ISSN 1655-5112

Twelfth

Annual Report
Volume I

2004

Bangko Sentral ng Pilipinas
Manila, Philippines

Bangko Sentral ng Pilipinas

MANILA

OFFICE OF THE GOVERNOR

31 March 2005

HER EXCELLENCY
GLORIA MACAPAGAL-ARROYO
President
Republic of the Philippines
Malacañang, Manila

Dear Madame President:

I have the honor to submit the ***2004 Annual Report of the Bangko Sentral ng Pilipinas*** *(BSP)* pursuant to the provisions of Sections 39 and 40 of Republic Act No. 7653.

The report contains a review of key economic and financial developments in 2004, the major policies and other key measures adopted by the monetary authorities and highlights of the BSP's operations and activities.

Respectfully yours,

RAFAEL B. BUENAVENTURA
Governor

The Governor's Foreword

The Philippines' growth story in 2004 in more ways than one was remarkable.

Not only was such a performance recorded against such odds as political uncertainty surrounding the May 2004 presidential election, the large fiscal overhang and the record-breaking global oil prices, but it also surpassed all macroeconomic expectations. An output expansion of 6.1 percent should be enough to convince the market that business was not as usual in the Philippines anymore.

The upbeat economic activity energized the stock market where the volume of turnover more than tripled and the value of trading rose by more than 40 percent. Investments in equities rallied in the fourth quarter spurred by reports of strong third quarter corporate earnings and the decision of the Supreme Court to uphold the Mining Act and open mineral exploration to foreign investments. No doubt investor confidence was revived and this was supported by the increase in foreign direct investments. Also contributing to investor confidence was the narrowing of the fiscal deficit and the passage of the Excise Tax Act on alcohol, cigarettes and tobacco.

The banking system was also a beneficiary of the gathering growth momentum. Its resources climbed and asset quality gradually improved. Asset disposal involving sale of non-performing assets to individuals and special purpose vehicles picked up in the last quarter of the year.

Monetary policy carried out its mandate of promoting price stability consistent with the trajectory of growth. The BSP maintained its monetary policy for the most part of 2004 except in the early part of the year when the volatile foreign exchange market warranted a monetary policy action through an increase in liquidity reserve. The price of inaction in that front would have been a creep in inflation.

To ensure a robust channel of monetary policy, the BSP further strengthened the banking system. During the year, reform initiatives of the BSP prioritized cleaning up banks' balance sheets and addressing fundamental weaknesses in managing credit risks. Prudential regulatory standards were likewise upgraded to align them with international standards. Measures were also implemented to promote the development of the domestic capital market as an alternative source of financing.

The BSP also covered another important pillar by making significant advances in further improving its payments infrastructure with the implementation of the Delivery-versus-Payment (DvP) system for transactions on secondary trading of government securities. The new system is expected to help eliminate the settlement risk inherent to financial transactions, enhance market liquidity, and spur the development of the financial sector.

Looking ahead, the BSP will continue to adopt the policy mix that will sustain an inflation environment conducive to the strong growth of the economy in 2005. The BSP shall continue to keep a close watch on inflationary risks and shall rely on non-monetary policy measures to address supply side-risks to inflation while emphasizing its readiness to take appropriate monetary actions to mitigate demand-side risks.

As 2005 unfolds, the BSP commits to continue the reform process in the financial system that has taken roots, raised business confidence, improved productivity and enhance the country's competitiveness with greater vigor. Banking reforms will focus on restructuring and reforming the financial system by ensuring the passage of key legislative measures to further enhance existing legal and regulatory frameworks that govern the system. These reforms will focus on creating a deep and efficiently functioning domestic capital market through the establishment of basic market infrastructures and an enabling environment that will promote increased business activity. In the external front, the BSP will rally behind endeavors that would support export development and growth, expand the country's share in the market and increase its global competitiveness. It will also continue to keep an eagle's eye on external debt sustainability.

All up, the remaining challenge for the BSP is to further intensify capacity building to strengthen its ability to anticipate and deal with both external and domestic shocks. Therein lies the value added of a strong, independent central monetary authority in the greater macroeconomic system.

RAFAEL B. BUENAVENTURA
Governor

31 March 2005

CONTENTS

The Governor's Foreword

Part One: Introduction

About the BSP
Monetary Board
Management Team

Part Two: The Philippine Economy

Domestic Economy	1
Aggregate Output and Demand	2
Labor, Employment and Wages	4
Prices	4
Box Article 1: The Role of Supply Shocks in Philippine Inflation Dynamics	7
Box Article 2: Consumer Debt and the Transmission Mechanism of Monetary Policy	12
Operations of the National Government	16
Monetary and Financial Conditions	17
Monetary Conditions	17
Monetary Aggregates	17
Interest Rate	18
Exchange Rate	22
Financial Conditions	26
The Banking Sector	27
Stock Market Developments	34
Debt Securities Market Developments	36
Box Article 3: Issues Facing the Philippine Bond Market	38
External Sector	42
Balance of Payments	42
International Reserves	46
External Debt	47

Part Three: The Bank's Operations

Monetary Stability	50
Financial Stability	52
Box Article 4: Financial Soundness Indicators—Tools for Ensuring Financial Stability	57
Payment and Settlement System	59
The Bank's Other Key Operations	60
Loans and Credit	60
Asset Management	62
Reserves Management	62
International Operations	63
Notes and Securities Printing	64
Currency Issuance and Retirement	64
Mint and Refinery	64
Economic Research, Statistical, and Information Dissemination Activities	65
Supervisory Policy Development and Banking Statistical Activities	68
Branch Operations	69
Advocacy Programs (Microfinance, Economic Information, and Financial Literacy)	70
Institutional Development (Corporate Planning, Human Resource management, Conferences, Seminars and Workshops, and Information Technology)	72
International Economic Cooperation	76

Part Four: Financial Condition of the BSP

Financial Condition	84
Results of Operations	85

About the BSP

"The Congress shall establish an independent central monetary authority… (which) shall provide policy direction in the areas of money, banking and credit. It shall have supervision over the operations of banks and exercise such regulatory powers as may be provided by law over the operations of finance companies and other institutions performing similar functions."

Section 20, Article XII, 1987 Philippine Constitution

"The State shall maintain a central monetary authority that shall function and operate as an independent and accountable body corporate in the discharge of its mandated responsibilities concerning money, banking and credit. In line with this policy, and considering its unique functions and responsibilities, the central monetary authority established under this Act, while being a government-owned corporation, shall enjoy fiscal and administrative autonomy.

Section 1, Article 1, Chapter 1
Republic Act No. 7653 (The New Central Bank Act)

The BSP's Legal Mandate

The Bangko Sentral ng Pilipinas (BSP) is the central bank of the Republic of the Philippines. It was established on 3 July 1993 as the country's independent central monetary authority, pursuant to the Constitution and the New Central Bank Act. The BSP replaced the old Central Bank of the Philippines, which was established on 3 January 1949, as the country's central monetary authority.

A government corporation with fiscal and administrative autonomy, the BSP is responsible, among other things, for:

- Maintaining price stability conducive to a balanced and sustainable growth of the economy;
- Formulating and implementing policy in the areas of money, banking and credit; and
- Supervising and regulating banks and quasi-banks, including their subsidiaries and affiliates engaged in allied activities.

Powers and Functions

The BSP's Charter also provides that, as the country's central monetary authority, the Bangko Sentral performs the following functions:

- *Liquidity management*. The BSP formulates and implements monetary policy aimed at influencing money supply consistent with its primary objective to maintain price stability.

- *Currency issue.* The BSP has the exclusive power to issue the national currency. All notes and coins issued by the BSP are fully guaranteed by the Government and are considered legal tender for all private and public debts.

- *Lender of last resort.* The BSP extends discounts, loans and advances to banking institutions for liquidity purposes.

- *Financial supervision.* The BSP supervises banks and exercises regulatory powers over non-bank institutions performing quasi-banking functions.

- *Management of foreign currency reserves*. The BSP seeks to maintain sufficient international reserves to meet any foreseeable net demands for foreign currencies in order to preserve the international stability and convertibility of the Philippine peso.

- *Determination of exchange rate policy.* The BSP determines the exchange rate policy of the Philippines. It adheres to a market-oriented foreign exchange rate policy such that the role of Bangko Sentral is principally to ensure orderly conditions in the market.

- *Other activities.* The BSP functions as the banker, financial advisor and official depository of the Government, its political subdivisions and instrumentalities and Government owned and controlled corporations.

The New Central Bank Act imposes limitations and other conditions on the exercise of such powers by the BSP. Among others, it limits the circumstances in which the BSP may extend credit to the Government and prohibits it from engaging in development banking or financing.

Our Vision

The BSP, imbued with the values of integrity, excellence and patriotism, aims to be a world-class monetary authority and a catalyst for a globally competitive economy and financial system that delivers a high quality of life for all Filipinos.

Our Mission

The BSP is committed to promote and maintain price stability and provide pro-active leadership in bringing about a strong financial system conducive to a balanced and sustainable growth of the economy. Towards this end, it shall conduct sound monetary policy and effective supervision over financial institutions under its jurisdiction.

The Monetary Board

Rafael B. Buenaventura
Chairman and Governor

Juanita D. Amatong*
Member

Juan Quintos, Jr.
Member

Antonino L. Alindogan, Jr.
Member

Melito S. Salazar, Jr.
Member

Fe B. Barin**
Member

Vicente B. Valdepeñas, Jr.
Member

* Monetary Board Member (MBM) until 15 February 2005 upon her retirement from the Department of Finance. She was replaced by Secretary Cesar V. Purisima who was appointed MBM on 21 February 2005.
** Appointed MBM on 25 September 2002. She was replaced by Mr. Raul A. Boncan, who was appointed MBM on 16 November 2004.

The Management Team

Executive Management Sector

Rafael B. Buenaventura
Governor

Juan J. de Zuñiga
Assistant Governor - General Counsel

Vicente S. Aquino
Executive Director II

Teresita O. Hatta
Assistant Governor

Monetary Stability Sector

Amando M. Tetangco, Jr.
Deputy Governor

Diwa C. Guinigundo
Assistant Governor

Rene N. Carreon
Managing Director

Supervision and Examination Sector

Alberto V. Reyes
Deputy Governor

Nestor A. Espenilla, Jr.
Assistant Governor

Ma. Dolores B. Yuvienco
Managing Director

Ricardo P. Lirio
Managing Director

Resource Management Sector

Armando L. Suratos
Deputy Governor

Evelyna C. Avila
Managing Director

Orlando T. Cabanlig
Managing Director

Security Plant Complex

Armando L. Suratos
Concurrent Head

Nestor B. Salanio
Officer-In-Charge

LIST OF ACRONYMS, ABBREVIATIONS AND SYMBOLS

ABF	Asian Bond Fund
ABMI	Asian Bond Market Initiative
ABW	Asian Bonds Online Website
ACC	Asian Consultative Council
ADB	Asian Development Bank
ADFM	ASEAN Finance and Central Bank Deputies Meeting
AFAS	ASEAN Framework Agreement on Services
ALF	Agricultural Loan Fund
AMCs	Asset Management Companies
AMLC	Anti-Money Laundering Council
APEC	Asia Pacific Economic Cooperation
APG	Asia-Pacific Group
ASA	ASEAN Swap Arrangement
ASD	Administrative and Services Department
ASEAN	Association of Southeast Asian Nations
ASR	ASEAN Surveillance Report
BAP	Bankers Association of the Philippines
BES	Business Expectations Survey
BIR	Bureau of Internal Revenue
BIS	Bank for International Settlements
BLES	Bureau of Labor and Employment Statistics
BMBE	Barangay Micro Business Enterprise
BOC	Bureau of Customs
BOJ	Bank of Japan
BOP	Balance of Payments
BOT	Build-Operate-Transfer
BPM5	Fifth Edition of the BOP Manual
BPR	Bank Performance Report
BSA	Bilateral Swap Arrangement
BSP	Bangko Sentral ng Pilipinas
BSPD	Banknotes and Securities Printing Department
BSP-SPC	Bangko Sentral ng Pilipinas Strategic Planning Conference
BTr	Bureau of the Treasury
BTRCP	Bureau of Trade Regulation and Consumer Protection
CalPERS	California Public Employees' Retirement System
CAR	Capital Adequacy Ratio
CAS	Central Accounting System
CCBS	Center for Central Banking Studies
CCE	Coordinated Compilation Exercise
CCR	Credit Card Receivable
CDRP	Committee on the Disposal of Real Properties
CES	Consumer Expectations Survey
CFA	Chartered Financial Analyst
CISA	Certified Information System Auditor

