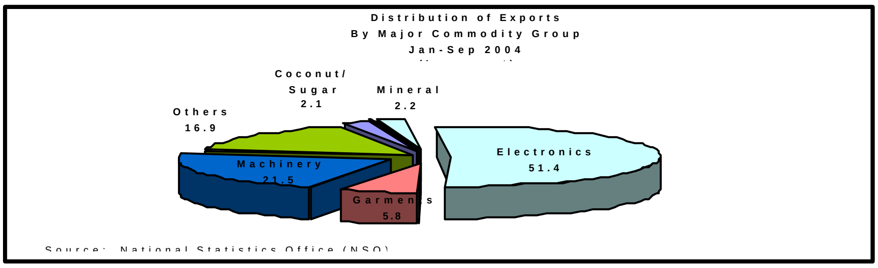
BALANCE OF PAYMENTS DEVELOPMENTS
THIRD QUARTER 2004

✍ Overall Position

BOP in the third quarter of the year yields a higher deficit. BOP deficit for the first nine months narrows due to stronger 2nd quarter performance.

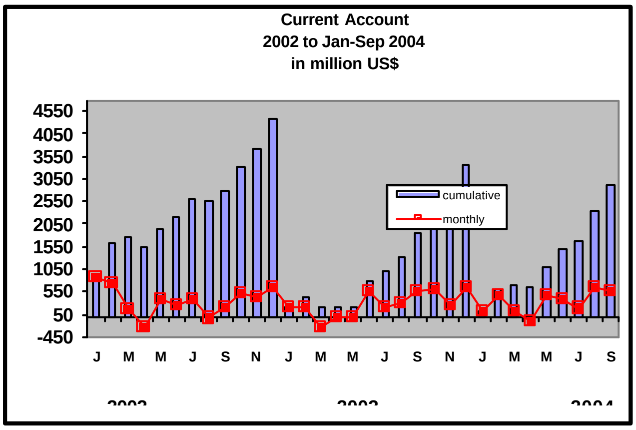
The balance of payments (BOP) position in the third quarter of 2004 yielded a higher deficit of US$246 million compared to the year-ago deficit of US$166 million due mainly to the widening of the net outflow in the capital and financial account even as the current account continue to perform strongly. However, the strong BOP surplus in the second quarter provided the cushion to end the year-to-date deficit at USUS$178 million, significantly lower than the deficit of US$775 million in the comparable period last year. Underpinning this development was the improvement in both the current and capital and financial accounts, following the strong global economic activity reflecting the upturn in industrialized countries and the continued strength in global IT demand (Table 1). The BOP deficit for the whole of 2004 is expected to widen to US$516 million due largely to the maturing obligations and expectation of higher imports. This is in contrast to the US$111 million surplus realized in 2003.



✍ Current Account

The current account continues to perform robustly.

The current account during the quarter in review remained in surplus at US$1,410 million, equivalent to 6.6 percent of GDP. This level was substantially higher than US$1,068 million (5.5 percent of GDP) surplus posted in the same quarter last year. The continued strength of the current account was attributed to the higher net income receipts and the narrower trade-in-goods deficit, which more than offset the weaker performance of services and current transfers. This led to a cumulative three-quarter surplus of US$2,906 million, an improvement of 57.1 percent over last year's level. The year-to-date level is equivalent to 4.7 percent of GDP, higher compared to the 3.2 percent a year ago. Looking ahead, the current account is expected to remain in surplus for the whole of 2004 at US$2,649 million, or 3.1 percent of GDP following the anticipated expansion in exports of goods and the sustained surplus in the income account. Exports, projected to grow by 10 percent, are backed by the recovery in electronics exports, which in recent months trailed other Asian electronics in world market performance. Imports of goods on the other hand, are anticipated to rise by 13.0 percent due largely to higher oil import bill following the hike in the world market price of crude oil as well as the expected increase in imports of raw materials and capital goods as economic activity appears more buoyant than earlier predicted.

