BALANCE OF PAYMENTS DEVELOPMENTS THIRD QUARTER 2005

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➢ Overall Position

The BOP position reverses to a surplus in the third quarter of the year due to the strong gains posted in the capital and financial account.

The balance of payments (BOP) position in the third quarter of 2005 yielded a surplus of US$749 million, a reversal from the US$246 million deficit posted in the same quarter last year due primarily to the strength of the capital and financial account. The current account while posting a weaker performance this quarter remained in surplus. These positive results led to the remarkable advancement in the overall BOP position in the first three quarters of the year as it reverted to a high surplus of US$2.730 billion from a deficit of US$176 million a year ago on the back of robust gains registered in the current and the capital and financial accounts (Table 1).

Balance of Payments (US$ m)

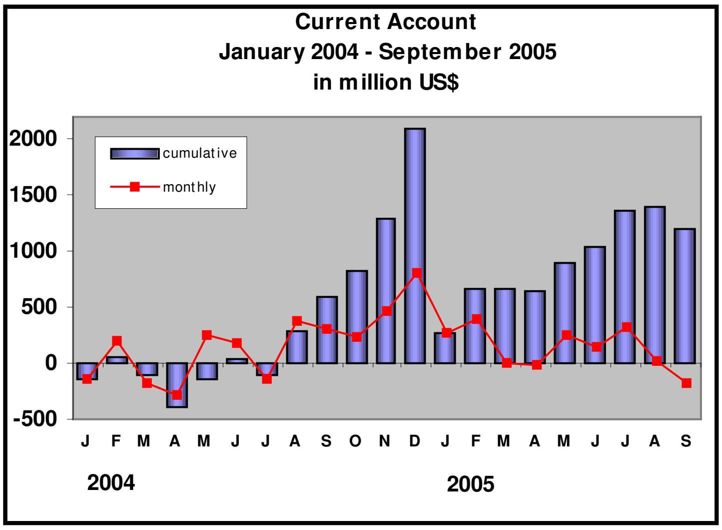
	Q3		Growth	Jan-Sep		Growth
	2005	2004	Rate (%)	2005	2004	Rate (%)
I. Current Account	167	540	-69.1	1205	584	106.3
II. Capital & Fin'l Account	533	-671	179.4	2249	-407	652.6
III. Net Unclassified Items	49	-115	142.6	-724	-353	-105.1
IV. Overall BOP	**749**	**-246**	**404.5**	**2730**	**-176**	**1651.1**

* Totals may not add up due to rounding.

➢ Current Account

The current account remains in surplus on the back of sustained remittances from OFWs.

The current account posted a surplus of US$167 million (0.7 percent of GDP) in the third quarter of 2005, albeit lower than the year-ago level of US$540 million. The higher surplus in current transfers due to the continuous growth in workers' remittances was partly offset by the higher deficits in the income and trade-in-goods accounts even as the services account posted a lower deficit during the quarter. However, despite the weaker third quarter performance of the current account, the cumulative nine-month balance continued to post a hefty surplus of US$1.205 billion, representing 1.7 percent of GDP. The significant expansion from the year-ago surplus of US$584 million was attributed largely to the strong inflows of OFW remittances in the current transfers account combined with the contraction in the services account deficit which more than compensated for the widening of the deficit in the trade-in-goods and income accounts.

