BALANCE OF PAYMENTS DEVELOPMENTS
SECOND QUARTER 2005

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✍ Overall Position

The BOP position registers a significantly higher surplus in the second quarter of the year owing to the gains in the current account.

The balance of payments (BOP) position in the second quarter of 2005 yielded a surplus of US$1,198 million, more than two-and-a-half times the US$448 million posted in the same quarter last year due to a stronger current account. The capital and financial account, while less robust, likewise remained in surplus during the quarter in review. These favorable outcomes led to the significant improvement in the overall BOP position in the first semester of the year as both the current and the capital and financial accounts posted gains over last year's levels (Table 1).

Balance of Payments (US$ m)

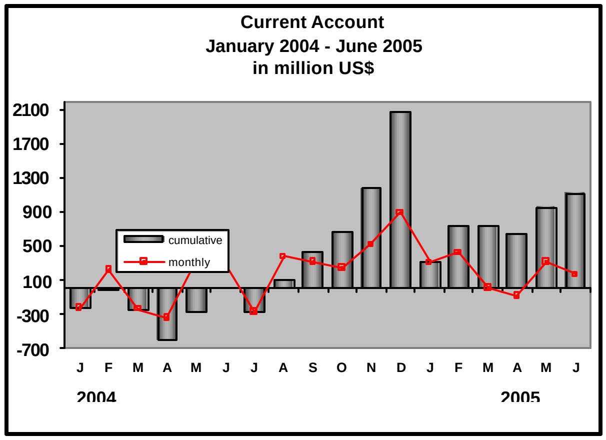
		Q2		Growth	Jan-June		Growth
		2005	2004	Rate (%)	2005	2004	Rate (%)
I.	Current Account	386	247	56.3	1123	152	638.8
II.	Capital & Fin'l Account	457	781	-41.5	1499	303	394.7
III.	Net Unclassified Items	355	-580	161.2	-641	-385	-66.5
IV.	**Overall BOP**	**1198**	**448**	**167.4**	**1981**	**70**	**2730.0**

* Totals may not add up due to rounding.

✍ Current Account

Strong inflows from OFW remittances help sustain the current account surplus position.

The current account posted a higher surplus of US$386 million in the second quarter of 2005, equivalent to 1.6 percent of GDP, largely traced to the higher surplus in current transfers due in turn to the continuous growth in workers remittances. The strong workers remittances, combined with the lower deficit in the services account more than offset the contraction in net income receipts and the higher deficit in the trade-in-goods account. These positive developments triggered the current account surplus to rise by more than 600 percent in the first six months of 2005 to reach US$1,123 million, representing 2.5 percent of GDP.

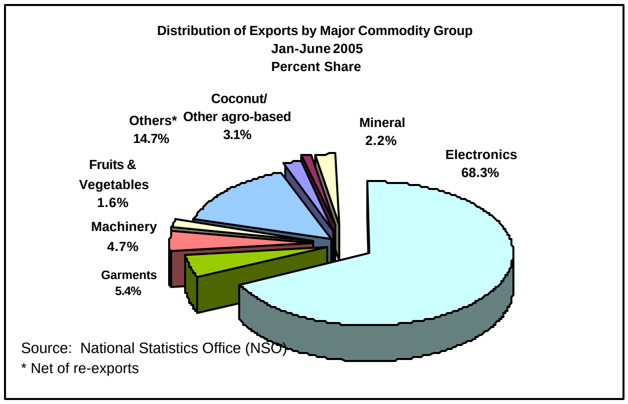


✍ Trade-in-Goods

The trade-in-goods account posts a higher deficit in the second quarter as the growth in imports outpaced the expansion in exports.