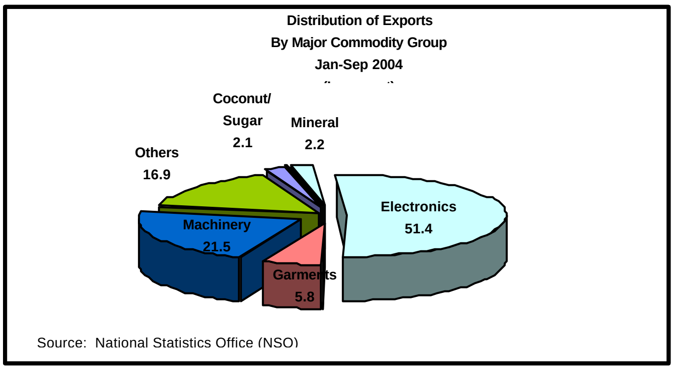


✍ Trade-in-Goods

Higher export growth narrows the deficit in trade-in-goods account.

The trade-in-goods account yielded a lower deficit of US$23 million in the third quarter of 2004 compared to year-ago deficit of US$65 million. This was attained as exports of goods, expanding by 11.5 percent to US$9,980 million during the quarter, outpaced the rise in imports at 10.9 percent to US$10,003 million. The expansion rates in both exports and imports of goods were in contrast with the 3.1 percent and 4.2 percent decline in the same quarter last year. The growth in the exports was propelled by electronics and machinery and transport equipment, which rose by 14.6 percent and 15.4 percent, respectively. Mineral products, specifically copper metal; coconut oil and chemicals also contributed to the strong export performance. Garments exports, while on the downtrend, remained to be the third largest export earner with a 6.4 percent share to total exports. These developments led to the 10.5 percent expansion in the cumulative level of exports for the first nine months of the year (Table 2.1).[1]

[1] Based on BPM5 concept (i.e., excluding from the National Statistics Office (NSO) figures, those goods that did not involve change in ownership).



Electronics exports continue to expand in the third quarter.

Electronics. Exports of electronics posted three consecutive quarters of growth registering a 14.6 percent expansion in the third quarter to reach US$5,433 million. This brought the three-quarter cumulative growth to 10.2 percent, a reversal of the contraction of 2.8 percent in the same period last year. The sustained growth in electronics exports was boosted by the double-digit expansion in shipments of electrical machineries, equipment and parts (14.3 percent), electronic microcircuits (30.2 percent) and ignition wiring (41.4 percent). Semiconductors–comprising 42 percent of total electronics exports–picked up only in the third quarter when global demand improved following inventory clearing in mid-2004. Bulk of Philippine semiconductors was shipped to Malaysia, Hong Kong, Singapore and the U.S. Singapore posted the heaviest absorption of Philippine semiconductors due in part to the boom in the production of IT-related products such as information/communications and consumer electronics, consisting largely of mobile handsets.

Exports of machinery and transport equipment remain in the second lead.

b) *Machinery and Transport Equipment*. Exports of machinery and transport equipment, the country's second top export earner, continued to post double-digit growths since February. For the third quarter, receipts from this commodity rose by 15.4 percent to reach US$2,013 million. Demand for input/output of peripheral units of computers and automatic data processing machines, as well as automotive-related products have been on the rise since February which led to the 23.4 percent growth in cumulative exports of machinery and transport equipment to US$6,211 million in the first three quarters of 2004. The government continued to lend support to the automotive industry through the implementation of policies and programs aimed at promoting efficient operations, reducing transaction costs and enhancing the industry's competitiveness. This was effected through the issuance of Executive Order (EO) Nos.

244 and 312 in October 2003 and May 2004, respectively, which provided for the grant of export credit incentives to participants in the Automotive Export Program from 2004 until 2008. Moreover, E.O. No. 313 allows zero percent duty to BOI-registered export-oriented enterprises on their importation of machinery and equipment, spare parts and accessories.

Exports of garments continue to decline.

c) *Garments*. Exports of garments remained weak in the third quarter of 2004 at US$635 million or a slide of 3.1 percent. Three quarter-cumulative garments shipments declined by 5.8 percent to US$1,673 million from the year-ago level of US$1,777 million. The slack in garments exports began in July 2003 due to the stiff competition from other market contenders such as China, Mexico, and other emerging economies. This resulted in the dwindling share of garments to total exports beginning July 2003.