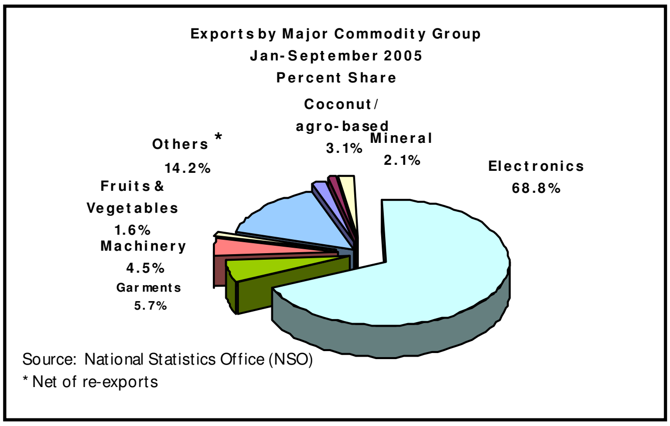


▪ Trade-in-Goods

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

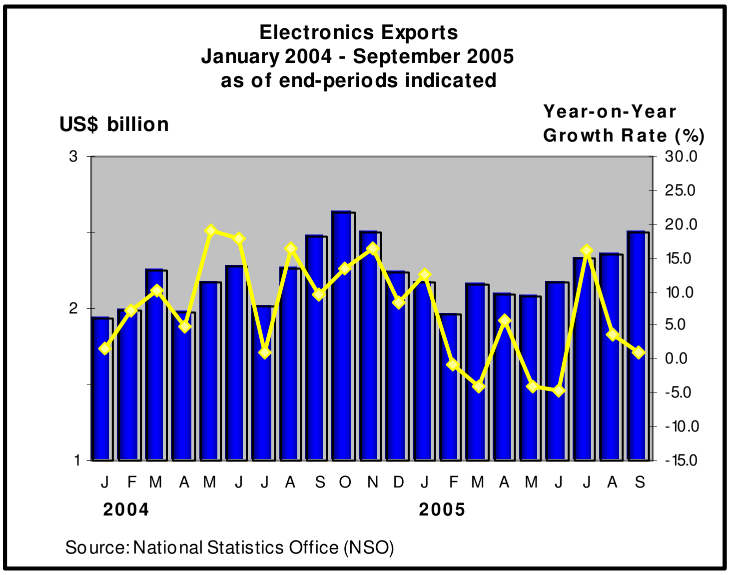
Developments in the third quarter of 2005 showed the trade-in-goods account yielding a higher deficit of US$2.397 billion compared to the US$1.320 billion deficit posted in the same quarter last year. This was traced to the brisker expansion in goods imports at 12.3 percent compared to that of goods exports at 3.1 percent.[1] Total revenues from exports in the third quarter of the year aggregated US$10.297 billion with growth arising mainly from shipments of electronics and garments, while the total import bill was recorded at US$12.694 billion, backed by increased purchases in all major commodity groups. Imports of mineral fuels and lubricants recorded the highest growth at 54.0 percent following the increase in both volume and price of petroleum crude. As a result of these developments, there was a 26.2 percent widening of the trade-in-goods deficit during the first nine months of the year as the 6.9 percent expansion in imports of goods outpaced that of exports at 3.6 percent. The nine-month cumulative levels of exports and imports of goods stood at US$29.315 billion and US$35.380 billion, respectively (Table 2.1).

[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 (See Annex 1).



Electronics exports expand.

a) *Electronics*. Shipments of electronics products (including electronic equipment and parts) grew in the third quarter of the year to reach US$7.329 billion, up by 3.5 percent from last year's level of US$7.084 billion. The third quarter's expansion was attributed largely to increased exports of other digital monolithic (137.8 percent) electrical machineries and equipment (55.0 percent) and input/output peripherals units (15.6 percent), which negated the contraction of semiconductor devices exports. These non-semiconductor products were marketed largely to the U.S., Netherlands, China and Japan. Exports of semiconductor devices while less robust, remained the largest component of electronics exports, cornering about 30 percent, and were shipped to China, Malaysia, Singapore and Hong Kong. These favorable developments led to the 2.1 percent growth in electronics shipments for the nine-month period to US$20.596 billion.



Exports of machinery and transport equipment post a marginal decline in the third quarter of the year

b) *Machinery and Transport Equipment.* Exports of machinery and transport equipment declined by 1.9 percent in the third quarter of the year to US$413 million due largely to the drop in demand for transport vessels for passengers and goods. This was a reversal from the 24.2 percent growth posted last year. However, despite the weaker third quarter performance, shipments of this commodity group rose by 12.3 percent in the first three quarters of 2005 to reach US$1.337 billion as shipments of parts and accessories of motor vehicles and gear boxes of motor vehicles continued to post gains. As the industry harnesses its potentials to becoming an automotive hub, government's support to enhance the industry's global competitiveness has been underway. These programs were focused on improving competencies in the following areas which in the long term, will steer the industry in acquiring larger market share in Japan, U.S., the ASEAN and Europe:

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, Executive Order (EO) Nos. 244 and 312 in October 2003 and May 2004, respectively, which grant export credit incentives to participants in the Automotive Export Program from 2004 until 2008 and E.O. No. 313 which allows zero percent duty to BOI-registered export-oriented enterprises on their importation of machinery and equipment, spare parts and accessories are expected to boost the competitiveness of the machinery and transport industry.