CLDs	Credit-Linked Deposits
CLLs	Credit-Linked Loans
CLNs	Credit-Linked Notes
CMI	Chiang Mai Initiative
COE	Certificate of Eligibility
CORAO	Corporate Affairs Office
CPI	Consumer Price Index
CPO	Corporate Planning Office
CRIS	Credit Information System
CSCS	Cross-Sector Consolidated Supervision
CTF	Common Trust Fund
CTRM	Committee on Tariff and Related Matters
CVCS	Currency Verification, Counting and Sorting
DA	Department of Agriculture
DBCC	Development Budget Coordinating Committee
DDA	Demand Deposit Account
DECS	Department of Education, Culture and Sports
DER	Department of Economic Research
DILG	Department of Interior and Local Government
DLPN	Dollar-Linked Peso Notes
DOH	Department of Health
DOJ	Department of Justice
DOSRI	Director, Officer, Stockholder and Related Interests
DTI	Department of Trade and Industry
DvP	Delivery versus Payment
EDB	Electronic Data Base
EDPC	Electronic Data Processing Center
EDYRF	Exporters' Dollar and Yen Rediscount Facility
EFTIS	Electronic Funds Transfer Instruction System
EMEAP	Executives' Meeting of East Asia and the Pacific (Central Banks)
ERB	Energy Regulatory Board
EWS	Early Warning System
FATF	Financial Action Task Force
FCDs	Foreign Currency Deposits
FCDUs	Foreign Currency Deposit Units
FDI	Foreign Direct Investment
FOMC	Federal Open Market Committee
FSI	Financial Soundness Indicator
GBL	General Banking Law of 2000
GDP	Gross Domestic Product
GIR	Gross International Reserves
GNP	Gross National Product
GS	Government Securities
HLURB	Housing and Land Use Regulatory Board
HRMD	Human Resource Management Department
IAC-TCS	Inter-agency Committee on Trade in Services
IAC-TIA	Inter-agency Committee on Trade and Investment Agreements
IAP	Individual Action Plan

IC	Insurance Commission
IMF	International Monetary Fund
IRIS	Integrated Regional Information System
IRO	Investor Relations Office
IT	Information Technology
JPEPA	Japan-Philippine Economic Partnership Agreement
KBs	Commercial Banks
LCs	Letters of Credit
LFS	Labor Force Survey
LIBOR	London Interbank Offered Rate
LTO	Land Transportation Office
M3	Domestic Liquidity
MART	Money Market Association of the Philippines
MBMs	Monetary Board Members
MER	Mutual Evaluation Report
MERALCO	Manila Electric Company
MLT	Medium- and Long-Term
MPI	Macroprudential Indicator
MOU	Memorandum of Understanding
MROD	Mint and Refinery Operations Department
MTP	Major Trading Partner
MWSS	Manila Water Sewerage System
NBFIs	Non-Bank Financial Institutions
NBQBs	Non-Bank with Quasi-Banking Functions
NDC	Net Domestic Credits
NCR	National Capital Region
NEER	Nominal Effective Exchange Rate
NFA	Net Foreign Assets
NG	National Government
NIR	Net International Reserves
NLEX	North Luzon Expressway
NPAs	Non-Performing Assets
NPC	National Power Corporation
NPLs	Non-Performing Loans
NRI	Nomura Research Institute
NSCB	National Statistical Coordination Board
NSO	National Statistics Office
NTC	National Telecommunications Commission
OBUs	Offshore Banking Units
OFWs	Overseas Filipino Workers
OMOs	Open Market Operations
OSPD	Office of the Supervisory Policy Development
PCAAC	Philippine Council on ASEAN and APEC Cooperation
PDIC	Philippine Deposit Insurance Corporation
PDS	Philippine Dealing System
PFO	Provident Fund Office
PhilPASS	Philippine Payment and Settlement System
PHISIX	Philippine Composite Stock Index

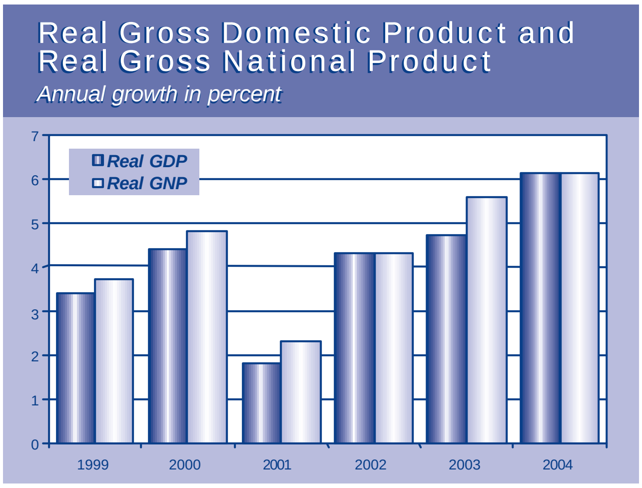
PIC	Public Information Campaign
PO	Procurement Office
PPM	Post-Program Monitoring
PRAISE	Program, Awards and Incentives for Service Excellence
PSE	Philippine Stock Exchange
R.A.	Republic Act
RB	Rural Bank
REER	Real Effective Exchange Rate
RGIs	Record of Goods Imported
RIA	Roadmap for Integration of ASEAN
RICA	Revised Investment Company Act
RMS	Risk Management System
ROA	Return on Assets
ROE	Return on Equity
ROPOA	Real and Other Properties Owned and Acquired
ROSC	Report on the Observance of Standards and Codes
ROSS	Registry of Scripless Securities
RP	Repurchase
RRP	Reverse Repurchase
RTGS	Real-Time Gross Settlements
SAP	System Application and Products
SDC	Supervisory Data Center
SDDS	Special Data Dissemination Standard
SEACEN	South East Asian Central Banks
SEANZA	South East Asia, New Zealand and Australia
SEC	Securities and Exchange Commission
SEM	Security Engineer Machine
SMEs	Small and Medium Enterprises
SPC	Security Plant Complex
SPV	Special Purpose Vehicle
SPEI	Selected Philippine Economic Indicators
SRSO	Supervisory Research and Studies Office
TA	Technical Assistance
TB	Thrift Bank
T-bills	Treasury Bills
TLP	Total Loan Portfolio
UITF	Unit Investment Trust Fund
UN	United Nations
VAP	Vientiane Action Plan
VAT	Value-Added Tax
WB	World Bank
WG/FM	Working Group on Financial Markets
WTO	World Trade Organization

PART TWO: THE PHILIPPINE ECONOMY

Domestic Economy

Philippine economy records strongest growth since 1996

The Philippine economy expanded by 6.1 percent in 2004 driven mainly by the strong performance of the services sector, on the production side, and brisk consumer spending and exports, on the demand side. This GDP growth figure was the strongest recorded since the peak growth of 5.8 percent in 1996 and even exceeded market expectations as well as the government's target of 4.9-5.8 percent. The expansion in 2004 was achieved amid negative pressures that loomed over the economy during the period—the political uncertainty linked to the national elections in May, the government's sizeable fiscal deficit, the rise in international oil prices, and the devastating typhoons that hit the country during the latter part of 2004.



The economic growth generated a 3.2 percent increase in employment mainly from the services sector. However, unemployment remained high as the employment gain did not match the faster growth in the labor force, resulting in an unemployment rate of 11.8 percent. On the supply-side, factors such as the worldwide rise in oil prices as well as domestic supply constraints raised the cost of production, pushing the inflation rate above the 5 percent target for the year to 5.5 percent. The uptrend in prices was reflected particularly in food, fuel, transport and other energy-related goods and services.

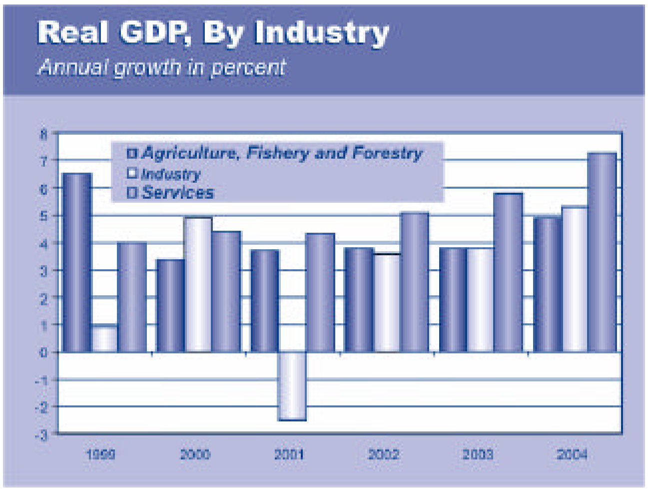
On the part of government, sustained vigilance in revenue collection efforts coupled with higher revenues buoyed by economic growth enabled the National Government (NG) to outperform its fiscal deficit target of 4.2 percent to an improved fiscal deficit to GDP ratio of 3.8 percent.

Aggregate Output and Demand

Services sector propels growth

Services, industry and agriculture surpass their 2003 growth rates

The three major sectors of production—services, industry and agriculture—fueled the expansion of the domestic economy as all of them surpassed their growth rates in 2003. Meanwhile, increased private consumer spending as well as brisk activity in exports and investments continued to drive economic growth on the demand side.



Transportation, communication and storage propels growth of services sector

Supply side growth continued to be led by the service sector which contributed 3.4 percentage points to the 6.1 percent GDP expansion (Table 1). Transportation, communication and storage led the services growth owing to the continued enhancements in and demand for mobile communication services. Likewise, trade services expanded due to the brisk consumer sales of pharmaceutical products, petroleum and passenger motor vehicles. Finance services also contributed to the growth following the increase in trading gains from investments in government securities.

Manufacturing remains as the principal driver of growth in industry

The second biggest source of economic growth was the industry sector which grew by 5.3 percent and churned a 1.8 percentage point contribution to GDP growth. Manufacturing remained the major driver of growth for the sector, boosted mainly by the increases in food manufactures, electrical machinery, beverage and furniture and fixtures. Construction likewise, showed a marked recovery from the previous year's decline. The construction sector benefited from the recovery of the real estate industry particularly for middle housing projects as well as the completion of infrastructure projects such as the North Luzon Expressway (NLEX).

The combined agriculture, fishery and forestry representing 20 percent of total GDP output contributed one percentage point to economic growth. This sector made considerable inroads from technical programs involving the distribution of hybrid and certified seeds, dispersal of fish and fingerlings and the introduction of new techniques for seaweed cultivation.

Private consumer spending leads growth on the demand side

On the demand or expenditure side of the economy's balance sheet, growth was largely driven by private consumer spending (Table 1a). Improved farm production and hiked remittances of the country's overseas Filipino workers (OFWs) boosted consumer and investment spending. Election-related activities likewise spurred consumer spending during the first half of the year. The continued adoption of a neutral monetary policy stance helped keep real interest rates stable thus, encouraging investments, particularly in construction and real estate.

Exports records hefty growth due to solid expansion of the global economy

Strong export performance was also a major force behind the demand-side growth. The solid expansion of the global economy in 2004—driven by the robust business spending in the US, recovery in Japan, and the rapid growth of fixed investments in China—was a welcome opportunity for Philippine exports. As a result, total exports of goods and non-factor services recorded a hefty 14 percent growth in 2004 with both merchandise and services exports registering double-digit growth rates during the year. The top five contributors to the growth of merchandise exports were semiconductors, finished electrical machinery, bars and rods of copper, transmission apparatus and centrifugal sugar.