With the termination of the quota system in 2005, the garments industry will be market-driven and the Philippines will have to compete with China and other emerging economies. In response to the challenges, the government, through the Confederation of Garments Exporters of the Philippines (CONGEP) in coordination with the Department of Trade and Industry (DTI) and the private sector has an on-going study on the possibility of a free trade agreement with the US to ensure continued access of Philippine garments exports in the US market. Moreover, the country's garments exporters have joined the Istanbul Declaration of garments federations in 37 nations that have petitioned the World Trade Organization (WTO) to postpone the phase-out of the export quotas.

Furthermore, the GTEB through the Industry Transformation Plan is now preparing the second phase of the transformation program. The plan involves three assistance packages:

i. Development assistance programs designed to improve productivity through investments in technology and skills upgrading, to address speed-to-market concerns, develop and promote diversified markets and products, and provide access to financing;

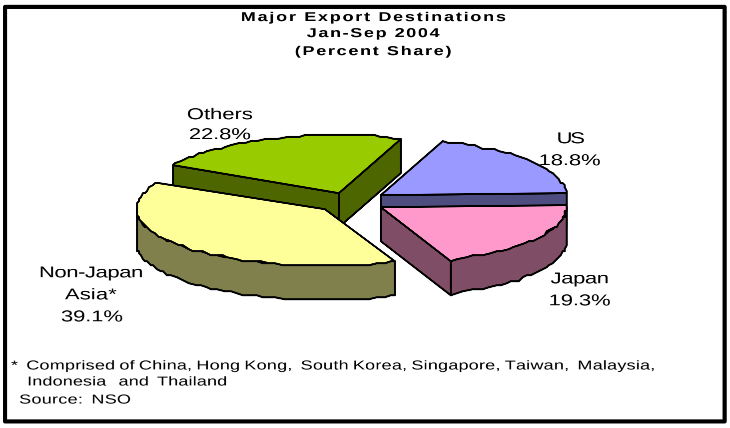
ii. Assistance involving the bwering of business costs through reduction in quota fees by 30 percent to help exporters compete with other low-cost countries. Starting January 2004, all quota fees were already eliminated;

iii. Quota incentives to encourage exporters to undertake productivity and growth-enhancing activities that are critical to achieving greater competitiveness.

According to the GTEB, around 17 percent of the 1,184 accredited exporters in the country have shifted or are in the process of shifting to high-end branded products where the country has a competitive edge.

Export market share of non-Japan Asian countries continues to take the lead.

The rising intra-trade with non-Japan Asian economies specifically China, Hong Kong, Indonesia, Malaysia, Singapore, South Korea, Taiwan and Thailand has resulted in increased share of 39.1 percent of the country's export destination in the first nine months of 2004 compared with only 17.3 percent in 1990. Mainland China remained the most dynamic market posting an annual average growth of about 45.4 percent in the last six years. In the first three quarters of the year, export shipments to China grew by 21.2 percent, representing about 6.2 percent of the total exports.



Import growth rises.

Imports of goods in the third quarter aggregated US$10,003 million, or an improvement of 10.9 percent. The expansion, which was in contrast to the 4.2 percent decline during the same quarter in 2003, was bolstered by imports of raw materials and intermediate goods, mineral fuel and lubricants as well as consumer goods. The combined imports of these commodity groups comprised about 58.3 percent of total imports of goods during the review quarter. The rise in procurement in these commodity groups brought the first nine months' total imports to US$29,419 million or an increase of 9.1 percent (Table 2.2).[2]

[2] Based on BPM5 concept.

Capital goods imports remain high but slightly decline.

Imports of capital goods although posting a slight decline remained high at US$3,899 million in the third quarter of 2004. This was largely traceable to increased imports of telecommunications equipment and power generating and specialized machines. This is in line with the advances in information technology and wireless communication, in turn, driven by the continuing boom in the production of micro-chips and telecommunication devices. This development led the total capital goods imports for the first three quarters to expand by 4.8 percent to US$11,651 million.

Imports of raw materials and intermediate goods increase.