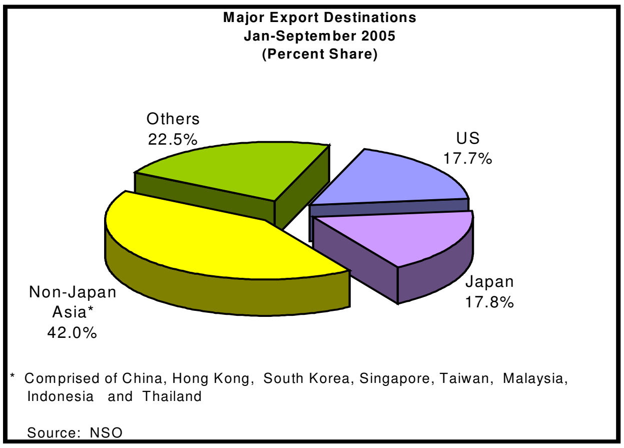
Exports of garments rebound.

c) *Garments*. Garments exports rebounded in the third quarter of 2005 with a 6.1 percent improvement which reached US$673 million from the year-ago level of US$634 million. This was a reversal from the contraction of 2.7 percent in the same period last year. As a result, total export earnings for the first three quarters of 2005 at US$1.713 billion rose by 2.4 percent from last year's level.

Despite the competition posed by other supplier-countries, e.g., China, Mexico, and the start of the quota-free environment in 2005, positive developments highlighted the third quarter performance of garments exporters as a result of the concerted efforts of the government and the private sector to help the industry cope with these challenges. For one, the Industry Transformation Plan which was launched prior to the quota phase-out contained development assistance programs intended to help the garments export industry 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 reduce manufacturing cost and help exporters compete with other low-cost countries.

Intra-Asian trade sustains its growth.

The strengthening of trade with non-Japan Asian countries, with a combined market share of 42.0 percent in the first three quarters of 2005 compared to only 17.3 percent in 1990, has been largely dominated by trade with Mainland China. Exports to China surged by 71.0 percent in 2002, 58.2 percent in 2003 and 23.7 percent in 2004. It remained the most dynamic market for the Philippines posting an annual average growth of about 37.6 percent in the last five years. In the first nine months of 2005, export shipments to China rose by 71.0 percent, in contrast to a growth of only 21.3 percent in 2004. Exports to China represented about 10.2 percent of total exports compared to 6.2 percent share in the same period last year.



Total imports rise due to higher purchases across most major commodity groups.

Imports of goods in the third quarter of 2005 grew by 12.3 percent to US$12.694 billion as all commodity groups except special transactions registered gains over last year's level. Consequently, the total import bill in the first nine months of 2005 amounted to US$35.380 billion or a growth of 6.9 percent (Table 2.2).[2]

Capital goods imports expand in the third quarter.

Imports of capital goods increased by 7.2 percent to US$2.376 billion in the third quarter of 2005, a significant improvement from the 0.8 percent contraction in the same quarter a year ago. Growth was traced to higher procurement of power generating and specialized machines. However, the cumulative nine-month procurement of capital goods posted a contraction of 2.1 percent to US$6.503 billion, owing largely to the decline in purchases of telecommunications equipment as well as office and EDP machines compared to year-ago levels.

Imports of raw materials and intermediate goods likewise rise.

Imports of raw materials and intermediate goods reached US$7.437 billion in the third quarter of 2005, up by 8.6 percent from last year's level. Expansion was due largely to the rise in purchases of the following products: a) materials and accessories for the manufacture of electronics exports; b) semi-processed raw materials such as chemical compounds, artificial resins and medicinal and pharmaceutical chemicals; c) manufactured goods like iron & steel and textile yarn and fabric; and d) embroideries. This led to the 4.0 percent growth in imports of this commodity group to US$21.026 billion for the nine-month period. Expectations of higher investments in the export sector will further boost raw material requirements for export production in the coming months.