Labor, Employment and Wages

Unemployment rate increases

Unemployment rises

Employment conditions improved in 2004 as the economy grew beyond target. The number of employed workers rose by 3.2 percent equivalent to 976,000 new jobs generated, almost double the increase posted in 2003 (Table 2). However, new entrants in the labor force led to the increase in the number of unemployed. Consequently, the unemployment rate rose to 11.8 percent in 2004 as the growth in jobs was likewise affected by the impact of higher oil prices on the economy and weak demand for additional labor following the upward adjustment in minimum wages since August 2004.

Prices

Inflation trends upward

The year 2004 generally saw rising prices for key goods and services, particularly food, fuel, and transport. The average inflation for 2004 based on the 1994 Consumer Price Index (CPI) series was 5.5 percent, higher than the 3.0 percent inflation recorded in the previous year (Table 3) and the Government-announced target of 4-5 percent. Likewise, the 2000-based headline inflation tracked a similar rising pattern.[1] Inflation averaged 6.0 percent in 2004 using the 2000 CPI series, up from just 3.5 percent in 2003.

Rise in oil prices, spate of typhoons and domestic supply constraints raise inflation

The uptrend in inflation in 2004 was attributed mainly to a series of supply-side shocks. These included the worldwide rise in oil prices, which translated into higher cost of transport services and other goods, and the spate of typhoons and domestic supply constraints that affected the availability of certain food products. On the other hand, demand-side pressures on prices were kept largely at bay despite robust consumption spending and increased merchandise trade. Price pressures coming from the demand side remained limited as improvements in the domestic economy occurred amid relatively high unemployment as well as moderate lending and investment activities.

---

[1] The new 2000-based CPI series was derived from an updated basket of goods and services that captures the current spending patterns and preferences of Filipino consumers. Food, beverage and tobacco account for only 50 percent of the CPI basket under the 2000-based series vis-à-vis 55 percent in the 1994-based series.

Inflation for food, beverage and tobacco accelerated to 5.6 percent (1994=100) in 2004 from 2.0 percent in 2003. Price increases were recorded for most major food items, particularly corn, fish and meat. The price of corn increased in 2004 following the lower corn production in the second semester of 2003 due to adverse weather conditions. The higher prices of corn in the international market also exerted upward pressure on local corn prices. Meanwhile, the higher meat and fish prices could be traced, in part, to the higher cost of feedstuffs. In addition, the higher meat and fish prices were also linked to the recurrence of the avian flu virus in other Asian countries, which led to increased demand for pork and fish among local consumers in lieu of poultry.

Non-food items such as fuel and services allied to transport and communication edge higher

Similarly, the average non-food inflation edged higher to 5.4 percent (1994=100) in 2004 from 4.1 percent a year ago as indices for all major non-food items rose. Fuel and services allied to transport and communication posted double-digit inflation rates of 12.3 percent and 13.3 percent, respectively. These developments were due mainly to the rise in world oil prices which led to increases in domestic pump prices of oil as well as corresponding adjustments in transport fares and utility charges.

On a regional basis, the 2004 average headline inflation for Metro Manila and areas outside Metro Manila both settled at 5.5 percent (1994=100). These were higher than the 2003 average inflation rates of 3.8 percent in Metro Manila and the 2.7 percent in areas outside Metro Manila.

Meanwhile, core inflation suggested moderately broadening pressures on consumer prices. The National Statistics Office (NSO) reported rising core inflation rates in 2004 for both 1994 and 2000 series.[2] The 1994-based core inflation rose to 5.5 percent in 2004 from 3.0 percent a year ago. Meanwhile the 2000-based core inflation inched up to 5.7 percent during the year from 3.4 percent in 2003.

[2] Core inflation is defined as headline inflation after excluding certain food and energy items.

Core Inflation Measures Year-on-Year Change				
	1994=100		2000=100	
	2004	2003	2004	2003
Official Measure[1/]	5.5	3.0	5.7	3.4
Trimmed Mean[2/]	4.4	3.6	5.0	3.2
Weighted Median[3/]	3.8	3.2	4.1	3.2
Net of Volatile Items[4/]	4.8	3.6	4.5	2.1

[1/] The 1994-based official core inflation definition excludes 20.2 percent of the CPI basket as follows: rice, corn, fruits and vegetables and fuel items (gas, LPG, kerosene, oil, gasoline and diesel. The 2000-based official core inflation definition excludes 18.4 percent of the CPI basket as follows: rice, corn, fruits and vegetables and fuel items (gas, LPG, kerosene, oil, gasoline and diesel)

[2/] The trimmed mean represents the average inflation rate of the (weighted) middle 70 percent in a lowest-to-highest ranking of year-on-year inflation rates for all CPI components.

[3/] The weighted median represents the middle inflation rate (corresponding to a cumulative CPI weight of 50 percent) in a lowest-to-highest ranking of year-on-year inflation rates.

[4/] The net of volatile items method excludes the following items: educational services, fruits and vegetables, personal services, rentals, recreational services, rice, and corn.

Alternative measures of core inflation as estimated by the BSP likewise picked up in 2004. The trimmed mean, weighted median and net of volatile items edged higher in 2004 compared to the rates recorded in 2003 as can be seen in the table above.

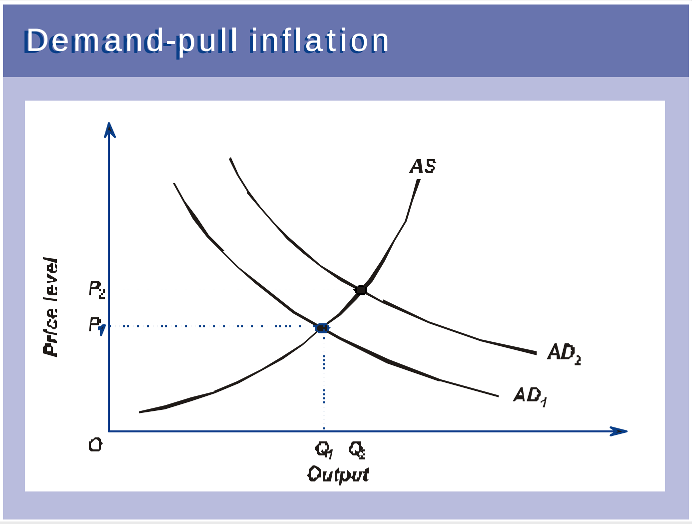
Box Article 1

THE ROLE OF SUPPLY SHOCKS IN PHILIPPINE INFLATION DYNAMICS

Over the past year, the various policy pronouncements and communications of the BSP with the public have emphasized the primary role of supply shocks in the current uptrend in inflation. This article provides a background on supply shocks, their role in Philippine inflation dynamics and their implications for monetary policy.

Anatomy of a shock

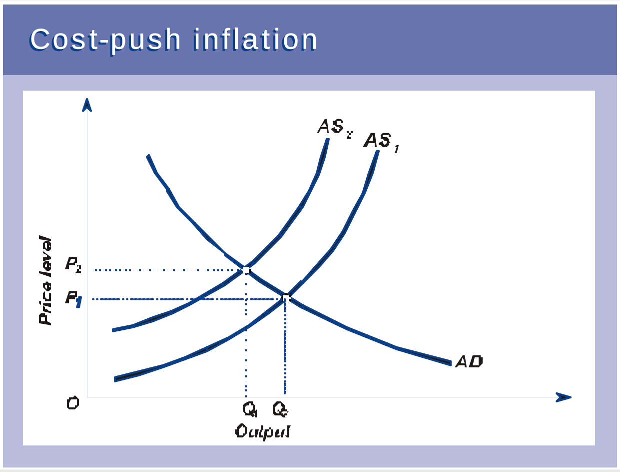
Events or disturbances that cause sharp, unanticipated adjustments in macroeconomic variables are commonly referred to as **shocks**. Shocks that affect the demand for goods and services (i.e., aggregate demand), in general, are called **demand-side shocks**. Some forms of demand-side shocks could lead to a reduction in overall demand such as increases in taxes, which reduces disposable income, or a slowdown in global economic growth, which decreases foreign demand for local products. Graphically, this is represented by a downward shift of the aggregate demand curve. Meanwhile, other forms of demand side shocks can produce a surge in the demand for goods and services thereby leading to **demand-pull inflation.** Such shocks would include a reduction in direct taxation that raises consumers' disposable income; rapid growth of the money supply as a consequence of increased bank and property lending; and rapid economic growth in trading partner countries that boosts Philippine exports overseas. Graphically, this is represented by an upward shift in the aggregate demand curve. The impact of demand-side shocks on inflation becomes more pronounced when the economy is operating at or near full employment such that increases in demand could not be matched by increases in supply.



The aggregate supply (AS) curve shows the total supply of goods and services that firms are able to produce at each and every price level, with the corresponding national output (GDP) level. At low levels of output when there is plenty of spare productive capacity, firms can easily expand output to meet increases in demand.

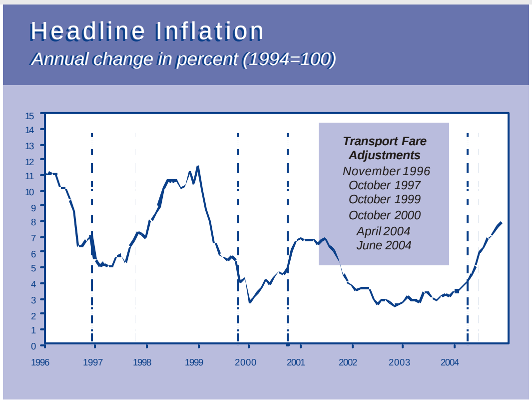
As the economy approaches full employment (or full capacity), labor and raw material shortages mean that it becomes more difficult for firms to expand production to meet rising demand. As a result, the AS curve becomes more inelastic (or more vertical). In such a case, when aggregate demand (AD) increases from AD1 to AD2 as the economy moves toward full capacity, firms are forced to implement increases in prices from P_1 to P_2.

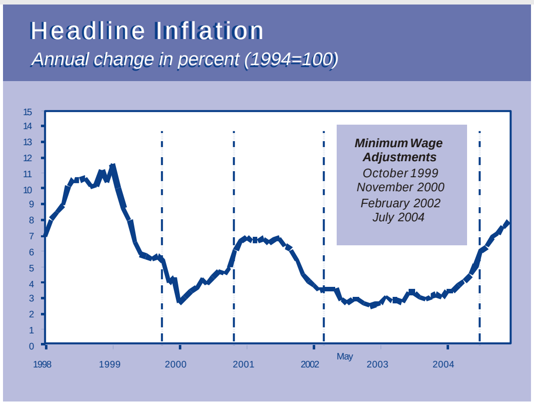
Meanwhile, shocks that cause changes in the cost of inputs are commonly referred to as **supply-side shocks**. Supply-side shocks could either have a positive or negative impact on prices. Shocks that could lead to lower prices, which are commonly referred to as positive supply shocks, include the discovery of new resources (i.e., oil reserves) and the introduction of new technology. Meanwhile, some types of supply-side shocks could also raise inflation. Examples of these are worldwide increases in the price of oil; shortages in food supply due to weather phenomena such as the El Niño or strong typhoons; and sharp nominal exchange rate depreciations that raise the price of imported goods. These shocks result into what is called as **cost-push inflation**. This article focuses on the second type of supply side shock, which is more prevalent in the Philippine economy. From hereon, the discussion on supply side shocks would refer to those that could result into cost-push inflation.



Increases in the cost of production inputs could lead into an upward shift of the AS curve resulting into an increase in the general price from P_1 to P_2. Note that there is also an associated contraction in national output (or GDP) from Q1 to Q2.