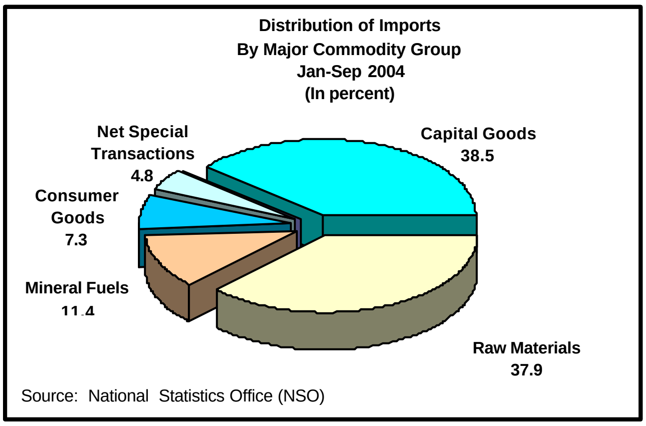
Meanwhile, imports of raw materials and intermediate goods rose by 9.7 percent in the third quarter of 2004, reflecting higher imports of all sub-commodity groups. The first three-quarter import growth for raw material goods reached 5.3 percent amounting to US$11,467 million.

Consumer goods imports also on the uptrend.

Imports of consumer goods were also up by 13.1 percent to reach US$801 million triggered by the rise in purchases of both non-durable and durable goods. The increase was traced to higher imports of rice and other food products as well as passenger cars & motorized cycles and home appliances. These developments led to the expansion in total overseas purchases of consumer goods for the first nine months of the year by 6.8 percent, albeit lower than the 10.4 percent growth last year.

Mineral fuels and lubricants imports show hefty growth.

Imports of mineral fuels and lubricants grew by 30.1 percent in the third quarter of 2004, attributed mainly to the increase in import volume and price of other petroleum products such as gas and fuel oils, motor gasoline, propane and butane and kerosene. Meanwhile, imports of petroleum crude dropped by 5.3 percent to US$611 million in the third quarter of 2004 due to the decline in import volume following the rising share of imported finished oil products in the country's imported oil mix. Relative to last year's level, import volume of petroleum crude dropped to 15.7 million barrels in the third quarter of the year from 23.7 million barrels a year ago. The drop in import volume cushioned the impact of the increase in the average price of petroleum crude, which rose to US$38.9 per barrel in the third quarter of 2004 from US$27.2 per barrel in the same period last year. These developments led to the 17.9 percent rise in imports of mineral fuels and lubricants for the first nine months of the year.



✍ Trade-in-Services

The trade-in-services account posts a higher deficit.

The deficit in the trade-in-services balance widened to US$267 million in the third quarter of 2004 compared with US$208 million deficit in the same period last year. This developed due largely to higher outlays for freight following the rise in imports of goods, as well as higher disbursements in communication, financial and government services, more than offsetting the increase in receipts from travel and construction services. Net inflows from travel grew by 26.6 percent to US$319 million in the third quarter owing to the government's intensified promotion campaigns to help the tourism industry sustain its recovery. By end-September, net travel inflows already posted a cumulative expansion of 75.6 percent, narrowing the nine-month deficit in the services account to only US$701 million from the year-ago deficit of US$1,020 million. Visitor arrivals for the first nine months of the year rose by 26.7 percent with the tourists coming mainly from the U.S., Japan, Korea, Hong Kong, Taiwan, Australia, Singapore, Canada, U.K., and Germany. Further contributing to the narrowing of the nine-month cumulative deficit in the services account was the net inflow in communication and construction services coupled with the lower outlays for royalties and fees and miscellaneous business, professional and technical services.

✍ Income

Higher OFW remittances boost the income account.

The income account posted a higher surplus in the third quarter of the year at US$1,553 million compared to the level in the same quarter in 2003. The 30.4 percent increase was achieved with the higher growth in income receipts than disbursements. Gross income receipts for the quarter in review grew by 21.3 percent with the bulk of the increase attributed to higher OFW remittances, which rose to US$2,180 million. These developments brought the cumulative net income flows during the three quarters to rise by 13.6 percent to US$4,315 million, compared to US$3,798 million in 2003. Deployment of both land-based and sea-based workers in the first nine months of 2004 increased by about 3.1 percent and 2.7 percent, respectively.[3] By contrast, the investment income account posted a higher net outflow of US$627 million from US$592 million in the same quarter last year owing largely to higher payments of dividends and profits as well as increased interest payments on foreign borrowings by the National Government. This brought the cumulative net outflow in investment income to widen by nearly 1.0 percent (Table 4). For the whole of 2004, income receipts are expected to expand due mainly to the projected 6.0 percent increase in remittances from OFWs.

✍ Current Transfers

The surplus in the current transfers account declines.