Developments in the second quarter of 2005 showed the trade-in-goods account yielding a higher deficit of US$2,181 million compared to the US$1,727 million deficit posted in the same quarter last year. This was traced to the more rapid expansion in goods imports at 6.8 percent compared to that of goods exports at 3.2 percent. Total revenues from exports in the second quarter of 2005 aggregated US$9,658 million with growth arising mainly from shipments of electronics and machinery and transport equipment, while the total import bill was recorded at US$11,839 million, backed by increased purchases of capital goods, mineral fuels & lubricants and consumer goods. As a result of these developments, there was a 5.0 percent widening of the trade-in-goods deficit during the first half of the year as the 3.8 percent expansion in imports of goods outpaced that of exports at 3.6 percent. The six-month cumulative levels of exports and imports of goods stood at US$18,978 million and US$22,637 million, respectively (Table 2.1).[1]

[1] Based on BPM5 concept (i.e., excluding from the National Statistics Office figures, those goods that did not involve change in ownership). Imports per BOP also reflect preliminary adjustments on the valuation of consigned raw materials for electronics and garments exports.



Electronics exports in the second quarter of 2005 post a marginal decline.

a) *Electronics*. Electronics exports (including electronic equipment and parts) declined marginally in the second quarter of the year to reach US$6,644 million as export revenue was pulled down by the transfer of a major electronic company's high-end product line (i.e., notebook PCs) to China. Despite this development, exports of electronics products still managed to pull off a 1.2 percent growth for the six-month period largely on account of exports of semiconductor devices and components which rose by more than 9.7 percent. Notably, exports of semiconductor devices to China rose by 148.3 percent and to Malaysia by 7.6 percent. Semiconductor devices and components comprised 73.8 percent of total electronics exports. Other electronics products such as those for automotive instrumentation, telecommunications, control and instrumentation, and medical/industrial instrumentation rose from their year-ago levels.

Exports of machinery and transport equipment post a hefty growth in the second quarter of the year

b) *Machinery and Transport Equipment.* As the country enhances its role as industrial hub for auto parts manufacturing, shipments of machinery and transport equipment in the second quarter of 2005 reached US$479 million, posting a growth of 23.3 percent. The strong performance was consequently reflected in the first semester of the year as the 18.9 percent rise in export earnings of this commodity group was supported by higher demand for parts and accessories of motor vehicles, vessels for passengers and goods and gear boxes of motor vehicles. To help harness the automotive industry's potentials, the government has been supportive of the industry's plans and programs to be globally competitive. Part of the government's commitment to enhance the industry's global competitiveness were policies and programs intended to enhance the industry's competencies in the areas of:

i. product and market development;
ii. price competitiveness; and
iii. improvement of management systems, use of new technologies, development of strategic marketing approaches and heightening of productivity levels.

Moreover, measures to reduce transaction costs were already implemented 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.

Looking ahead, these development strategies were outlined to attain a targeted increase of the Philippine market share in Japan, U.S., the ASEAN and Europe.

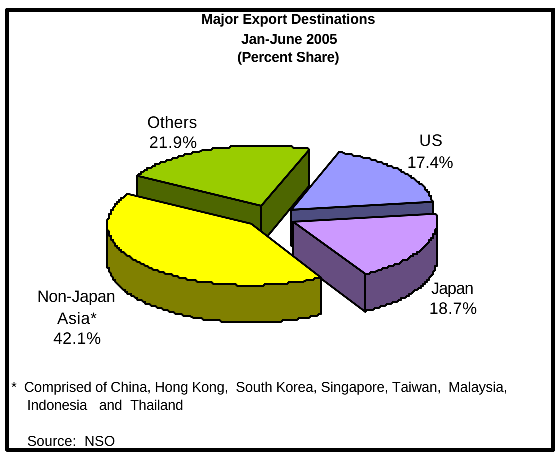
Exports of garments start to show the impact of the quota system phase-out.

c) *Garments*. By contrast, the garments industry failed to sustain the recovery made in the preceding two quarters as its exports posted a decline of 1.4 percent in the second quarter of the year to reach US$509 million. As a result, total export earnings for the first half of 2005, at US$1,040 million, were almost unchanged from last year's level.