The impact of supply shocks on inflation is often considered to be transitory in nature; that is, the resulting price pressures are not self-sustaining and do not have a permanent effect on the long-run path of inflation. This view accords with historical experience, which shows that inflation has a tendency to quickly revert to trend following episodes of supply shocks. The charts below show that a one-time increase in transport fares and a one-time increase in wages result only in short-lived surges in inflation.





However, some shocks can last for several quarters and have secondary effects on prices. For example, if a sustained rise in oil prices leads to increased pump prices, transport and power utility rates, such increases would constitute the **first-round effects** of the shock. As these effects cascade down to other consumer goods and services, the resulting erosion of purchasing power may prompt labor groups to ask for minimum wage increases. If their petitions are granted, the wage increase would constitute a **second-round effect** of the original oil price shock.

It is also possible for supply shocks to create demand-side pressures on inflation. Sustained increases in the cost of production and consumer goods in general may convince consumers and firms to buy now rather than later when prices could rise more sharply. Such expectations could lead to increased demand for goods.

Supply shocks and the uptrend in 2004 inflation

The uptrend in inflation and the subsequent breach of the 2004 inflation target was due largely to supply shocks. These included the worldwide rise in oil prices, which translated into higher cost of transport services and other goods, and the spate of typhoons and domestic supply constraints that affected the availability of certain food products. In 2004, a confluence of global demand and supply factors raised international oil prices to unanticipated levels. Dubai crude oil price increased by US$6.84 per barrel to average US$33.63 in 2004 from US$26.69 in the previous year. The higher cost of imported oil in turn has led to hikes in domestic pump prices which led to adjustments in transport fares and electricity rates. Meanwhile, price increases were also recorded for most major food items, particularly corn, fish and meat. The price of corn increased following the lower corn production in the second semester of 2003 due to adverse weather conditions. The higher prices of corn in the international market also exerted upward pressure on local corn prices. Meanwhile, the higher meat and fish prices could be traced, in part, to the higher cost of feedstuffs. In addition, the higher meat and fish prices were also linked to the recurrence of the avian flu virus in other Asian countries, which led to increased demand for pork and fish among local consumers in lieu of poultry.

On the other hand, demand-side pressures on prices were kept largely at bay despite robust consumption spending and increased merchandise trade. Price pressures coming from the demand side remained limited as improvements in the domestic economy occurred amid relatively high unemployment as well as moderate lending and investment activities.

BSP estimates showed that the contribution of supply shocks to inflation amounted to around 1.5 percentage points (1994=100) in 2004. The total inflation rate for any commodity is the end-result of both supply and demand factors. Thus, to identify the proportion of inflation that could be attributed to supply shocks, the inflation rate of the commodities that were believed to be most affected by the supply shocks was decomposed to account for the individual attribution of demand- and supply-side factors. These commodities—which include fuel, corn fish and meat—were pre-identified based on two considerations: (1) the volatility of their inflation as measured by the year-to-date average inflation and (2) prior evidence which support indications of supply bottlenecks. The BSP's estimates of the contribution of supply shocks to inflation for both the 1994 and 2000 based CPI are shown in the table below.

Percentage Point Contribution of Supply Shocks to Inflation, 2004-2006 estimates as of 15 December 2004

	World Oil Prices[1/]	Food[2/]				Total Contribution
		Corn	Fish	Meat	Total	
Using 1994=100 CPI series						
2004	0.35	0.08	0.29	0.82	1.19	1.53
2005	0.69	0.01	0.03	0.08	0.12	0.81
2006	0.62	0.00	0.00	0.00	0.00	0.62
Using 2000=100 CPI series						
2004	0.21	0.08	0.29	0.82	1.19	1.40
2005	0.42	0.01	0.03	0.08	0.12	0.54
2006	0.38	0.00	0.00	0.00	0.00	0.38

[1/] The contribution of world oil price shock to inflation is based on the estimated increase in inflation resulting from one percent increase in world oil price multiplied by the following corresponding projected increases in Dubai crude oil price from 29 January 2004 to 15 December 2004: 15 percent, 30 percent and 27 percent for 2004, 2005 and 2006, respectively.
[2/] Food items in the CPI basket that exhibited the highest price volatility. Inflation for corn, fish and meat were each decomposed between those arising from demand factors and those due to supply bottlenecks. The contribution of supply shocks to inflation for corn, fish and meat was estimated as the difference between the total CPI inflation for each of these volatile items and the estimated average inflation for non-volatile food items (which is assumed to be attributable to demand). The resulting supply shock-generated inflation for the each of volatile commodities was computed using CPI weights. The succeeding impact of the supply shocks on the annual inflation for 2004-2006 was estimated by applying the supply shock-generated inflation to the CPI levels and computing the difference over the baseline CPI levels (without the supply shocks).

It could therefore be argued that, in the absence of supply shocks, the 2004 inflation would have been lower by about 1.5 percentage points and thus would have been within the targeted range of 4.0-5.0 percent (1994=100).

How do policymakers deal with supply shocks?

Generally speaking, monetary policy seeks to respond to demand-side inflationary pressures rather than supply-side pressures, since the latter are often driven by factors that are outside the control of the central bank. This is because monetary policy affects inflation mainly by influencing the demand for products and services. For example, higher policy interest rates tend to reduce bank lending and investment spending, which is a component of aggregate demand. Changes in policy rates as a rule cannot directly affect the cost of production inputs.

Demand-pull inflation is often thought to be monetary in origin, and results when the money supply grows faster than the ability of the economy to supply goods and services. The phrase often used by economists is that there is "too much money chasing too few goods".

A shock to oil prices presents a special challenge to monetary policy, since it not only generates cost-push inflation but tends to reduce output. Central banks therefore need to ensure a balance between meeting the inflation goal and minimizing the ouput losses associated with oil price shocks.

Typically, inflation-targeting central banks also predefine a set of acceptable circumstances under which they may fail to achieve their inflation target. Such exemptions recognize the fact that there are limits to the effectiveness of monetary policy and that deviations from the inflation target may sometimes result because of factors beyond the control of the central bank. Under the inflation targeting framework of the BSP, these exemptions include price pressures arising from: (a) volatility in the prices of agricultural products; (b) natural calamities or events that affect a major part of the economy; (c) volatility in the prices of oil products and (d) significant government policy changes in the tax structure, incentives and subsidies. To a large extent, the increase in inflation in 2004 above the target can be explained by factors that fall under the BSP's exemption clauses particularly, the uptrend in prices of agricultural products and the volatility in oil prices.

Against these considerations, the BSP opted to keep its monetary policy settings unchanged in 2004 despite the perceived need to tighten policy stance against a backdrop of rising inflation. The predominant influence of supply-side factors in the inflation uptrend in the past year or so as well as the absence of strong evidence of mounting demand-side inflationary pressures supported the authorities' assessment that price pressures would be best addressed through non-monetary means. Thus, the BSP continues to actively support use of non-monetary measures.

Looking forward, the risk of a sustained period of rising oil prices may still lead to economic dislocations in the form of reductions in domestic demand and self-sustaining inflation pressures reinforced by public expectations of persistently high inflation. Monetary action may become necessary when the available evidence begins to point more strongly to inflation pressures that are over and above those generated by ongoing supply shocks, or to emerging demand-side pressures on prices. In addition, the BSP may also resort to the use of monetary measures if there is a risk of prolonged exchange market pressures due to the narrowing of interest rate differentials which could feed into inflation and inflation expectations. The BSP continues to reassure the public that, if necessary, the BSP is prepared to undertake monetary policy action to head off a sustained inflation spiral and thus, ensure a gradual disinflation towards the desired low and stable inflation path.

Box Article 2

Consumer Debt and the Transmission Mechanism of Monetary Policy

Consumer debt and the transmission mechanism

The current general consensus is that the primary objective of monetary policy should be domestic price stability, commonly measured using some variant of the consumer price index. This reflects the results both of research and experience: If growth were stimulated by expansionary policies, the effects on output will be short-lived, while inflation will both rise and become more unpredictable. Thus, central banks in general must accept full responsibility for inflation in the long run and have the tools to achieve price stability. However, the conduct of this responsibility has been made more difficult. Today, it is recognized that the relationship between money growth (which is the traditional instrument of monetary policy) and inflation has weakened, mainly because of financial innovations. There exist "long and variable lags" between policy actions and their economic effects. This underscores the need for proper identification of the transmission channels of monetary policy actions, in order to reduce the uncertainty regarding the strength and timing of the impacts of monetary policy actions.

Several channels by which monetary policy changes impact on the economy have been identified, and these are the credit, exchange rate, interest rate, and expectations channels.[i] The manner in which consumer debt enters into the transmission mechanism would be split up among these various channels, with each channel, in turn, feeding into consumer spending.

Consumer spending habits contribute greatly to the performance of an economy. In contrast to private investment spending which can be volatile and can magnify the fluctuations in the business cycle, consumption spending is often much more robust, and can serve as a buffer against the impact of shocks in the economy. This has been seen in the case of the Philippines, where consumers at times became the engine of growth in the face of sluggish business investment and industrial and manufacturing output.

However, there is need for caution and careful monitoring by policy authorities both of consumer spending and consumer credit in the case when consumer spending is fueled by either rising consumer credit or by the wealth effect of a stock market boom. The danger is that consumer willingness to incur new long-term debt may be primarily driven by interest rates, house prices and employment. A rise in interest rates can impact particularly hard on heavily-indebted consumers. Therefore, the longer the time that a boom has been fueled by consumer spending, to the extent that this has been accompanied by increasing consumer debt, the deeper would be the contractionary impact of an increase in interest rates. Several factors influence households' sensitivity to such interest rate changes:

- The larger the proportion of household mortgage that is on a floating rate basis, the greater the sensitivity of household spending to monetary policy actions. In contrast to the situation in other countries, a significant portion of household mortgages in the Philippines is financed through long-term loans originating from government housing agencies, which are subject to fixed interest rates, can reduce the sensitivity of household debt to changes in market interest rates.

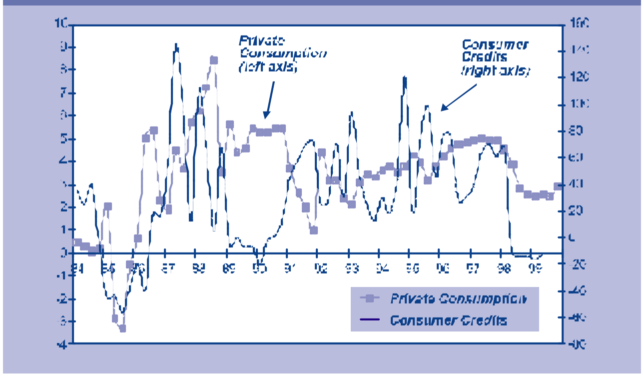
- The size of household debt relative to income can increase the sensitivity of household spending to the rate of interest. While this may strengthen the interest rate channel of the monetary transmission mechanism, it can also likely complicate the stabilization task of policy, by making households vulnerable to other disturbances that impact on the interest rate.

Robust consumption growth in the face of sluggish credit conditions

In the Philippines, consumer spending was a major driver behind the acceleration in economic growth to 6.2 percent in real GDP terms during the first three quarters of 2004. The robust consumption spending came amid generally sluggish credit conditions, as can be seen in the plot below.

Consumption Spending and Consumer Credits

Annual growth in percent, 1984-1999



The slowdown in liquidity growth appears to be at odds with recent evidence of the improving output performance of the economy. Such robust performance of consumption and, on a broader level, of GDP growth, in the face of credit slowdown poses important issues for policy, and therefore needs to be studied more carefully. Indeed, the plot shows that, except for the crisis period in the mid-1980s when both consumer credit and expenditure suffered contractions, consumer expenditure has been stable and has sustained its growth better than consumer credit.

Consumption: income- or credit-driven?