Net current transfers in the third quarter of 2004 at US$147 million dropped by 2.0 percent from year-ago level due to lower net transfers from foreign governments. This pulled down the net current transfers for the first nine months of 2004 to US$425 million, or a contraction of 4.7 percent, reversing the 25.3 percent expansion during the first three quarters of 2003 (Table 5).

✍ Capital and Financial Account

The capital and financial account deficit widens in the third quarter.

The capital and financial account deficit in the third quarter of 2004 widened to US$1,245 million compared to the net outflow of US$1,198 million in the same period in 2003. This developed due to the weaker performance of the other investments account which negated the robust growth in both direct and portfolio investments accounts. However, the deficit in the capital and financial account in the first three quarters of the year narrowed by 56.8 percent to US$1,685 million from US$3,903 million in the same quarter last year as all investment accounts posted significant improvement.

✍ Capital Account

The capital account deteriorates.

The capital account reversed to a deficit of US$6 million in the third quarter of the year from a US$9 million surplus last year largely on account of the net outflow in the net capital transfers

[3] Of the 687,815 Filipino workers deployed in January-September 2004 based on data from the Philippine Overseas Employment Administration (POEA) on rehire and newly hired OFWs, 519,785 (75.6 percent) were land-based workers and 168,030 (24.4 percent) were sea-based workers.

to the private sector. As a result, the first nine months followed the same trend with the capital account posting a net outflow of US$14 million from a surplus of US$16 million in 2003 (Table 6).[4]

✍ Direct Investments

Direct investment flows gain momentum.

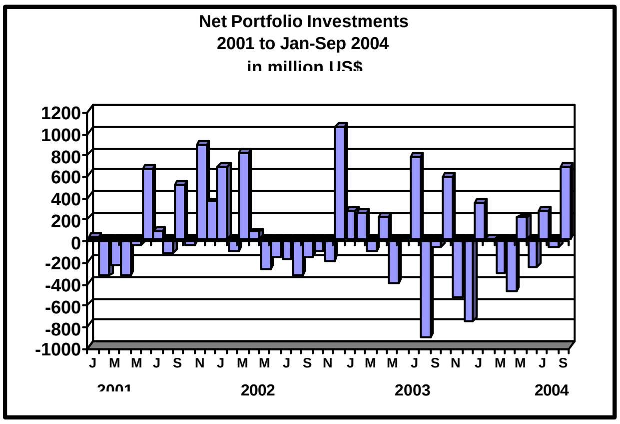
The direct investment account recovered in the third quarter of 2004 posting a higher net inflow of US$255 million, 347.4 percent higher than the year-ago net inflow of US$57 million. The more-than-four-fold rise in direct investments was attributed to the higher non-residents' placement of equity capital. The top investing countries were Japan and the U.S., channeling their funds to the manufacturing (e.g., disposable syringes, intravenous catheter, power conversion products) and services sectors (contact center and business processing operations). Also contributory to this positive performance was the higher net inflows in the other capital covering both bank and non-bank intercompany accounts (Table7).

✍ Portfolio Investments

Portfolio investment flows reverses to a surplus.

The portfolio investment account posted a net inflow of US$872 million, a reversal of the US$213 million net outflow recorded in the third quarter of 2004. The favorable performance during the reference quarter was attributed to non-residents' increased subscription to the bond issuances by the National Government (US$1.3 billion Reopening of RP Global Bonds) and US$422 million Reopening of RP Euro Bonds) and non-residents' purchase of offshore-issued Philippine debt papers from resident holders. These developments were sufficient to mitigate the effect of increased placements by domestic commercial banks in foreign securities coupled with the bond redemption by the NG and monetary authorities. Despite the continuing concerns over the country's fiscal and political climate, the Philippines remained as one of the preferred sites by investors to park their investments following the government's resolve to address the country's economic woes. On the aggregate, portfolio investments in the first nine months of 2004 posted a higher surplus of US$401 million compared to the US$8 million surplus last year (Table 8).

[4] The capital account consists largely of capital transfers. Capital transfers are transactions that involve the 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.



✍ Other Investments

The other investments account balance deteriorates.

