

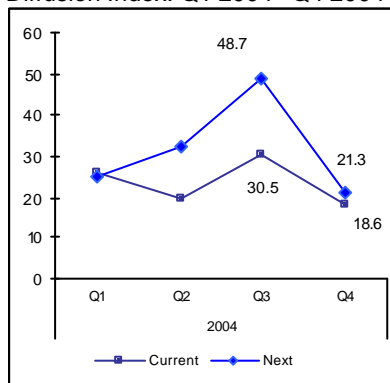


Business Outlook Remains Positive In the Fourth Quarter of 2004 and First Quarter of 2005[?]

Overall business outlook

In the midst of rising oil prices business turns less optimistic

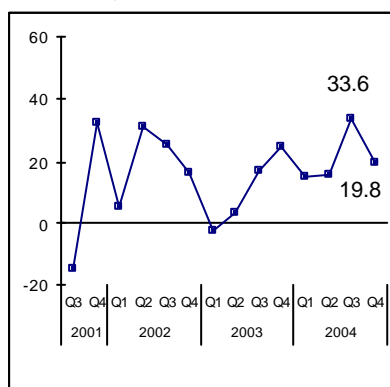
Overall Business Outlook
Diffusion Index: Q1 2004–Q4 2004



Business confidence in the economy remained positive as the overall business outlook diffusion index (DI) registered 18.6 percent and 21.3 percent, for the fourth quarter of 2004 and the first quarter of 2005, respectively. Compared to the previous quarter's survey, the current quarter DI decreased by 11.9 percentage points while the next quarter DI likewise decreased by 27.4 percentage points. (Tables 1 and 2).¹ The significant declines in the DI indicate respondents' less optimistic but still positive expectations on business and economic performance for the next two quarters.

Respondents attributed the decline in their business optimism to rising oil prices, increasing cost of raw materials, higher inflation, high interest rates and the fiscal deficit. On the other hand, despite these problems, business optimism remains due to anticipated increase in consumer demand during the Christmas holidays, increase in income due to the harvest season, expected increases in dollar remittances and export receipts.

NCR Business Outlook
Current Quarter

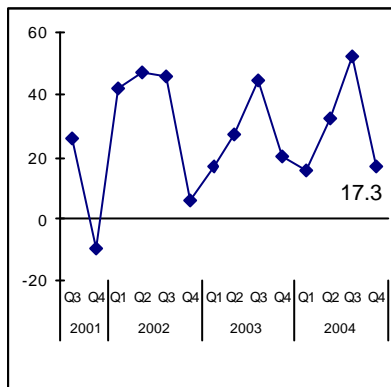


NCR respondents registered less optimistic business expectations as the overall business outlook index for the current quarter decreased to 19.8 percent from 33.6 percent in the previous period's survey (Table 2).

[?] Results of the Fourth Quarter BES Survey conducted from 1 October to 10 November 2004. The survey period was extended due to the expansion of survey coverage to Regions III and IV.

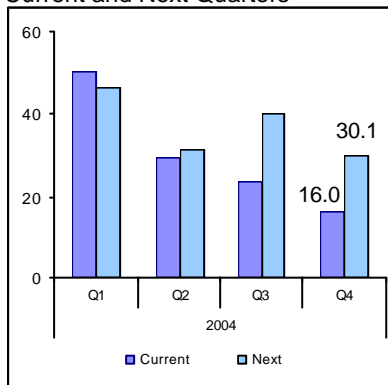
¹ The diffusion Index (DI) is computed as the percentage share of firms that answered in the affirmative less percentage share of firms that answered negative in a given indicator. A positive DI indicates a favorable view, except for the average inflation rate and the average peso-borrowing rate, where a positive DI indicates the opposite. Please note that all index figures are diffusion indices.