It is possible to test empirically whether consumption is driven by income or by credit and transfers. Following Bacchetta and Gerlach (1997) and using quarterly data for 1981-1999, we apply a more direct test for credit constraints on consumption by explicitly incorporating data on credit conditions into the consumption equation using an instrumental variable (IV) estimation procedure.[ii] We model consumption as a function of income, credit, and the spread between lending rates and the benchmark T-bill rate.[iii] We also include two additional variables: (1) the level of OFW remittances to see whether income transfers affect consumption via consumption smoothing, and (2) the deviation of deseasonalized agricultural output from its trend as a proxy for agricultural income.

The results, shown below, indicate that income variables (disposable income and agricultural income) are significant determinants of changes in consumption spending. This finding is consistent with the evidence from the empirical literature on the “excess sensitivity” of consumption to income. It also suggests that Filipino consumers typically tend to rely more on their own income rather than on borrowing for their consumption needs. At the same time, we also find that the credit variables (changes in consumer credit and the differential between lending rates and the 91-day T-bill rate) are not significant explanatory variables for consumption. (In fact, the lending spread displays the incorrect sign.) Finally, the data also indicate that overseas remittances are not a significant determinant of consumption levels, which is at odds with what conventional wisdom would suggest.

Table 1. Determinants of Consumption Spending				
Dependent Variable: DLOG(PCE)				
Method: Two-Stage Least Squares				
Sample (adjusted): 1984:2 1999:4				
Included observations: 62				
Excluded observations: 1 after adjusting endpoints				
Newey-West HAC Standard Errors & Covariance (lag truncation=3)				
Instrument list: DLOG(DISPOS_INC(-2)) DLOG(DISPOS_INC(-3))				
DLOG(DISPOS_INC(-4)) DLOG(PCE(-2)) DLOG(PCE(-3))				
DLOG(PCE(-4)) DLOG(CONSCRED(-2)) DLOG(CONSCRED(-3))				
DLOG(CONSCRED(-4)) (AVGLENDING(-2)-TBILL91(-2))				
(AVGLENDING(-3)-TBILL91(-3)) (AVGLENDING(-4)-TBILL91(-4))				
LOG(PCE(-2)/DISPOS_INC(-2))				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.040955	0.018845	2.173313	0.0340
DLOG(DISPOS_INC)	0.944510	0.074682	12.64717	0.0000
LOG(CONSCRED)-LOG(CONSCRED(-4))	-0.014478	0.018104	-0.799716	0.4273
AVGLENDING(-3)-TBILL91(-3)	-1.03E-05	0.000925	-0.011164	0.9911
LOG(OFW_PHP)-LOG(OFW_PHP(-4))	-0.157239	0.073072	-2.151854	0.0357
AGRISA (-2)-AGRISA_HP(-2)	2.89E-05	1.23E-05	2.349396	0.0224
R-squared	0.629718	Mean dependent var		0.011852
Adjusted R-squared	0.596657	S.D. dependent var		0.107732
S.E. of regression	0.068420	Sum squared resid		0.262151
F-statistic	24.25175	Durbin-Watson stat		1.934481
Prob(F-statistic)	0.000000			

Note: c_t is the log of private consumption, x_t is a vector of explanatory variables in logs. Consumption and disposable income are in quarterly differences, while the other variables are in four-quarter differences. The instruments are lags two to four of changes in disposable income, consumption, consumer credit, the spread between the average lending rate and the 91-day T-bill rate, and the second lag of the ratio between consumption and income.

<u>Variable definitions are as follows:</u>

DISPOS_INC – disposable income
CONSCRED – consumer credit
AVGLENDING – average lending rate
PCE – personal consumption expenditure
OFW_PHP – overseas workers remittances
AGRISA-AGRISA_HP – deviation of deseasonalized agricultural output from trend

The above findings suggest that changes in the aggregate supply of credit, which tend to be reflected in the movements in M3, do not appear to significantly influence consumption in the Philippines, since consumers tend to rely more on their own income than on credit for financing their consumption. This means that a reduction in the supply of credit (as would be reflected by a slowdown in M3 growth) would not adversely affect the aggregate level of consumer spending. This is a plus factor for economic stability, since it helps insulate economic activity from shocks that may impact on the financial sector.

On the obverse side, stable, prudent growth of consumer credit can provide an additional support to consumer spending. The constant deepening of credit markets—with the aim of providing households with new tools to flexibly manage their consumption and savings decisions—will help ensure that robust household consumer spending can continue to support economic growth without jeopardizing credit institutions. The challenge is for financial sector supervisors and regulators to continue to institute prudent standards of credit risk management to ensure that growth in consumer credit is not excessive and, at the same time, would not create balance sheet vulnerability for financial institutions.

References

Bacchetta, P. and Gerlach, S. (1997). "Consumption and Credit Constraints: International Evidence". *Journal of Monetary Economics*, Vol. 40, pp. 207-238.

De Bondt, G. (1999). "Credit Channels and Consumption in Europe: Empirical Evidence," Bank for International Settlements (BIS) Working Papers No. 69, June 1999.

Greenspan, Alan, remarks before the Economic Club of New York, New York City, December 19, 2002

Hong Kong Monetary Authority (2002). "The Nexus of Consumer Credit, Household Debt Service and Consumption," HKMA Quarterly Bulletin, November 2002. Available in electronic format at http://www.info.gov.hk/hkma/eng/public /qb200211/fa2.pdf

Kohn, Donald L., remarks before the Banking and Finance Lecture Series, Widener University, Chester, Pennsylvania, April 1, 2004

Ludvigson, S. (1996) "Consumption and credit: a model of time-varying liquidity constraints," Federal Reserve Bank of New York Research Paper No. 9624, August 1996. Available in electronic format at http://www.newyorkfed.org/ research/staff_ reports/research_ papers/9624.html.

Maki, Dean M. (2000), "The Growth of Consumer Credit and the Household Debt Service Burden", Board of Governors of the Federal Reserve System Finance and Economic Discussion Paper 2000-12, February 2000.

Monetary Policy Committee, Bank of England, *The Transmission Mechanism of Monetary Policy* (www.bankofengland.co.uk).

Sveriges Riksbank, *The Transmission Mechanism of Monetary Policy* (www.riksbank.com)

Zhang, W. and J. Zhuang (2002). "Leading Indicators of Business Cycles in Malaysia and the Philippines," Asian Development Bank Economics and Research Department Working Paper No. 32, December 2002

[i] See, for example, Sveriges Riksbank, *The Transmission Mechanism of Monetary Policy* (www.riksbank.com) and Monetary Policy Committee, Bank of England, *The Transmission Mechanism of Monetary Policy* (www.bankofengland.co.uk).

[ii] The use of instrumental variables in the estimation allows us to assume that the coefficients of the consumption equation to be *time-varying* (i.e., not fixed over time) [Bacchetta and Gerlach 1997]. Instrumental variables are typically assumed to be correlated with the explanatory variables in the equation and uncorrelated with the disturbances. The assumption of time-varying coefficients implies that the proportion of consumers who consume only out of their income is not constant over time, i.e., some consumers are able to borrow for their consumption. This enables us to include credit variables in the consumption equation.

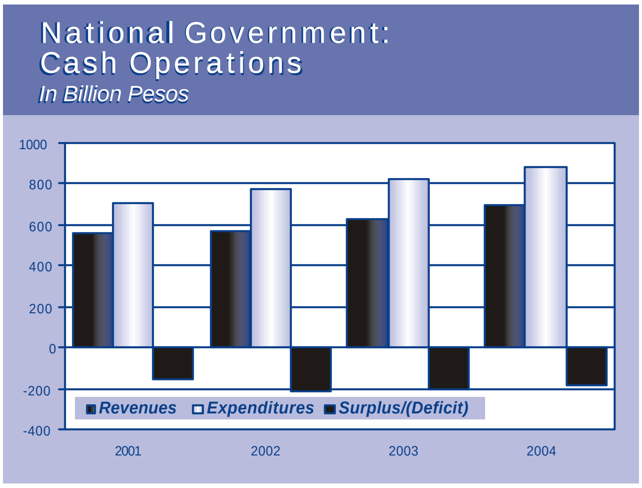
[iii] The choice of sample period is dictated mainly by the availability of time series data, particularly for consumer credit.

Operations of the National Government

National Government's cash position improves

NG's cash position posts lower deficit for the second consecutive year

The fiscal deficit declined to 3.8 percent of GDP, below the target of 4.2 percent of GDP and down from the 4.6 percent of GDP in 2003, affirming NG's resolve to achieve fiscal balance in 2010, or even earlier should the remaining priority revenue legislative measures be passed by October 2005.



The lower deficit was due to the upturn in revenues by 11.4 percent, which surpassed the revenue target by 3.2 percent (Table 4). The increase in taxes, the major revenue source, was due to the strong performance of the Bureau of Internal Revenue (BIR) and the Bureau of Customs (BOC), which contributed 70.6 percent and 27.0 percent, respectively. However, despite the improved administrative measures adopted by the BIR and the BOC, tax revenue effort continued to move sideways at 12.3 percent of GDP from 12.5 percent in 2003. The increase in non-tax revenue collections was largely accounted for by the Bureau of the Treasury (BTr), which exceeded both its target and the 2003 performance on account mainly of the rise in its investment income and interest earnings on deposits.

Total expenditure as a share of GDP lower at 18.3 percent

Total expenditures were also higher than the year-ago and the programmed levels, with interest payments accounting for 59.6 percent of the increase. While improved revenue collections allowed some elbowroom for government spending, total expenditures as a share of GDP was lower at 18.3 percent compared to the 19.2 percent in 2003, following NG's belt-tightening measures.

The deficit was financed mainly from domestic sources which covered 57.0 percent of the total financing requirements. The share of domestic borrowings, however, was lower than the targeted 80.0 percent of the financing mix, following the availability of foreign financing that carried more concessional interest rates and provided for longer maturities.

Monetary and Financial Conditions

The monetary system was generally liquid in 2004 with domestic credit flowing more to the public sector. Money demand was fueled by the continued strong appetite for government securities among financial institutions, with public sector credit growing by 17.6 percent compared to only 4.7 percent in the private sector credit. Lending to the private sector remained generally subdued despite the supportive stance of monetary policy.

Despite the generally liquid market, domestic interest rates trended upward across the yield spectrum due to market concerns over the continued rise in inflation particularly beginning the second semester of the year, fiscal sustainability and possible credit rating downgrades. The exchange rate was also weaker in 2004 compared to 2003, but was less volatile.

Monetary Conditions

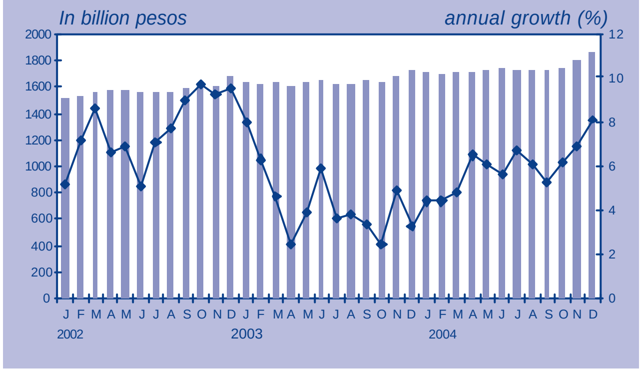
Monetary Aggregates

Money demand strengthens

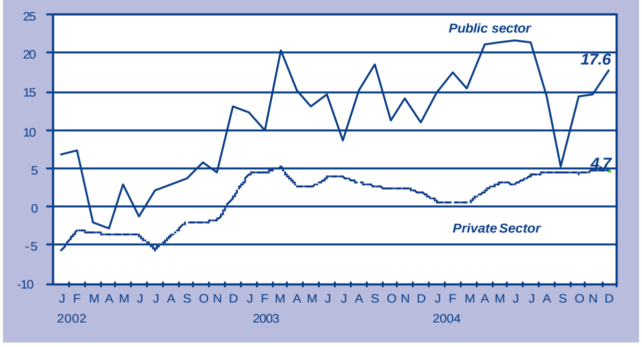
Domestic liquidity or M3 grows faster in 2004 due to increased appetite for GS

Demand for money as measured by M3 was stronger in 2004 at 9.2 percent compared to 3.3 percent in the previous year due mainly to the banking system's credits to the public sector, as the market continued to show strong appetite for government securities (GS) (Table 5). Banks' preference for GS over lending to the private sector has been linked mainly to banks' cautious attitude to providing credit due to risk asset concerns. However, banks have begun to dispose of their non-performing loans (NPLs) and real and other properties owned or acquired (ROPOA) under the benefits of the Special Purpose Vehicle (SPV) Law.