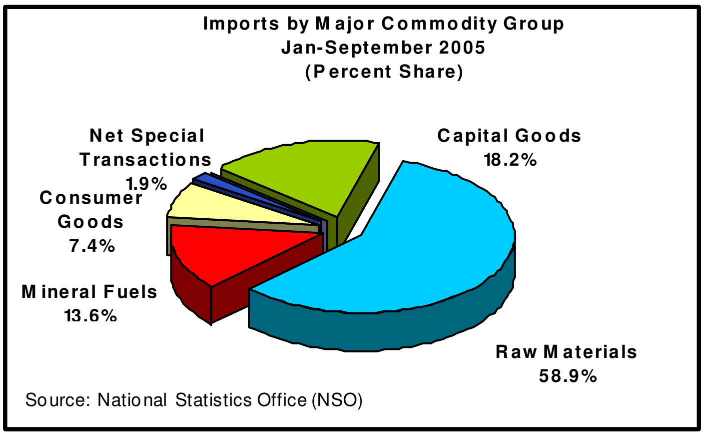
[2] Based on BPM5 concept.

Procurement of durable and non-durable consumer goods increases.

Imports of consumer goods reached US$884 million in the third 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 nine months of 2005 to rise by nearly 20 percent to US$2.646 billion. This cumulative expansion was traced largely to higher purchases of rice (104.8 percent) in the early part of the 2005 to cushion the expected supply deficiency arising from the impact of the El Niño phenomenon in the second quarter of 2005, and passenger cars and motorized cycles (27.9 percent).

Imports of mineral fuels and lubricants, particularly petroleum crude post a hefty growth amid the rise in global prices of oil.

The substant
al increase in imports of mineral fuels and lubricants in the third quarter of 2005 at US$ 1.836 billion was triggered by the continuing hike in world oil prices. The 54.0 percent increase was attributed mainly to the combined effects of the increase in the average price and volume of petroleum crude imports. In particular, imports of petroleum crude rose by 96.7 percent to US$1.202 billion as the average price climbed to US$55.04 per barrel from US$38.89 per barrel while volume also increased to 21.84 million barrels from 15.71 million barrels during the quarter in review. These developments led to the 40.9 percent increment in imports of mineral fuels and lubricants in the nine months of the year to US$4.855 billion.



▪ Trade-in-Services

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

The trade-in-services account during the third quarter of 2005 posted a lower deficit of US$255 million owing largely to higher net inflows of travel, communication, construction, and computer and information services as well as passenger transportation services, coupled with lower net outlays for transportation, other business services, royalties and fees, and financial services. Net receipts from travel improved by 35.7 percent to US$209 million while that from communication services reached US$114 million or a growth of 31.0 percent. These positive developments translated to a 24.5 percent improvement in trade-in-services during the first nine months of the year as the deficit narrowed to US$984 million from US$1.303 billion a year ago. The improvement for the nine-month period was traced to the lower deficits in transportation services and other business as well as receipts from travel, construction and computer and information services. Travel receipts for the first three quarters rose by 25.0 percent, an indication that the Department of Tourism's intensified market-specific campaigns to promote the country's tourism industry, particularly in customizing travel packages to cater to the requirements of foreign visitors continued to gain headway. Visitor arrivals in January-September 2005 rose by 13.1 percent to 1.9 million, with foreign travelers coming largely from the U.S., Korea, Japan, Hong Kong, Taiwan, Australia, Canada, China, U.K., Singapore and Germany.

- **Income**

The income account posts a higher deficit.

The deficit in the income account in the third quarter of 2005 widened to US$262 million from only US$24 million in the same period a year-ago. This was brought about by higher net outflow in both direct and portfolio investment income accounts, arising mainly from higher net outlays of dividends and profits to direct investors coupled with increased interest payments by the general government on its bond and notes issues. The widening of the net outflow in investment income negated the marginal increment in compensation income of resident OFWs, which reached US$731 million during the review quarter due to higher deployment of sea-based workers.[3] These developments contributed to the widening of the net outflow in the net income account to US$377 million in the first three quarters of the year from a net outflow of US$184 million in the same period last year. The 7.1 percent improvement in the compensation income of resident OFWs was not sufficient to offset the 15.0 percent increase in the investment income account deficit during the nine-month period (Table 4).

[3] 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 gross earnings are reflected under the Income Account. Meanwhile, OFWs who are working for one year or more in the host economy are classified as non-resident OFWs and their remittances are reflected under the Current Transfers Account. Gross earnings 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.