Even before the termination of the quota system in 2004, the garments industry experienced stiff competition from other markets such as China, Mexico, and other emerging economies that resulted in the declining share of garments to total exports beginning July 2003. The end of the quota system starting January 2005 has taken its toll on the performance of the garments industry. It must be noted, however, that both the government and the private sector exerted efforts to alleviate the predicament of the garments exporters. For one, the Industry Transformation Plan was launched prior to the quota phase-out. It contained development assistance programs intended to help the industry players enhance productivity through technology and skills upgrading, develop and promote diversified markets and products, and provide access to financing. Moreover, all quota fees were also discontinued early this year to help exporters compete with other low-cost countries. Quota incentives were likewise granted to encourage exporters to undertake more productive and growth-enhancing activities to achieve greater competitiveness.

Intra-Asian trade continues to gain strength.

Intra-regional trade particularly with non-Japan Asian economies continues to strengthen with a combined market share of 42.1 percent in the first half of 2005, a remarkable increase from only 17.3 percent in 1990. Mainland China remained the most vigorous market posting an annual average growth of about 37.6 percent in the last five years. It has increasingly become a major contributor to intra-regional trade flows with export growth surging at 71.0 percent and 58.2 percent in 2002 and 2003, respectively. In the first semester of 2005, export shipments to China surged by 73.4 percent, in stark contrast to a growth of only 26.0 percent in 2004. This represented about 9.4 percent of total exports compared to 5.6 percent share last year.



Total imports rise due to higher purchases of capital goods, mineral fuels and lubricants, and consumers goods.

Imports of goods in the second quarter of 2005 aggregated US$11,839 million, 6.8 percent higher than the level in the comparable quarter a year ago. Growth was driven largely by higher purchases of capital goods, mineral fuels & lubricants and consumer goods which more than offset the decline in imports of raw materials and intermediate goods. Consequently, the total import bill in the first half of 2005 amounted to US$22,637 million or a growth of 3.8 percent (Table 2.2).[2]

[2] Based on BPM5 concept.

Capital goods imports expand in the second quarter.

Imports of capital goods increased by 25.4 percent to US$2,750 million in the second quarter of 2005, comparing favorably with the 1.3 percent expansion in same quarter a year ago. The improvement was traced to higher procurement of office and EDP machines, land transport equipment, and aircraft, ships and boats. However, the cumulative six-month procurement of capital goods posted a contraction of 5.7 percent to US$4,156 million, owing largely to the decline in purchases of telecommunications equipment, followed by office and EDP machines and power generating and specialized machines. This developed even as purchases of land transport equipment and aircraft, ships & boats increased compared to year-ago levels.

Imports of raw materials and intermediate goods decline in the second quarter of the year.

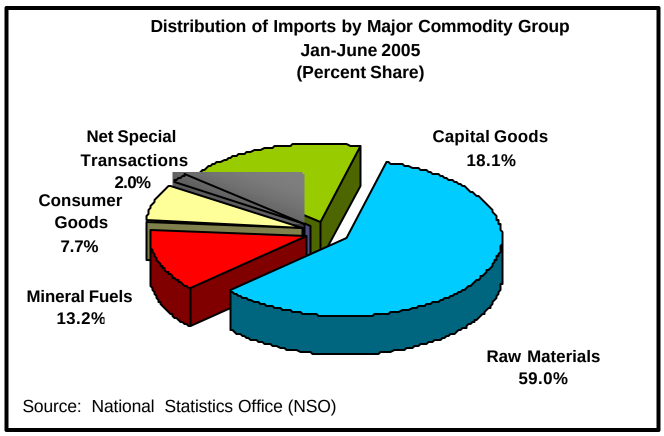
Imports of raw materials and intermediate goods reached US$6,337 million in the second quarter of 2005, declining by 6.2 percent from last year's level due largely to the decline in purchases of materials and accessories for the manufacture of electronics exports, followed by inedible crude materials, artificial resins, textile yarn and fabrics and non-ferrous metals. However, in the first half of the year, total imports of this commodity group managed to post a modest expansion of 1.0 percent on account of increased procurement of raw material inputs for electronics, iron & steel, embroideries, chemical compounds and other medicinal & pharmaceutical chemicals. Moving forward, the prospects of increased investments in export-related industries are projected to augment raw material requirements for export production.