Domestic Liquidity



Monetary System:
Net Domestic Credits
Annual growth in percent



Stronger money growth was also influenced by improved deposit generation as savings and time deposits increased by 9.5 percent year-on-year due to favorable yields on longer-term time deposits.

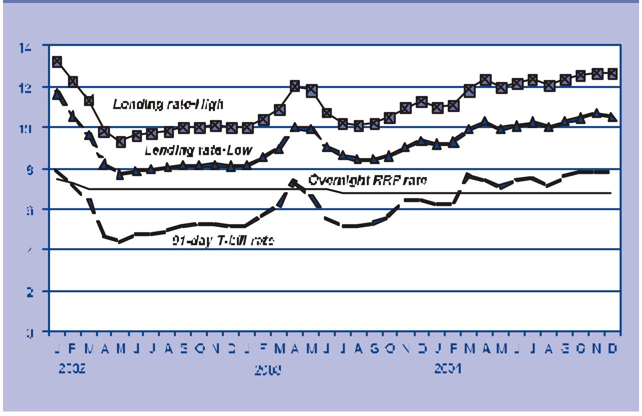
Interest Rates

Interest rates on the uptrend

Market concerns push interest rates higher

Domestic interest rates trended upward in 2004 despite ample liquidity and the BSP's supportive monetary policy stance (Table 6). Rates in the primary Treasury bill market were bid up by market concerns over the sustainability of the government's fiscal position, higher inflation, expectations of rising foreign interest rates, and volatility in the foreign exchange market. Compared to the start of the year, the benchmark 91-day Treasury bill rate rose by almost one and a half percentage point to an average of 7.8 percent in December 2004. As a result, the range of bank lending rates widened by more than one percentage point to 10.5-12.6 percent in December 2004.

Domestic Interest Rates

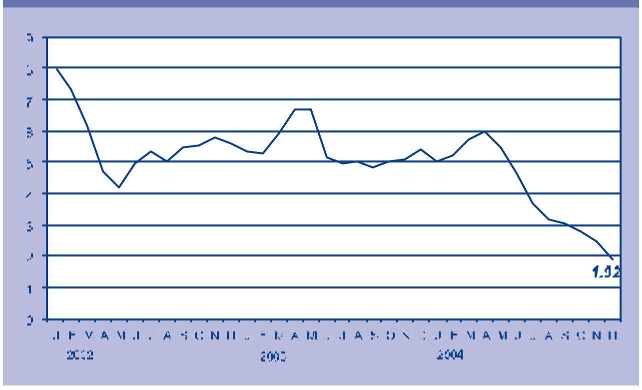


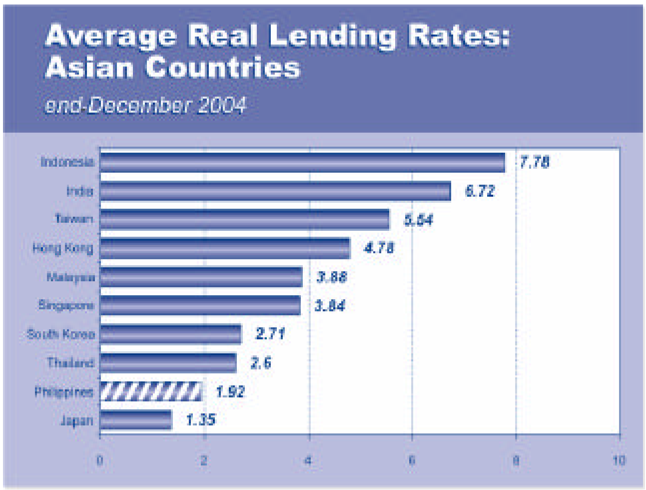
RP's real lending rates remain one of the lowest in the Asian region

Despite the increase in nominal interest rates, real lending rates have been declining since May 2004 following the rise in the inflation rate. RP's lending rates are one of the lowest in the Asian region.

Real Lending Rates: Philippines

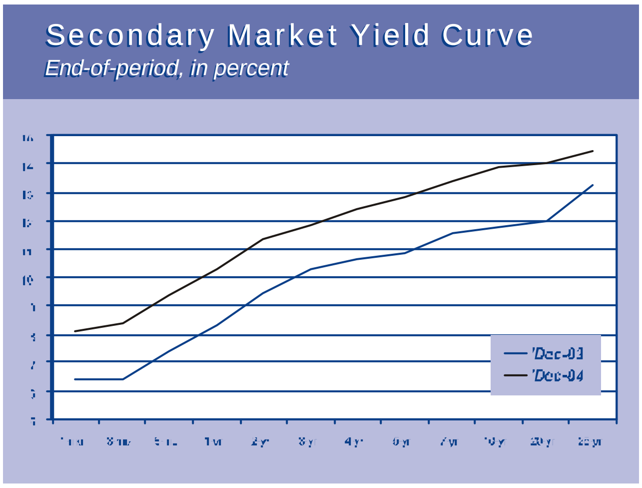
Average bank lending rates less CPI Inflation





Secondary market yields reflected uptrend in the primary market

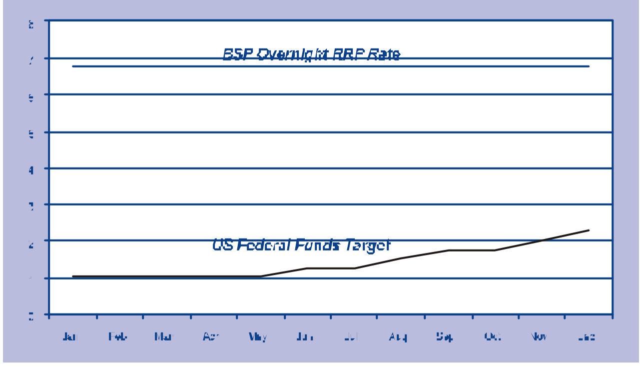
The yield curve for GS remained upward-sloping in 2004, reflecting higher inflation expectations and markets' concerns over the fiscal sustainability and possible credit rating downgrades. Relative to the previous year, the yield curve also shifted upward, mirroring the general rise in market interest rates.



Differentials between RP and US interest rates narrow

The differential between the BSP's policy interest rate (overnight borrowing or reverse repurchase (RRP) rate) and the US federal funds target rate narrowed to 450 basis points. This was due mainly to the series of increases in the US federal funds target rate by the US Federal Open Market Committee (FOMC) which brought the fed rate to 2.25 percent by end-December 2004.

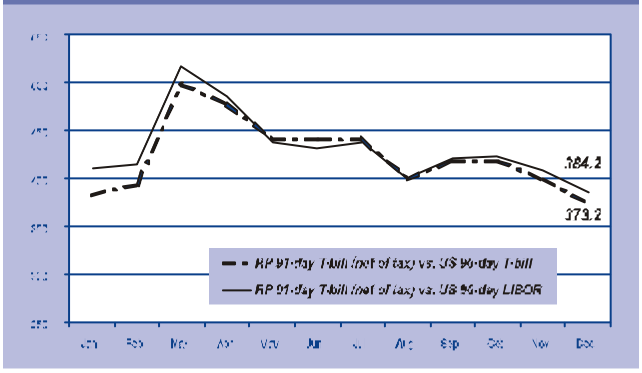
BSP Policy Rate vs.
US Federal Funds Target Rate
2004



2004	BSP RRP Rate (%)	US Fed Funds Rate (%)	Differential (basis points)
Jan	6.75	1.00	575
Feb	6.75	1.00	575
Mar	6.75	1.00	575
Apr	6.75	1.00	575
May	6.75	1.00	575
Jun	6.75	1.25	550
Jul	6.75	1.25	550
Aug	6.75	1.50	525
Sep	6.75	1.75	500
Oct	6.75	1.75	500
Nov	6.75	2.00	475
Dec	6.75	2.25	450

Consequently, Philippine interest rate differentials with those of the US interest rates tightened but remained sizeable. The differential between the RP 91-day T-bill rate (net of tax) and the US 90-day London Interbank Offered Rate (LIBOR) and US 90-day T-bill narrowed to 373.2 basis points and 384.2 basis points, respectively from 383.4 basis points and 409.3 basis points in January 2004 as foreign interest rates increased.

Domestic and Foreign Interest Rate Spreads
2004, in basis points



Exchange Rate

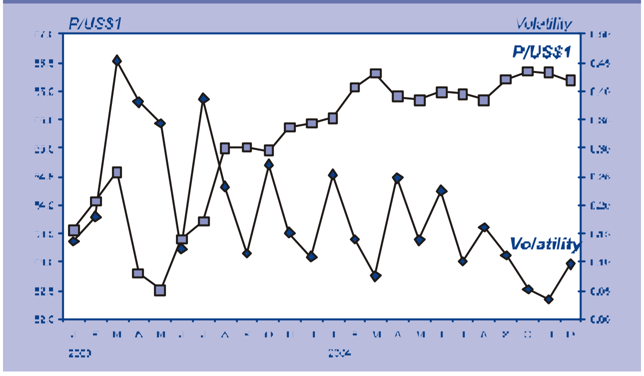
Peso weighed down by increased corporate dollar demand and heightened market concerns over fiscal issues

Peso weakens against the US dollar

The peso weakened slightly against the US dollar in nominal terms, averaging ₱56.04/US$1 in 2004, 3.28 percent lower than the year-ago average (Table 7). This level was near the higher end of the Government's expectation of ₱54-56/US$1.

Dollar demand in the corporate sector increased during the year because of higher import requirements—due mainly to the hike in world oil prices, foreign exchange obligations and hedging against future dollar requirements, particularly in light of the volatility in energy prices. Concerns over the country's fiscal situation and the surge in world oil prices, which fueled market fears of higher inflation and interest rates also weighed down on the peso.

Peso Dollar Rate, Average and Volatility
2003-2004



Credit rating downgrades by international agencies Moody's Investors Service,[3] Standard and Poor's[4] and Fitch Ratings[5] also affected the local currency. Reasons cited for the downgrade included the political uncertainty surrounding the May presidential elections and the risks associated with the government's fiscal position, which could make the economy vulnerable to shocks such as adverse changes in interest rates and exchange rates.

A comparison of credit ratings across emerging countries shows that the Philippines' credit ratings on its foreign currency obligations ranked higher than Indonesia and Argentina; while it is at par with Brazil.

---

[3] On 27 January 2004, Moody's Investors Service downgraded the country's long-term foreign and local currency debt by one notch to Ba2 from Ba1 and to Ba2 from Baa3, respectively.
[4] On 29 July 2004, Standard and Poor's lowered the country's long-term local currency rating to BBB- from BBB, while maintaining the short-term local currency rating at A-3.
[5] On 8 December 2004, Fitch Ratings revised the outlook on the Philippines from stable to negative.

Comparative Credit Ratings As of February 2005						
	Standard and Poor's Ratings Services 1/			Moody's Investors Service 2/		
	Foreign Currency Obligations			Foreign Currency Obligations		
	Long-Term	Short-Term	Outlook	Long-Term	Short-Term	Outlook
Latin American Countries						
Argentina	SD	SD	--	Caa1	NP	Stable
Brazil	BB-	B	Stable	B1	NP	Positive
ASEAN Countries						
Indonesia	B+	B	Positive	B2	NP	Positive
Malaysia	A-	A-2	Stable	A3	P-1	Stable
Philippines	BB-	B	Stable	B1	NP	Stable
Singapore	AAA	A-1+	Stable	Aaa	P-1	Stable
Thailand	BBB+	A-2	Stable	Baa1	P-2	Stable

1/ As of 25 February 2005
2/ As of 21 February 2005

Standard and Poor's Ratings Services
AAA: Highest rating assigned to an obligation wherein the capacity to meet financial commitments is extremely strong.
A: Rating assigned to an obligation wherein the capacity to meet financial commitments is strong.
BBB: Rating assigned to an obligation which exhibits adequate protection parameters.
BB: Rating assigned to an obligation which is less vulnerable to nonpayment than other speculative issues.
B: Rating assigned to an obligation which is more vulnerable to nonpayment.
SD (selective default): Rating assigned to an obligor which has failed to pay one or more of its financial obligations, rated or unrated, when it came due.