**NCR Business Outlook
Next Quarter**



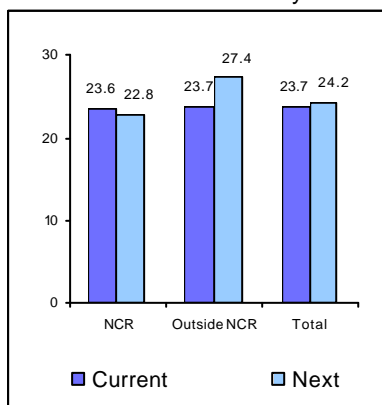
Meanwhile, the next quarter business outlook index for NCR respondents decreased further to 17.3 percent from 52.5 percent during the previous survey, indicating an even less optimistic outlook for the next quarter. This could be explained by the fact that consumption expenditures usually peak during the Christmas season and slow down in the next quarter.

**Areas Outside NCR
Business Outlook
Current and Next Quarters**



Business confidence index of respondent firms in areas outside the NCR also decreased but remained positive at 16.0 percent for the current quarter from 23.6 percent in the third quarter survey. Business outlook index for the next quarter also decreased to 30.1 percent from 40.2 percent recorded during the previous survey.

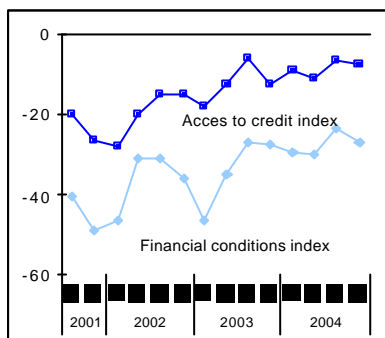
**Business-related factors
Volume of Business Activity**



Expectations of a slowdown in the economy were further confirmed as majority of the firms projected lower increase in the volume of business in the fourth quarter of 2004 and in the first quarter of 2005, with indices of 23.7 percent and 24.2 percent, respectively. This sentiment is reflected particularly in the volume of business activity index for NCR respondents, which decreased to 23.6 percent in the fourth quarter from 31.8 percent in the third quarter, and then decreased further to 22.8 percent in the first quarter of 2005. The corresponding index outside NCR, however, increased to 23.7 percent in the fourth quarter from 15.9 percent in the third quarter and increased in the first quarter of 2005 to 27.4 percent. (Table 2).

Access to credit

NCR

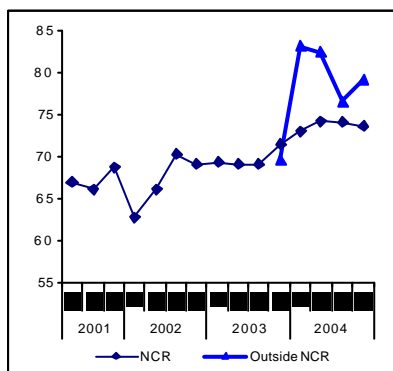


Indices for business-related factors show a slight decline in financial conditions and credit access for respondent firms in the NCR. The NCR financial conditions index declined slightly from -23.2 percent in the third quarter to -26.6 percent in the fourth quarter, while the credit access index also declined slightly from -6.5 percent to -7.5 percent during the same periods (Table 2).²

Respondent firms outside NCR anticipate better access to credit and improving financial conditions compared to the previous quarter. The credit access index for non-NCR respondents improved to -7.4 percent from -9.0 percent, while the financial conditions index also decreased to -21.6 percent from -31.3 percent. This could be due to relatively stable interest rates despite rising inflation (Table 2).