▪ Current Transfers

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

Net current transfers in the third quarter of 2005 rose to US$3.081 billion from the year-ago level of US$2.399 billion. The 28.4 percent improvement was attributed mainly to higher workers' remittances which grew by 27.8 percent to reach US$2.803 billion during the quarter in review, coupled with the increase in gifts and donations which are lodged in "other transfers" component. This brought net receipts from current transfers in the first nine months of 2005 to US$8.631 billion. The 25.5 percent expansion during the nine-month period compared favorably with the 8.5 percent improvement in the same period last year. Workers' remittances amounted to US$7.908 billion in the first nine months of 2005. These represented inflows from higher-paid land-based overseas Filipino workers (e.g., professionals, medical-and-health-related personnel, service workers) whose deployment supported the uptrend in the current transfers account. Moreover, the introduction of enhanced modes of money transfer and the establishment of more remittance centers further boosted OFW remittance inflows coursed through formal channels to the country (Table 5).[4]

➢ Capital and Financial Account

The capital and financial account reverses to a surplus as direct and portfolio investment accounts post significant gains.

The capital and financial account in the third quarter of 2005 reversed to a surplus of US$533 million in contrast to the US$671 million deficit posted in the same quarter last year. The reversal resulted from the recovery of the portfolio investment account to post a surplus of US$1.151 billion from an outflow of US$127 million which, combined with the higher direct investment inflows, more than offset the higher outflows in the other investment account. These developments brought the year-to-date capital and financial account balance to a surplus of US$2.249 billion from the US$407 million deficit posted in the same period a year-ago.

▪ Capital Account

The capital account reverses

The capital account balance reversed to a surplus of US$2 million during the review quarter from the US$6 million deficit

[4] 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.

to a surplus. following the higher receipt of capital transfers from the other sectors, in particular, migrants' transfers (Table 6).[5]

▪ Direct Investment

Direct investment posts higher surplus with higher non-residents' investment.

The direct investment account surplus widened to US$327 million during the review quarter from US$226 million in the same quarter a year-ago. This positive performance resulted from higher non-residents' net investments which grew by 13.0 percent to reach US$347 million, in tandem with the 75.3 percent decline in residents' investments abroad amounting to US$20 million. Despite political concerns during the quarter, positive investor sentiment resulted in higher equity placements by non-residents amounting to US$373 million, the bulk of which came from the U.S., Japan, and Germany. Absorbing the stream of inflows during the review quarter were the following sectors: manufacturing (sound and video apparatus, telecommunication, copper smelting), retail/merchandising and other services (call centers, internet access, email account, chat).

As a result, direct investment during the nine-month period rebounded to post a surplus of US$756 million from a deficit of US$39 million on the combined effects of higher non-residents' equity investment and lower equity placements by residents abroad.

▪ Portfolio Investments

Portfolio investment flows remain strong amid domestic concerns.

The portfolio investment account recorded a surplus of US$1.151 billion in the third quarter of the year, a reversal from the US$127 million deficit posted in the same quarter of 2004. The turnaround was on account of the: a) withdrawal by resident banks of their placements in debt securities abroad amounting to US$1.137 billion; b) non-residents' increased placements in equity securities of US$803 million; and c) non-residents' subscription to the bond and note issuances by the national government and a government corporation. However, partly offsetting the impact of these inflows were: a) net purchase by residents of foreign-issued Philippine debt papers; and b) bond repayments by both the national government and private entities.

[5] 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.

The following positive developments renewed investor confidence and provided impetus to the strength in portfolio investments: a) favorable third quarter corporate earnings results; b) decelerating inflation rates; c) fiscal surplus in August; d) continued export growth; and e) double-digit growth in OFW remittances.

The market's upbeat mood resulted in net portfolio investment inflows of US$3.178 billion during the nine-month period, a turnaround from the US$902 million net outflow recorded a year-ago.

- **Financial Derivatives**

Financial derivatives balance reverses to a surplus.

Financial derivatives reversed to a surplus of US$18 million during the third quarter from a deficit of US$17 million in the same period a year ago as settlement by residents of forward and swap transactions entered into with non-residents resulted in more gains than losses.

- **Other Investments**

The other investment account deficit widens mainly due to higher residents' investments abroad.