Consumer goods imports rise as procurement of both durable and non-durable goods increases.

By contrast, imports of consumer goods reached US$966 million in the second quarter of the year triggered by the rise in purchases of both durable and non-durable goods. This brought total consumer goods purchased during the first half of 2005 to US$1,764 million. The 25.6 percent growth was traced largely to higher imports of rice to avert an expected supply shortage due to the impact of the El Niño this year. Other commodities that contributed to the higher imports of consumer goods were passenger cars and motorized cycles, other food products such as dairy products, and fish and fish preparations.

Import bill for mineral fuels and lubricants, particularly petroleum crude rise amid the upsurge in world prices of oil.

The substantial increase in imports of mineral fuels and lubricants for the second quarter of 2005 at US$ 1,710 million was spawned by the persistent sharp run-up in world oil prices. The 40.6 percent rise was attributed mainly to the increase in the average price of petroleum crude. Imports of petroleum crude rose by 56.4 percent to US$1,029 million as the average price climbed to US$56.54 per barrel rose from US$33.39 per barrel during the quarter in review. Imports of other petroleum products likewise increased to US$635 million on account mainly of the 51.0 percent hike in the average price to US$60.30 per barrel from US$39.93 per barrel a year ago. Other petroleum products comprised mainly of gas and fuel oils, motor gasoline, propane and butane and kerosene. These developments led to the 33.9 percent rise in imports of mineral fuels and lubricants in the first half of the year to US$3,019 million.



✍ Trade-in-Services

The deficit in the trade-in-services account narrows.

The trade-in-services account during the second quarter of 2005 posted a lower deficit of US$291 million due to higher net inflows of travel, communication, construction and computer and information services, coupled with lower net outlays for government and other business services. Net receipts from travel improved by 26.9 percent to US$212 million resulting from higher travel exports combined with lower travel imports. These developments translated to a 30.0 percent improvement in trade-in-services during the first six months of the year as the deficit narrowed to US$430 million from US$614 million a year ago. Services exports grew by 10.9 percent outpacing the 1.6 percent increase in services imports. The 2005 cumulative six-month net receipts from travel grew by 20.3 percent owing to the 12.7 percent rise in number of tourists visiting the country.[3] The Department of Tourism's market-specific campaigns to promote the country's tourism industry have been gaining ground particularly in customizing travel packages offered to meet the needs of tourists visiting the country. The major country origins of foreign travelers were the U.S., Korea, Japan, Hong Kong, Taiwan, Australia, Canada, China, U.K., Singapore and Germany.

✍ Income

The income account remains in surplus in the second quarter of 2005.

The income account in the second quarter of 2005 posted a lower surplus of US$28 million from the year-ago level of US$124 million. The decline was attributed to the higher net outflow in investment income arising mainly from higher net outlays of dividends and profits to direct investors coupled with increase in interest payments. The decline in investment income was, however, partly offset by the 7.4 percent increment in compensation income of resident OFWs,[4] which reached US$740 million during the review quarter due to higher deployment of sea-based workers. For the first half of the year, the deficit in the income account narrowed by 77.1 percent to US$11 million. The 13.2 percent improvement in the compensation income of resident OFWs more than made up for the 10.1 percent widening of the deficit in the investment income account (Table 4).

✍ Current Transfers

Strong OFW remittances remain the driving force behind the surplus in the current transfers account.