Moody's Investors Service
Aaa: Highest rating assigned to an obligation.
A: Upper medium-grade rating assigned to an obligation that is subject to low credit risk.
Baa: Medium-grade rating assigned to an obligation that is subject to moderate credit risk.
B: Rating assigned to an obligation that is subject to high credit risk.
Caa: Rating assigned to an obligation that subject to high credit risk.
Note: Plus (+) or Minus(-) signs and modifiers 1,2 or 3 show relative standing within the rating categories.

The depreciation of the peso was likewise influenced by the general weakness among regional currencies against the US dollar (particularly during the third quarter), mainly as a reaction to monetary tightening by the US Federal Reserve.

Sustained remittances by OFWs and positive market sentiment propel the peso

Nevertheless, favorable developments helped temper the peso's depreciation. Sustained dollar remittances by OFWs continued to provide huge support for the peso. Positive market sentiment following the decision of California Public Employees' Retirement System (CalPERS), a large US pension fund, to keep the Philippines in its list of investment sites also boosted the peso.

The other factors which helped the peso to close the year within the Government's range of expectations included the easing of uncertainties over the political landscape with the proclamation of President-elect Gloria Macapagal-Arroyo. The peso also benefited from the subsequent announcement of the new administration's 10-point agenda, which centers on the implementation of structural reforms to achieve fiscal balance by 2010, to combat corruption and to reduce poverty. The continued strength of the country's economic fundamentals, particularly the stronger-than-expected economic growth rate provided further support to the peso.

Compared to its level at end-December 2003, the peso-dollar rate depreciated by 1.39 percent as of 29 December 2004, along with the Indonesian rupiah (9.41 percent). The same period saw most of the Asian currencies appreciating vis-à-vis the US dollar.

Asian Currency	Appr (+)/ Depr (-) from 31 Dec 2003 (in %)
Korean won	14.53
New Taiwan dollar	6.28
Japanese yen	3.87
Singapore dollar	4.03
Thai bath	1.43
Philippine peso	**(1.39)**
Indonesian rupiah	(9.41)

Peso gains external price competitiveness

The nominal depreciation of the peso in 2004 brought about the general declines in both the nominal effective exchange rate (NEER)[6] and real effective exchange rate (REER)[7] indices of the peso (Table 7a). The NEER index of the peso against its major trading partners (MTPs)[8] was lower by 7.62 percent. Similarly, the peso's NEER index decreased vis-à-vis the broad and narrow baskets of competitor countries[9] by 3.57 percent and 1.44 percent, respectively.

On a real, trade-weighted basis, the peso gained external price competitiveness relative to the currencies of its MTPs as shown by the 4.37 percent depreciation in its REER index during the same period. The peso likewise posted a 0.74 percent decline in its REER index over the same

[6] The NEER index represents the weighted average exchange rate of the peso vis-à-vis a basket of foreign currencies.
[7] The REER index represents the NEER index of the peso, adjusted for inflation rate differentials with the countries whose currencies comprise the NEER index basket.
[8] The basket of MTPs includes the currencies of the US, Japan, Euro-area and the United Kingdom.
[9] The broad basket of competitor countries is composed of the currencies of Singapore, South Korea, Taiwan, Malaysia, Thailand, Indonesia and Hong Kong, while the narrow basket is composed of the currencies of Indonesia, Malaysia and Thailand only.

period relative to the currencies of the Philippines' competitor countries in the broad series. The depreciation in the peso's REER relative to the currencies of the country's MTPs and competitor countries in the broad series was due mainly to the nominal depreciation of the peso. In contrast, the REER for the narrow basket of competitor countries increased slightly by 0.13 percent due to the widening of the price differential between the Philippines and its competitor countries in the narrow series.

Financial Conditions

Key financial indicators post improvements

The Philippine financial system showed broad improvements in key financial indicators. Aggregate resources expanded by 8.2 percent to ₱5,059 billion representing the highest growth rate since 2000. The banking industry continued to be the dominant player in the financial system, accounting for 82.3 percent of the system's total resources.

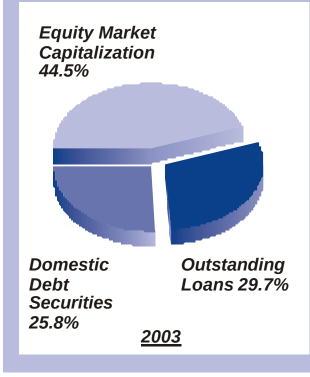
Total Resources of the Philippine Financial System
In billion pesos

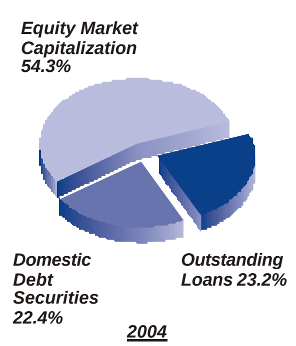
	2004	2003	Percent Change
TOTAL	5,059.5 p/	4,676.5 p/	8.2
Banks	4,166.0 p/	3,810.7	9.3
Commercial Banks	3,760.6	3,425.6	9.8
Thrift Banks	305.2 1/	292.7	4.3
Rural Banks	100.2 1/	92.4	8.5
Non-Banks	893.5 1/	865.8 p/	3.2

p Preliminary
1/ As of end-September 2004
Sources: SDC and DER, BSP

In the capital markets, stronger demand for both local equities and government debt papers fueled brisk trading in the second half of the year. The local stock market rebounded towards the end of 2004, posting the highest annual increase since 1997. Meanwhile, in the face of a cautious loan market, investible funds went to the government securities market. The regular T-bill auctions generally received bids in excess of the offered amount, as banks looked for safe investment outlets.

Financial Sector Profile
2003-2004





Performance of the Banking System

Philippine banking system displays steady growth

The Philippine banking system continued its steady growth in 2004 amid the modest corporate demand, persistent asset quality concerns and uncertain fiscal sustainability.

Deposit Generation

Growth of outstanding deposits accelerates

Growth in deposit liabilities of the banking system accelerates

The deposit liabilities of the Philippine banking system continued to advance in 2004 fueling the marked improvements in M3 and M4, which grew by 9.2 percent and 10.3 percent, respectively (Table 5). Outstanding deposits of the banking system registered an 11.6 percent increase, more than double the growth in 2003 (Table 8). KBs, which accounts for almost 90 percent of total deposits, led the expansion in deposit base registering an increase of 11.9 percent. Total deposit liabilities were still dominated by savings deposits with a 55.7 percent share of the total, but lower than the 60.3 percent recorded in 2003.

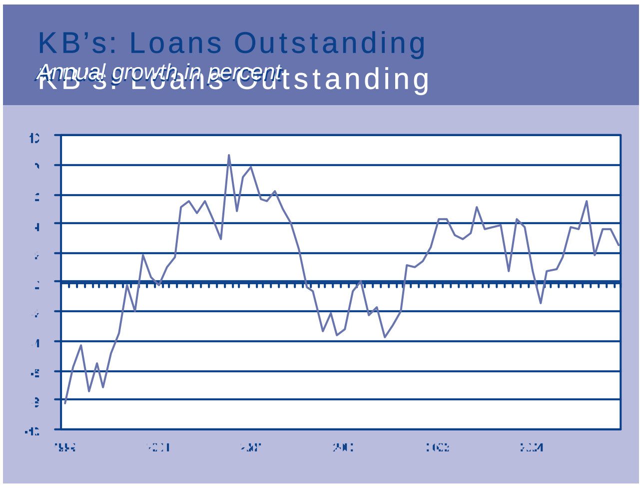
The 15.1 percent rise in foreign currency deposits outpaced the growth in peso deposits which increased by 8.6%. As a result, the share of foreign currency accounts to total deposits went up from 29.9 percent in 2003 to 31.2 percent in 2004. However, a large part of the deposit base still came from peso accounts at 68.8 percent (down from 70.1 percent in 2003).

Lending Operations

Lending by banks remains moderate

Commercial bank lending increases slightly

The increase in bank's deposit base failed to translate to a robust increase in commercial bank lending as banks preferred to invest in government securities. Lending by commercial banks showed a modest increase in 2004, rising by 2.6 percent year-on-year to ₽1,526 billion as of end-December 2004. The slow growth in KB lending reflected the slack in credit demand, bank's concerns over asset quality and the continued presence of spare capacity in the economy.



Manufacturing accounts for the largest share of KB loans

The manufacturing sector continued to account for the largest contribution to the rise in loans. Loans to the manufacturing sector accounted for more than a quarter of total KB loans and jumped by 14.1 percent year-on-year. Bank lending also increased in sectors such as agriculture, utilities and wholesale/retail trade. Meanwhile, a notable slowdown in bank lending was observed in the financial institutions, real estate and business services and construction sectors, which moderated the overall growth in KB loans.

Loans Classified by Economic Activity In percent		
	Percent Share to Total KB Loans	Annual Growth Rate
Agriculture, Fisheries & Forestry	6.1	17.2
Mining and Quarrying	0.8	-13.5
Manufacturing	27.5	14.1
Electricity, Gas and Water	5.1	19.4
Construction	2.0	-17.0
Wholesale and Retail Trade	14.0	1.6
Transportation, Storage & Comm.	4.9	-3.0
Fin. Inst., Real Estate & Bus. Services	23.9	-8.2
Community, Social & Personal Services	15.8	-0.1

Exposure to real estate increases slightly

The ratio of commercial banks' real estate loans to their total loans (inclusive of interbank loans) increased slightly as of end-June 2004 compared to its level a year ago. Commercial banks' real estate exposure rose to 10.09 percent as of June 2004 from 9.98 percent a year ago. The increase was driven by the increase in loans extended to the real estate sector which outpaced the increase in total outstanding loans. At this level, the ratio continued to remain below the BSP's 20 percent ceiling on bank lending to the real estate sector.

Over three-fourths of the loans to the sector were for the acquisition of residential properties, the development of housing subdivisions, the acquisition/development of commercial properties and the construction of infrastructure projects.

Credit Card Receivables rise

Reflective of increased consumer spending, total credit card receivables (CCRs) of the banking industry rose to ₱62.5 billion as of end-September 2004, up 20.6 percent from a year earlier. Commercial banks accounted for 69.3 percent of the total, with foreign banks accounting for half of the total CCRs.

Banks aggressively market their credit cards

Facing stiff competition, banks aggressively increased their client base resulting in some overextension of credit. It was observed that generous credit terms offered by banks and their credit card subsidiaries effectively enticed consumers to overspend beyond their regular earning capacity, which could eventually lead to delinquency. The combined past due CCRs of universal/commercial and thrift banks (bank proper and bank subsidiaries) grew by 50.9 percent from end-September 2003 to ₱14.03 billion at end-September 2004. The amount was 22.5 percent of total credit card receivables as against 18 percent in September 2003.