The other investment account deficit in the third quarter widened to US$965 million from US$747 million in the same quarter in 2004. Accounting for the higher deficit were the following: 1) lower loan availments of the National Government and private entities;[6] 2) withdrawal by non-residents of their deposits with domestic commercial banks; and 3) increased currency and deposits placement abroad by private entities (e.g. temporary placements by build-operate-transfer (BOT) companies of their idle project funds in their trust accounts abroad). Thus, the year-to-date other investment account balance was a deficit of US$1.679 billion from a surplus of US$567 million in the same period in 2004 (Table 10).

➢ Reserve Assets

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

Gross international reserves remain adequate to cover liquidity requirements.

The BSP's gross international reserves (GIR), including reserve position in the IMF, reached US$18.542 billion as of end-September 2005 (Table 12). This was 14.3 percent higher compared to the end-December 2004 level of US$16.228 billion. At this level, reserves remained comfortable and are equivalent to 4.1 months' worth of imports of goods and payment of services and income (MIGSI). In terms of debt coverage, the reserve level was 3.1 times the amount of the country's short-term external liabilities based on original maturity and 1.8 times based on residual maturity.[7]

A large part of the reserves was in the form of foreign investments (83.0 percent), with the balance in gold (13.8 percent), foreign exchange (2.5 percent) and combined SDRs and reserve position in the Fund (0.7 percent). By currency composition, reserves (excluding gold) were in US dollars (81.7 percent), in Euros (9.3 percent), in Japanese yen (4.5 percent), in pound sterling (2.5 percent) and the balance of 2.0 percent in other foreign currencies.

➢ Exchange Rate

Positive economic developments boost the peso.

The nominal peso-dollar exchange rate averaged ₱56.04/US$1 in the third quarter of 2005, marginally depreciating by 0.07 percent from last year's level of ₱56.00/US$1. For the period January-September 2005, however, the average nominal peso-dollar exchange rate appreciated by 1.3 percent to ₱55.24/US$1 from ₱55.96/US$1. The strength of OFW remittances coupled with inflows of foreign direct and portfolio investments provided foreign exchange liquidity that helped shore up the peso in the first three quarters of 2005.

Peso shows less volatility.

The peso was less volatile in the third quarter of 2005 as its standard deviation at ₱0.18 was lower than the year-ago deviation of ₱0.20. However, the peso was more volatile in the first nine months of the year at ₱0.76 compared to the previous year's ₱0.28. The peso-dollar exchange rate ranged from ₱53.91/US$1 to ₱56.34/US$1 during the nine-month period.

Peso external competitiveness

Compared with the previous year's level, the peso's average nominal effective exchange rate (NEER) index in the third

[7] 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.

weakens. quarter of 2005 appreciated by 0.34 percent against the currency basket of the country's major trading partners.[8] Relative to currency baskets of the broad and narrow groups of competitor countries, the peso's average NEER also appreciated by 0.11 percent and 5.41 percent, respectively.[9] Consequently, in terms of the real effective exchange rate (REER) index,[10] the peso lost external price competitiveness as the REER appreciated by 5.09 percent against the currency basket of the country's major trading partners, by 3.07 percent against the currencies in the broad basket, and by 4.16 percent against the currencies in the narrow basket. This reflected 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	**11.62**	**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**	**149.92**
	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**	**99.12**	**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	100.31	144.94
	Feb	11.68	27.59	56.06	57.00	100.09	147.07
	Mar	11.71	27.77	56.96	57.02	101.65	148.71
	Qtr 1	**11.60**	**27.52**	**56.06**	**56.58**	**100.35**	**146.91**
	Apr	11.81	28.09	57.90	57.48	101.64	149.46
	May	11.90	28.02	57.77	58.15	102.36	152.56
	Jun	11.90	27.88	57.71	58.60	103.30 E/	153.81 E/
	Qtr 2	**11.87**	**28.00**	**57.79**	**58.08**	**102.43**	**151.94**

[8] 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.
[9] 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
[10] The REER index is derived from the NEER index by adjusting for inflation differentials.

	Jul	11.85	27.87	57.73	58.61	104.12 E/	154.34 E/
	Aug	11.76	27.89	58.11	58.29 E/	104.43 E/	156.19 E/
	Sep	11.73	28.18	58.92	58.31 E/	104.92 E/	157.94 E/
	Qtr 3	**11.78**	**27.98**	**58.25**	**58.40**	**104.49**	**156.16**

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.