Net current transfers in the second quarter of 2005 rose to US$2,830 million from the year-ago level of US$2,199 million mainly on account of workers remittances. Transfers to the Philippine government and other sectors other than workers remittances likewise posted gains. This brought net receipts from current transfers in the first semester of 2005 to US$5,223 million, up by 21.5 percent, a reversal from the 1.6 percent contraction in the comparable period last year. Workers' remittances amounted to US$4,772 million in the

[3] It should be noted that both exports and imports of travel include OFW-related expenses. Travel exports include expenses in the Philippines of non-resident OFWs during their home visits while travel imports include expenses of resident OFW in the host economies. Expenses of resident OFWs in the first half of 2005 amounted to US$366 million while expenses of non-resident OFWs reached US$15 million.

[4] Under the BPM5, the residency of seasonal workers such as OFWs is classified according to the length of their stay in the host economy. OFWs who are working for less than one year are classified as resident OFWs and their remittances reflected under the Income Account. Meanwhile, OFWs who are working for one year or more in the host economy are classified as non-residents OFWs and their remittances are reflected under the Current Transfers Account. Remittances of performing artists and sea-based workers, who generally enter into contracts of less than one year are reflected under the Income Account. Meanwhile, remittances of all land-based workers, except performing artists, are included under the Current Transfers Account.

first six months of 2005. These represented inflows from land-based overseas Filipino workers (e.g., professionals, medical-and-health-related personnel, service workers) whose continued deployment kept the current transfers account on the uptrend. Inflows of remittances were further facilitated by the increased efficiency of remittance services abroad (Table 5).[5]

✍ Capital and Financial Account

The capital and financial account posts a lower surplus as the other investment account reverses to a deficit.

The capital and financial account surplus narrowed to US$457 million in the second quarter compared to the US$781 million recorded in the same quarter in 2004. Accounting for this development was the turnaround in the other investment account to a net outflow, partly offsetting the significant gains posted by both direct and portfolio investments. Despite these developments, the capital and financial account balance for the six-month period recorded a higher surplus of US$1.5 billion from only US$303 million in the comparable period in 2004 due largely to the surge in portfolio investment flows and the reversal of direct investments to a net inflow, which negated the impact of the net outflow in the other investment account.

✍ Capital Account

The capital account posts higher deficit.

The capital account deficit widened to US$10 million in the second quarter of 2005 from the year ago deficit of US$4 million following an increase in migrants' transfers. These represent household and personal effects of Philippine residents migrating to other countries (Table 6).[6]

✍ Direct Investments

Direct investment reverses to a surplus as residents' placements abroad decline.

The direct investment account reversed to a surplus of US$90 million in the second quarter of 2005 from a deficit of US$115 million in the comparable quarter a year-ago. The turnaround resulted from the significant decline in residents' equity investments abroad to US$19 million from a high of US$310 million a year-ago. Notwithstanding the political uncertainties

[5] Based on the National Statistics Office's Survey on Overseas Filipinos (NSO-SOF) in 2004, 81 percent of the total inflows of OFW remittances passed through the banking system, which was higher compared to 73 percent in 2003. The NSO-SOF is a nationwide survey that gathers information on overseas workers who left abroad during the last five years using the past six months reference period. The SOF is a rider survey to the October round of Labor Force Survey every year.

[6] 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 counter parties and are linked to the acquisition and disposal of fixed assets. By contrast, current transfers involve transactions that affect the level of disposable income and influence consumption of goods and services.

prevailing during the quarter, new foreign investments from non-residents flowed into the country amounting to US$193 million and came largely from the U.S., Hong Kong, Japan, Malaysia, and Mauritius. Among the sectors which benefited from these inflows were: manufacturing (e.g., cordless phones, communication devises, paper mill, disposable syringes, intravenous catheter), real estate, and financial intermediation.

During the six-month period, the balance of the direct investments account reversed to a surplus of US$450 million from a deficit of US$273 million a year-ago. Non-residents' investments rose to US$495 million, more than twice the year-ago level of US$170 million mainly on the back of the 35.3 percent rise in net equity capital.

✍ Portfolio Investments

Portfolio investment flows surge even as geopolitical concerns persist.