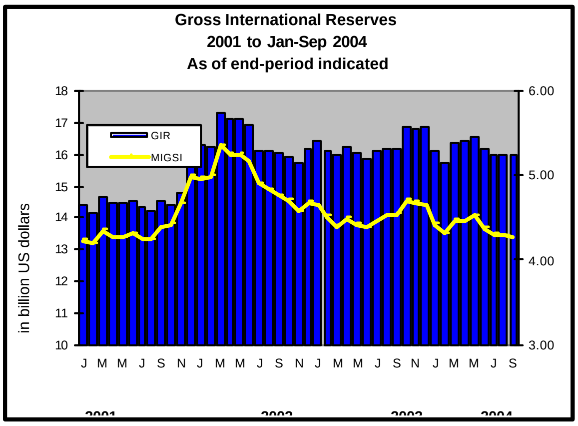
In the third quarter of 2004, the other investment account deficit widened to US$2,366 million, higher than the US$1,051 million in the same period in 2003. Accounting for this development was the combined impact of increase in bank's short-term loans receivable and increased loan repayments by the national government (NG). (Table 9). Loan repayments by NG reached US$329 million during the quarter, or 5.1 percent higher than the US$313 million repayments made in the comparable period in 2003 while, short-term loans receivable by domestic commercial banks reached US$231 million. Despite these developments, the cumulative other investments deficit was reduced to US$2,324 million from a high net outflow of US$4,070 million a year ago as the net inflows registered in the first two quarters offset the net outflow posted in the third quarter.

✍ Reserve Assets

Gross international reserves remain comfortable.

The BSP's gross international reserves (GIR), including reserve position in the IMF, reached US$15.9 billion as of end-September 2004 (Table 11). This was 5.5 percent lower compared to the end-December 2003 level of US$16.9 billion. Notwithstanding the decline, the end-September 2004 level of reserves which is equivalent to 4.1 months' worth of imports of goods and payment of services and income (MIGSI) remained comfortable. In terms of debt coverage, the reserve level was 2.5 times the amount of the country's short-term foreign liabilities based on original maturity and 1.4 times based on residual maturity.[5] By end-2004, the country's GIR is projected to reach US$14-US$15 billion, equivalent to 3.7 import cover.

A large part of the reserves was in the form of foreign investments (76.4 percent), with the balance in gold (21.3 percent), foreign exchange (1.5 percent) and combined SDRs and reserve position in the Fund (0.8 percent). By currency composition of reserves (excluding gold), 80.6 percent was in US dollar, 12.0 percent in Euro, 3.8 percent in Japanese yen, 2.2 percent in pound sterling and the balance of 1.4 percent in other foreign currencies.



✍ Exchange Rate

Peso depreciates in the third quarter.

The nominal peso-dollar exchange rate averaged ₱56.00/US$1 in the third quarter of 2004, depreciating by 2.5 percent from last year's level of ₱54.58/US$1. Increased dollar demand by corporates to cover import requirements, service foreign exchange obligations and hedge against future dollar requirements, particularly in light of the volatility in world oil prices contributed to the peso's weakening. The peso was also weighed down by concerns over the country's fiscal situation and the surge in world oil prices, which fueled market fears of higher inflation and interest rates. These economic and non-economic pressures drove the peso-dollar exchange rate to depreciate by 3.8 percent to ₱56.00/US$1 in the first three quarters of 2004.

Peso shows less volatility in the third quarter.

Notwithstanding, the peso was less volatile in the third quarter of 2004 as its standard deviation at ₱0.20 was lower than the year-ago level of ₱0.68. The peso's stability was realized with

[5] Residual maturity refers to outstanding short-term debt based on original maturity plus principal payments on medium- and long-term loans of the public and private sectors falling due in the next 12 months.

the sustained foreign exchange inflows from remittances of OFWs and the improvement in the foreign exchange earnings from exports of goods which helped alleviate foreign exchange demand. The average daily peso-dollar exchange rate ranged from ₱55.14/US$1– ₱56.44/US$1 from January to September 2004.

The peso's external competitiveness gains in nominal terms but weakens in real terms against the currencies in both broad and narrow baskets.