Capacity Utilization

Q4 2004



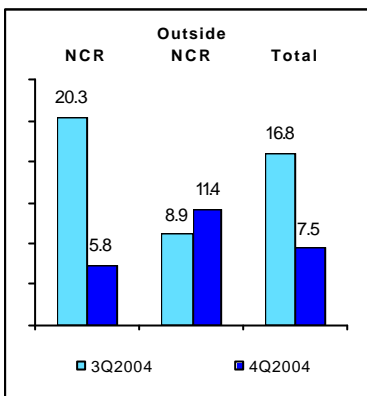
Despite the decline in business optimism in the next two quarters, the expected average capacity utilization in the industry sector slightly improved to 75.4 percent for the fourth quarter from 74.8 percent in the previous quarter. This was due largely to the increase in expected capacity utilization of firms outside NCR from 76.6 percent in the third quarter to 79.2 percent in the fourth quarter. Meanwhile, average expected capacity utilization for NCR firms remained virtually flat at about 73.7 percent in the fourth quarter. (Table 2).³

² The financial conditions index reflects the respondents' judgment on their general cash position, taking into account the level of cash and other cash items and repayment terms on loans. The access to credit index refers to the environment external to the firm, particularly the availability of credit from the banking system and other financial institutions.

³ The average capacity utilization of 75.4 percent in the fourth quarter 2004 of the BES sample firms from the industry sector in Metro Manila and the five selected regions differs from the average capacity utilization figures of 79.0 percent from Jan-Aug 2004 of the National Statistics Office (NSO), which were computed based on a sample of large manufacturing firms nationwide.

Employment Outlook

Q4 2004

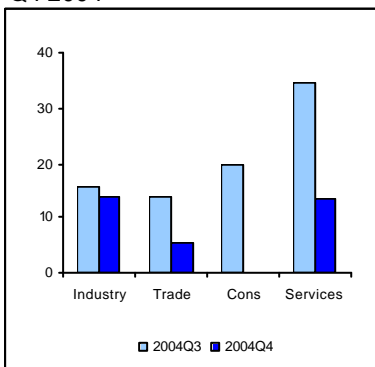


Consistent with the expected slowdown in the growth of business activity in the next two quarters, the overall employment outlook index also decreased but remained positive at 7.5 percent from 16.8 percent in the third quarter of 2004. The decrease in the overall employment index is due to the decrease of the index in NCR, which went down to 5.8 percent from 20.3 percent in the previous quarter. Cushioning the decline in the NCR, the employment index in areas outside NCR increased to 11.4 percent in the fourth quarter from 8.9 percent in the third quarter (Table 2). Overall, with the positive employment index both in the NCR and areas outside NCR, it is expected that new jobs will be created in the fourth quarter. The business sector further expect that compared to the previous quarter more new jobs will be available outside NCR while there could be a decrease in the number of new jobs created in the NCR for the fourth quarter.

With the positive employment outlook index in the fourth quarter of 2004, firms with expansion plans in the industry sector slightly increased to 26.4 percent from 23.4 percent in the third quarter of 2004 (Table 3).

Confidence indicators

Business Confidence Index
Q4 2004



Consistent with the less optimistic business outlook for the next two quarters, business confidence also showed positive but lower indices in the fourth quarter. The confidence indices for the industry and services sectors were most optimistic at 14.2 percent and 13.6 percent, respectively, followed by the wholesale and retail trade sector at 5.3 percent. Only the construction sector registered a zero confidence index, which could be attributed mainly to seasonal factors. These trends reflect also the business confidence in the NCR. Outside NCR, however, the confidence indices for industry and services sectors increased while the indices for wholesale and retail trade and the construction sectors declined (Table 4).

Sub-sector outlook

Industry is the major source of optimism in the fourth quarter of 2004 and first quarter of 2005

Industry, wholesale and retail trade, and services sectors recorded positive but lower diffusion indices for the fourth quarter of 2004 and first quarter of 2005. The industry sector recorded the most optimistic business outlook with overall diffusion indices of 22.6 percent and 27.1 percent in the current and the next quarters, respectively. The industry sector in the NCR posted a 28.0 percent DI in the fourth quarter and 24.5 percent in the first quarter of 2005. In areas

outside NCR, the industry sector registered a 16.4 percent DI in the fourth quarter which increased significantly to 30.1 percent in the next quarter. (Table 1).