The portfolio investment account recorded a surplus of US$1.6 billion in the second quarter of the year, a reversal from the US$192 million deficit posted in the same quarter of 2004. The turnaround was largely on account of non-residents' subscription to the bond and note issuances by both the National Government (RP Global bonds of US$750 million) and some private entities during the review quarter. Another contributory factor was the higher equity securities placements of US$991 million from US$392 million in the same period last year.

The surge in portfolio investments was realized on account of positive developments such as: 1) favorable second quarter corporate earnings results encouraging investor optimism on the country's economic recovery amid the political turmoil; 2) favorable fiscal results, posting surpluses in April and June; 3) real GDP growth of 4.8 percent for the second quarter of 2005; and 4) growth in exports.

The positive outturn resulted in portfolio net inflows of US$2.1 billion in the first semester of 2005, a rebound from the US$114 million net outflow recorded a year-ago.

✍ Financial Derivatives

Financial derivatives balance reverses to a surplus.

Financial derivatives reversed to a surplus of US$16 million during the second quarter from a deficit of US$1 million in the same period a year ago as gains of residents from forward and swap transactions outweighed those losses from non-residents.

✍ Other Investments

The other investment account reverses to net outflow arising from higher residents' investments abroad.

The other investment account in the second quarter reversed to a deficit amounting of US$1.2 billion from a surplus of US$1.1 billion in the same quarter in 2004. Accounting for the reversal were mainly the following: 1) lower loan availment of the National Government;[7] 2) net withdrawal by non-residents of their deposits with domestic commercial banks; and 3) residents' net claims abroad to fund foreign exchange transactions. In sum, the first semester other investment account posted a deficit of US$1.0 billion from a surplus of US$700 million in the same period in 2004 (Table 10).

✍ Reserve Assets

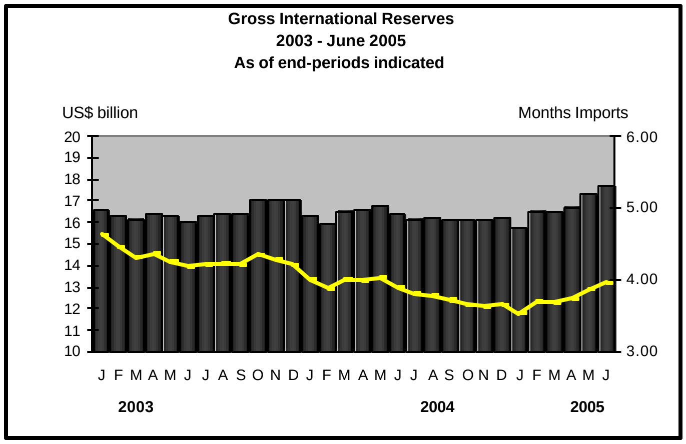
Gross international reserves remain comfortable.

The BSP's gross international reserves (GIR), including reserve position in the IMF, reached US$17.7 billion as of end-June 2005 (Table 12). This was 9.2 percent higher compared to the end-December 2004 level of US$16.2 billion. At this level, reserves remained comfortable and are equivalent to 3.9 months' worth of imports of goods and payment of services and income (MIGSI). In terms of debt coverage, the reserve level was 3.2 times the amount of the country's short-term foreign liabilities based on original maturity and 1.7 times based on residual maturity.[8]

A large part of the reserves was in the form of foreign investments (82.4 percent), with the balance in gold (14.6 percent), foreign exchange (2.3 percent) and combined SDRs and reserve position in the Fund (0.7 percent). By currency composition of reserves (excluding gold), 82.9 percent of reserves were in US dollars, 9.9 percent in Euros, 4.4 percent in Japanese yen, 1.8 percent in pound sterling and the balance of 1.0 percent in other foreign currencies.

[7] NG borrowings were mainly in the form of bonds/notes which were reflected under portfolio investments.

[8] 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.



✍ Exchange Rate

Positive economic developments boost the peso. The nominal peso-dollar exchange rate averaged ₱54.67/US$1 in the second quarter of 2005, marginally appreciating by 2.3 percent from last year's level of ₱55.91/US$1. Strong inflows from OFW remittances, and foreign direct and portfolio investments provided foreign exchange liquidity that helped prop up the local currency.