Relative to last year's level, the peso's average nominal effective exchange rate (NEER) index in the third quarter of 2004 depreciated by 6.5 percent against the currency basket of the country's major trading partners,[6] 0.70 percent against the currency basket of a broad group of competitor countries,[7] but appreciated 2.4 percent against the currency basket of a narrow group of competitor countries.[8] This was attributed to the larger depreciation of the peso vis-a-vis the U.S. dollar compared to that of the other currencies in these baskets. In terms of the real effective exchange rate (REER) index,[9] the peso gained external price competitiveness as the REER depreciated by 2.5 percent against the currency basket of the country's major trading partners. However, in comparison to the countries in both the broad and narrow baskets, the peso's external competitiveness waned as the REER appreciated by 2.3 percent and 4.4 percent, respectively, due to higher inflation gap vis-à-vis the countries whose currencies are included in the broad and narrow baskets.

[6] 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.
[7] The broad basket is composed of the currencies of Singapore, South Korea, Taiwan, Thailand, Indonesia and Hong Kong.
[8] The narrow basket is composed of the currencies of Indonesia, Malaysia and Thailand.
[9] The REER index is derived from the NEER index by adjusting for inflation differentials.

EFFECTIVE EXCHANGE RATE INDICES OF THE PESO For periods indicated							
		NEER			REER		
			CC			CC	
		MIC 1/	Broad 2/	Narrow 3/	MIC 1/	Broad 2/	Narrow 3/
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
	Qtr 1	**14.82**	**32.85**	**65.26**	**66.06**	**111.14**	**171.16**
	Apr	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
	Jun	14.45	31.02	59.78	64.29	106.01	159.66
	Qtr 2	**14.71**	**31.82**	**61.66**	**65.32**	**107.89**	**162.76**
	Jul	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
	Qtr 3	**13.88**	**30.45**	**59.43**	**62.10**	**105.02**	**159.18**
	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.	**Q4**	**13.43**	**29.85**	**58.19**	**60.14**	**101.87**	**152.53**
Ave.	**Jan-Dec**	**14.21**	**31.24**	**61.13**	**63.41**	**106.48**	**161.41**
2003	Jan	13.02	29.24	57.14	58.67	100.72	147.64
	Feb	12.87	29.05	56.61	57.86	98.84	146.17
	Mar	12.74	29.03	56.18	57.02	98.62	145.53
	Qtr 1	**12.88**	**29.10**	**56.64**	**57.85**	**99.39**	**146.45**
	Apr	13.17	29.94	57.68	59.03	101.78	148.36
	May	12.95	29.42	56.27	58.14	100.72	147.23
	Jun	12.71	28.65	54.36	57.62	100.04	144.84
	Qtr 2	**12.94**	**29.34**	**56.10**	**58.26**	**100.84**	**146.45**
	Jul	12.74	28.56	54.52	57.91	100.99	145.85
	Aug	12.52	28.06	53.96	56.83	99.00	144.24
	Sep	12.42	27.82	53.46	56.23	97.05	141.76
	Qtr 3	**12.56**	**28.15**	**53.98**	**56.99**	**99.01**	**143.95**
	Oct	12.14	27.73	53.23	55.09	95.66	139.95
	Nov	12.05	27.70	53.09	54.87	96.72	138.89
	Dec	11.83	27.64	52.92	54.03	95.76	138.11
	Qtr 4	**12.01**	**27.69**	**53.08**	**54.67**	**96.05**	**138.99**
Ave.	**Jan-Dec**	**12.60**	**28.57**	**54.95**	**56.94**	**98.82**	**144.05**
2004	Jan	11.67	27.38	52.31	53.61	95.93	135.95
	Feb	11.54	27.04	52.00	52.95	93.54	134.74
	Mar	11.63	27.12	52.39	53.33	94.13	136.43
	Qtr 1	**11.61**	**27.18**	**52.23**	**53.30**	**94.53**	**135.71**
	Apr	11.77	27.24	52.91	54.03	94.61	136.61
	May	11.88	27.89	54.61	54.63	97.54	143.49
	Jun	11.75	28.15	56.05	54.70	100.52	150.24
	Qtr 2	**11.80**	**27.76**	**54.52**	**54.45**	**97.56**	**143.45**
	Jul	11.72	27.86	54.82	55.31	100.99	148.43
	Aug	11.79	28.16	55.76	55.83	102.23	151.83
	Sep	11.71	27.84	55.21	55.61	100.66	149.99
	Qtr 3	**11.74**	**27.95**	**55.26**	**55.58**	**101.29**	**150.08**

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.