Wholesale and retail trade growth could slow down in the NCR but step-up in areas outside NCR.

Despite the positive seasonal effect of the Christmas season, the wholesale and retail trade business outlook is less optimistic in the fourth quarter. The fourth quarter DI for the sector declined to 11.0 percent from 26.0 percent in the previous quarter. The DI for NCR declined to 13.4 percent in the fourth quarter from 27.9 percent in the third quarter. In areas outside NCR, the DI for the fourth quarter of 2004 also declined to 4.0 percent from 20.4 percent in the previous quarter. The low expectations of respondents continue in the first quarter of 2005 with a DI of 14.3 percent compared to 60.2 percent in the previous survey. NCR respondents don't expect the trade sector to grow at a faster pace in the first quarter of 2005 as the DI further declined to 11.0 percent. On the other hand, respondents outside NCR expected the trade sector growth to move faster than the last quarter of 2004 as the DI increased to 24.0 percent.

Business services and hotels and restaurants will continue to drive the services sector in the fourth quarter of 2004 and first quarter of 2005.

The business outlook in the services sector indicates positive but slower growth as the DI also declined in the fourth quarter of 2004 and first quarter of 2005 to 22.3 percent and 17.4 percent, respectively. This behavior is due largely to the NCR where the business outlook index declined to 20.4 percent in the fourth quarter of 2004 and 16.1 percent in the first quarter of 2005. Outside NCR, however, growth is expected to be higher in the last quarter of 2004 as the DI increased to 42.7 percent from 28.6 percent in the previous quarter but could slowdown in the first quarter of 2005 with a DI of 31.1 percent from 37.8 percent in the previous survey.

Business services like rentals, computer services, advertising, consultancy and other related services are expected to continue expanding in the NCR and more so in areas outside NCR in the next two quarters. Hotels and restaurants also have better prospects both in the NCR and outside NCR.

Business outlook DI for financial intermediation, real estate, transportation, and community and social services sub-sectors declined in the fourth quarter of 2004 compared to the third quarter.

The biggest decline in business outlook for the current and next quarters came from the construction sector with a negative diffusion index of 6.1 percent. NCR had a zero index and outside NCR registered a negative DI of 25.0 percent in the fourth quarter of 2004. The decrease, however, is only

seasonal as the first quarter 2005 index became positive at 33.5 percent. Both the NCR and areas outside NCR registered positive DIs of 20.0 percent and 75.0 percent, respectively.

Business constraints

Increasing oil prices, higher inflation, and the large fiscal deficit are seen as the main risks to business

The recent sharp rise in world oil prices poses probably the most important near-term risk to business, while the possibility of a general rise in inflationary pressures remains a medium to long-term concern.

Stiff competition continue to constrain business activities in the fourth quarter of 2004

In addition to the macroeconomic risks, respondent firms cited stiff competition as the major factor that constrained production and business activity in the fourth quarter of 2004. Other major factors cited by respondent firms were unclear economic laws, high interest rates, and financial problems (Table 5).

Expectations on key economic indicators

Higher interest rates, higher inflation rate and a weaker peso are expected in the fourth quarter of 2004 and first quarter of 2005

Survey respondents anticipate the following in the current as well as in the next quarter: higher peso-borrowing rate; higher inflation rate; and a weaker peso (Table 6).

TECHNICAL NOTES

To provide a regional dimension to business prospects, the BES survey coverage was expanded to include regions outside the NCR. Starting from the fourth quarter of 2003, the BES was expanded to include Regions I, VII and XI. Beginning the third quarter of 2004, two more regions were included in the survey coverage, namely Regions III and IV. The expanded BES coverage now consists of firms in SEC's Top 5000 Corporations in 2002 which are based in NCR and five selected regions: Region I, III, IV, VII and XI. From each of these regions, a stratified random sample of 898 firms was selected across four major economic groups and 12 sub-groups namely: Group 1: Industry, which consists of manufacturing, mining and quarrying, electricity gas and water and agriculture fishery and forestry; Group II: Construction; Group III: Wholesale and Retail Trade and Group IV: Services Sector, which consists of financial intermediation, real estate, renting and business activities, hotels and restaurants, transport, storage and communication and community, social and personal services.