Peso shows more volatility. However, the peso was more volatile in the second quarter of 2005 as its standard deviation at ₱0.50 was higher than the year-ago deviation of ₱0.22. Higher volatility of the peso was also recorded in the first six months of the year at ₱0.60 compared to the previous year's ₱0.31. The peso-dollar exchange rate ranged from ₱53.91/US$1 to ₱56.341/US$1.

Peso external competitiveness weakens. Compared with the previous year's level, the peso's average nominal effective exchange rate (NEER) index in the second quarter of 2005 appreciated by 0.60 percent against the currency basket of the country's major trading partners.[9] Relative to currency baskets of the broad and narrow groups of competitor countries, the peso's average NEER also appreciated by 0.9 percent and 6.0 percent, respectively.[10] This was attributed to the larger appreciation of the peso vis-a-vis the U.S. dollar compared to those of the other currencies in these baskets. Consequently, in terms of the real effective exchange rate (REER) index,[11] the peso lost external price

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

competitiveness as the REER appreciated by 6.6 percent against the currency basket of the country's major trading partners, by 6.0 percent against the currencies in the broad basket, and by 8.8 percent against the currencies in the narrow basket. This was due to the country's strong currency and higher inflation vis-à-vis those in the countries whose currencies are included in the broad and narrow baskets.

EFFECTIVE EXCHANGE RATE INDICES OF THE PESO
For periods indicated
December 1980=100

		NEER			REER		
			CC			CC	
		MIC 1/	Broad 2/	Narrow 3/	MIC 1/	Broad 2/	Narrow 3/
2004	Jan	11.67	27.38	52.31	53.61	96.10	136.09
	Feb	11.54	27.04	52.00	52.95	93.67	134.74
	Mar	11.63	27.12	52.39	53.33	94.17	136.39
	Qtr 1	**11.61**	**27.18**	**52.23**	**53.30**	**94.65**	**135.74**
	Apr	11.77	27.24	52.91	54.03	94.32	136.05
	May	11.88	27.89	54.61	54.63	97.40	143.26
	Jun	11.75	28.15	56.05	54.70	100.65	149.92
	Qtr 2	**11.80**	**27.76**	**54.52**	**54.45**	**97.46**	**143.08**
	Jul	11.72	27.86	54.82	55.27	101.03	148.16
	Aug	11.79	28.16	55.76	55.80	102.35	151.75
	Sep	11.71	27.84	55.21	55.65	100.76	149.87
	Qtr 3	**11.74**	**27.95**	**55.26**	**55.57**	**101.38**	**149.93**
	Oct	11.59	27.63	54.75	55.00	99.17	147.24
	Nov	11.38	27.15	54.25	54.36	99.38	146.21
	Dec	11.28	27.11	54.81	54.29	98.83	147.87
	Qtr 4	**11.42**	**27.30**	**54.60**	**54.55**	**99.13**	**147.11**
Ave	**Jan-Dec**	**11.64**	**27.55**	**54.16**	**54.47**	**98.15**	**143.96**
2005	Jan	11.42	27.21	55.15	55.71	101.17	148.38
	Feb	11.68	27.59	56.06	57.00 p/	100.88 p/	150.57 p/
	Mar	11.71	27.77	56.96	57.02 p/	101.59 p/	152.22 p/
	Qtr 1	**11.60**	**27.52**	**56.06**	**56.58**	**101.21**	**150.39**
	Apr	11.81	28.09	57.90	57.62 p/	102.54 p/	153.50 p/
	May	11.90	28.02	57.77	58.10 p/	103.18 p/	155.95 p/
	Jun	11.90	27.88	57.71	58.39 p/	104.25 p/	157.74 p/
	Qtr 2	**11.87**	**28.00**	**57.79**	**58.04**	**103.32**	**155.73**

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.
p/ Preliminary