52 | 194.50 |
| | Jun | 14.82 | 35.00 | 72.67 | 64.37 | 118.10 | 192.44 |
| | Jul | 14.35 | 33.53 | 68.91 | 62.91 | 114.36 | 182.79 |
| | Aug | 14.39 | 31.77 | 62.11 | 63.14 | 108.47 | 165.76 |
| | Sep | 14.45 | 32.50 | 63.90 | 63.39 | 109.93 | 168.92 |
| | Oct | 14.42 | 33.29 | 66.77 | 63.40 | 111.59 | 175.46 |
| | Nov | 14.48 | 33.66 | 68.61 | 63.98 | 114.49 | 178.93 |
| | Dec | 14.61 | 31.04 | 65.60 | 64.87 | 110.46 | 170.57 |
| **Ave.** | **Jan-Dec** | **14.70** | **33.70** | **68.47** | **64.14** | **113.87** | **180.08** |
| **2002** | Jan | 14.74 | 32.99 | 65.99 | 65.88 | 113.22 | 174.31 |
| | Feb | 14.87 | 32.88 | 65.42 | 66.31 | 110.28 | 170.85 |
| | Mar | 14.84 | 32.69 | 64.38 | 66.01 | 109.93 | 168.33 |
| | April | 14.81 | 32.28 | 62.80 | 65.65 | 108.74 | 163.48 |
| | May | 14.87 | 32.17 | 62.40 | 66.02 | 108.92 | 165.15 |
| | June | 14.45 | 31.02 | 59.78 | 64.29 | 106.01 | 159.66 |
| | July | 14.06 | 30.81 | 60.27 | 62.78 | 106.30 | 161.19 |
| | Aug | 13.83 | 30.28 | 59.10 | 61.92 | 104.80 | 159.11 |
| | Sep | 13.76 | 30.27 | 58.92 | 61.60 | 103.94 | 157.23 |
| | Oct | 13.63 | 30.25 | 58.88 | 60.90 | 102.75 | 155.39 |
| | Nov | 13.38 | 29.77 | 58.19 | 59.84 | 102.05 | 152.14 |
| | Dec | 13.29 | 29.54 | 57.49 | 59.68 | 100.80 | 150.05 |
| **Ave.** | **Jan-May** | **14.83** | **32.60** | **64.20** | **65.97** | **110.22** | **168.42** |
| **Ave.** | **Jan-Dec** | **14.21** | **31.24** | **61.13** | **63.41** | **106.48** | **161.41** |
| **2003** | Jan | 13.02 | 29.24 | 57.14 | 58.35 | 100.72 | 147.64 |

[10] 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 euro and the British pound. Major trading partners include the U.S., Japan, European Monetary Union and the U.K.
[11] The broad basket is composed of the currencies of Singapore, South Korea, Taiwan, Malaysia, Thailand, Indonesia and Hong Kong.
[12] The narrow basket is composed of the currencies of Indonesia, Malaysia and Thailand.
[13] The REER index is derived from the NEER index by adjusting for inflation differentials.

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | Feb | 12.87 | 29.05 | 56.61 | 57.92 | 98.83 | 146.17 |
| | Mar | 12.74 | 29.03 | 56.18 | 57.07 | 98.62 | 145.53 |
| | April | 13.17 | 29.94 | 57.68 | 59.03 | 101.68 | 148.22 |
| | May | 12.95 | 29.42 | 56.27 | 58.13 | 100.71 | 147.23 |
| **Ave.** | **Jan-May** | **12.95** | **29.34** | **56.78** | **58.10** | **100.11** | **146.96** |

1/ Major trading countries: USA, Japan, European Monetary Union (EMU) 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.

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