The combined survey response rate for this quarter is 56 percent. The response rate is 71 percent for NCR and 39 percent for the selected regions outside NCR. It is worth noting that 36 percent of respondents belong to the small-firm category employing less than 100 workers. The distribution of sample size by region is shown below.

| SECTOR | Population | | | | | | | | Sample | | | | | | | |
|---|-------------|-------------|-------------|-----------|------------|------------|------------|-----------|------------|------------|-------------|-----------|------------|------------|------------|-----------|
| | Total | NCR | Outside NCR | I | III | IV | VII | XI | Total | NCR | Outside NCR | I | III | IV | VII | XI |
| Industry | 1932 | 1069 | 863 | 6 | 156 | 552 | 127 | 22 | 358 | 143 | 215 | 6 | 56 | 84 | 49 | 20 |
| Agriculture, Fisheries and Forestry | 69 | 38 | 31 | 0 | 5 | 7 | 5 | 14 | 28 | 7 | 21 | 0 | 2 | 3 | 2 | 14 |
| Mining and Quarrying | 22 | 18 | 4 | 0 | 0 | 2 | 1 | 1 | 5 | 2 | 3 | 0 | 0 | 2 | 0 | 1 |
| Manufacturing | 1782 | 974 | 808 | 5 | 142 | 537 | 117 | 7 | 309 | 129 | 180 | 5 | 50 | 75 | 45 | 5 |
| Electricity, Gas and Water Supply | 59 | 39 | 20 | 1 | 9 | 6 | 4 | 0 | 16 | 5 | 11 | 1 | 4 | 4 | 2 | 0 |
| Construction | 180 | 142 | 38 | 1 | 13 | 13 | 8 | 3 | 33 | 19 | 14 | 1 | 4 | 4 | 3 | 2 |
| Wholesale and Retail Trade | 1342 | 1051 | 291 | 23 | 110 | 83 | 63 | 12 | 258 | 140 | 118 | 23 | 35 | 25 | 25 | 10 |
| Services | 1397 | 1199 | 198 | 12 | 56 | 61 | 59 | 10 | 249 | 158 | 91 | 12 | 22 | 24 | 23 | 10 |
| Hotels and Restaurant | 139 | 110 | 29 | 4 | 12 | 9 | 4 | 0 | 30 | 15 | 15 | 4 | 5 | 4 | 2 | 0 |
| Transport, Storage and Communications | 246 | 199 | 47 | 1 | 17 | 11 | 13 | 5 | 46 | 26 | 20 | 1 | 5 | 4 | 5 | 5 |
| Financial Intermediation | 379 | 347 | 32 | 1 | 7 | 10 | 13 | 1 | 61 | 45 | 16 | 1 | 4 | 5 | 5 | 1 |
| Real Estate | 204 | 172 | 32 | 3 | 5 | 9 | 14 | 1 | 38 | 23 | 15 | 3 | 2 | 4 | 5 | 1 |
| Renting and Business Activities | 268 | 245 | 23 | 0 | 7 | 7 | 8 | 1 | 42 | 32 | 10 | 0 | 3 | 3 | 3 | 1 |
| Community, Social and Personal Services | 161 | 126 | 35 | 3 | 8 | 15 | 7 | 2 | 32 | 17 | 15 | 3 | 3 | 4 | 3 | 2 |
| TOTAL NUMBER OF FIRMS | 4851 | 3461 | 1390 | 42 | 335 | 709 | 257 | 47 | 898 | 460 | 438 | 42 | 117 | 137 | 100 | 42 |

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