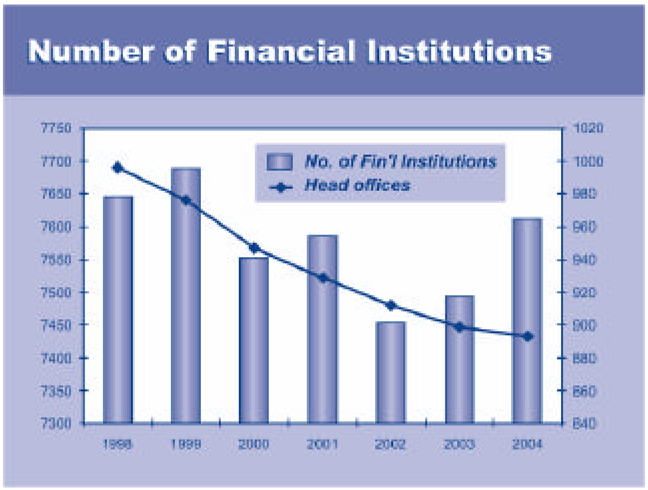
The rise in past due credit card receivables underscored the need for the creation of a centralized credit bureau to check the rapid growth of credit to cardholders. The credit bureau will be able to provide information on the credit history of a prospective borrower as well as information on the borrower's total level of debt thereby expediting credit investigation and minimizing cost of extending credit based on incomplete credit information.

Institutional Developments

In line with the growth in the deposit base, the Philippine banking system continued its steady growth in 2004, managing to register a 9.3 percent increase in total resources which aggregated ₱4,166.0 billion as of end-December 2004 (Table 9). The growth in the system's resources may be traced to the continued expansion in investments and loans of commercial banks (KBs) which hold the bulk of resources of the banking system (73.7percent).

Banking system continues to consolidate

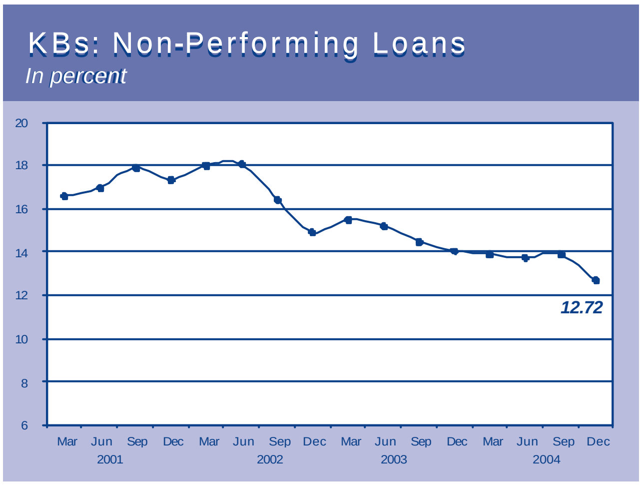
Reflecting the BSP's continued efforts to further strengthen the banking system by encouraging consolidation as well as closing weak banks, the number of banking institutions declined from 899 to 893 over the year (Table 9a). The total number comprised of 42 KBs, 87 thrift banks and 764 rural banks. However, the operating network of the banking system increased by 118 to 7,612 as of end-2004 reflecting the increase in commercial and thrift banks' branches (Table 9a).



Cleaning up of balance sheet gathers momentum

NPL ratio declines

With modest credit expansion, commercial banks' asset quality improved steadily as the NPL ratio declined to 12.72 percent as of end-December 2004 compared to a year ago level of 14.05 percent. This was a result of the simultaneous 6.1 percent decline in NPLs and the 0.1 percent growth in total loan portfolio (TLP).



Country's NPL relatively higher than those of its regional counterparts

Despite the improvement in banks' asset quality, the country's NPL ratio remained relatively high compared to those of other countries in the region. The Philippines' NPL ratio was higher than Thailand's 11.6 percent, Malaysia's 7.3 percent, Korea's 2.2 percent and Indonesia's 6.9 percent.[10] The lower NPL ratio in other Asian countries may be traced to the publicly-owned asset management companies' (AMC) purchases of the bulk of their NPLs.

BSP continues to prod banks to dispose their NPAs

The BSP continues to encourage banks to clean up their balance sheets of non-performing assets through the sale of these assets to private SPVs. The availment of incentives under the SPV Act of 2002 to dispose of non-performing assets (NPAs) accelerated towards the end of the year. As of end-2004, the BSP had issued one hundred twenty-one (121) Certificates of Eligibility (COEs)[11] involving a total amount of ₱26.2 billion worth of

[10] Source: ARIC Financial Indicators, ADB website. Thailand (Oct 2004, KBs), Malaysia (Oct 2004, KBs); Korea (Jun 2004, KBs); and Indonesia (Sep 2004, financial system).
[11] To be able to avail of the fiscal incentives provided under the SPV Law, the Certificate of Eligibility (COE) is issued by the BSP, Securities and Exchange Commission (SEC) and Department of Finance (DOF) to concerned financial institutions.

NPAs transferred under the SPV Law. The amount of NPAs transferred under the said Law increased from ₱713.3 million as of end-2003 to ₱26.2 billion as of end-2004.

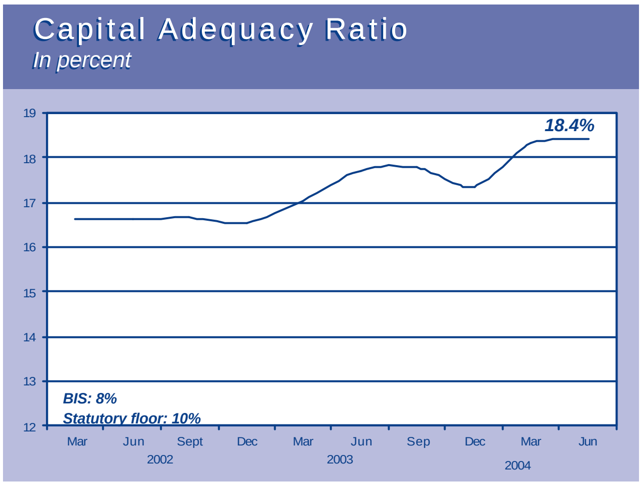
Loan-loss provisions remain adequate

Consistent with most of the industry's asset quality indicators, the NPL coverage ratio and the NPA coverage ratio strengthened to 60.40 percent (vs. 52.96 percent last year) and 35.56 percent (vs. 32.56 percent last year), respectively. These were results of beefed up loan loss reserves and NPA reserves as well as lower NPLs and NPAs. Loan loss reserves and NPA reserves as of end-December 2004 stood at ₱137.12 billion, 5.4 percent higher than the level a year ago. NPA reserves increased by 6.2 percent to reach ₱153.03 billion as of end-December 2004. The increase in coverage ratios reflected banks' diligent compliance with the loss provisioning requirements prescribed by the BSP as a cushion against possible losses

Capital Adequacy Ratio remains above statutory level

CAR reflects banks' ability to cover risky assets

The capital position of commercial banks continued to strengthen in 2004. Using the new risk-based framework, the KB's capital adequacy ratio (CAR)—a measure of net worth-to-risk assets—increased to 18.41 percent as of June 2004 from 17.71 percent a year ago. These developments were attributed to market participants' continued commitment to their respective capital build-up programs and reflects the banking system's improved ability to cover risky assets.



The industry's CAR exceeded the statutory level set by the BSP at 10.0 percent and the Bank for International Settlements (BIS) standard of 8.0 percent.[12] So far, the Philippines' CAR was relatively high compared to that of Malaysia (13.9 percent), Thailand (12.7 percent) and Korea (10.9 percent).[13] Indonesia posted the highest CAR in the region with 20.5 percent as of June 2004.

Stock Market Developments

Upbeat market sentiment buoys stock trading in second half of the year

Shaking off the uncertainties brought about by the May elections, trading in the Philippine Stock Exchange (PSE) steadily gained steam towards the second half of the year reflecting the influence of a string of positive developments during the period.

[12] BSP Circular No. 280, dated 29 March 2001, approved the guidelines for the adoption of the risk-based capital adequacy ratio along the criteria prescribed by the Bank for International Settlements (BIS).
[13] Source: ARIC Financial Indicators, ADB website. Commercial banks CAR: Malaysia (August 2004); Thailand (August 2004); and Korea (June 2004).

On a monthly basis, the Philippine Composite Stock Index (PHISIX) climbed from an average of 1,508.3 index points in January to 1,822.8 index points in December (Table 10). After rising in January 2004, the PHISIX dropped in February and March as institutional investors opted to shy away from equities trading on account of political uncertainties and renewed global security concerns. Philippine stocks started to gain strength in the second quarter with the main composite index staying generally above the 1,450 level during the entire quarter. The relatively upbeat trading in the local equities market was supported by market optimism on strong second quarter corporate earnings, continued strengthening of the peso against the US dollar, and the rebound in major stock markets abroad.

The bullish sentiments continued well into the third quarter with the PHISIX staying consistently above the 1,500–level during the period. Market optimism following the inauguration of the new administration, impressive first semester corporate earnings reports, and sustained growth of the economy in the second quarter propelled the index to three-year highs towards the latter part of the quarter. Resilient GDP numbers for the third quarter, fueled by strong consumption and the growth in the services sector attracted investors to invest further in the local bourse. The PHISIX attained its highest level for the year on 4 October 2004, which was a record high for almost the past four years. The gains in share prices were supported by year-end accumulation and positioning on select stocks and the optimism generated by the passage into law of the bill raising the excise taxes on cigarettes, tobacco and alcoholic products on 23 December 2004.

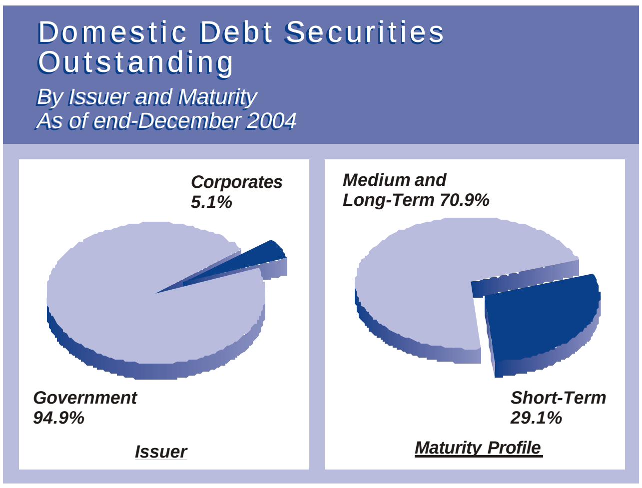
On an annual basis, the average PHISIX surged by 35.5 percent to 1,621.7 index points. The auspicious performance of the market was broad-based with all sectors registering growth from last year. Value turnover rose by 42.1 percent to ₱206.56 billion during the year. Meanwhile, volume turnover more than tripled in 2004 to 284.34 billion shares with the significant increase recorded in the mining, commercial and industrial, property and oil sectors. Market capitalization, measured by the value of outstanding shares, jumped by 60.3 percent to ₱4.77 trillion as of end-December 2004 from ₱2.97 trillion a year ago (Table 10).

Debt Securities Market Developments

Banks shift lending preference from private sector to government

Ample liquidity in the financial system brought about by weak credit demand and selective risk-averse attitude of banks dominated trading in the debt securities market as it fueled the market's appetite for GS. The regular T-bill auctions generally received bids in excess of the offered amount, as banks shifted their preference for lending to government rather than the private sector.

The market is still dominated by government issuances comprising 94.1 percent of total outstanding domestic debt securities. Short-term debt securities account for 29.1 percent of the total debt securities, unchanged from the level a year ago.



Lingering political concerns in the run-up to the May elections weakened the appetite for government securities in the first half of 2004. This was evidenced by the smaller level of oversubscription of T-bills auctioned in the first half of the year amounting to only ₽6.5 billion. The BTr managed to reject total tenders amounting to ₽63.1 billion to prevent the T-bill yield from rising further.

The market took a turn in the second half as liquidity in the financial system helped pump investible funds into the government securities market. Total oversubscriptions for the period amounted to around ₽56.0 billion. The Auction Committee tempered increases in T-bill rates by exercising its option to reject excessively high bids. Total rejections for the second half of the year reached ₽81.7 billion.

Results of Treasury Bill Auctions
In billion pesos

Quarter	Subscriptions	Accepted Bids	Rejections	Over-subscription
First	76.83	39.82	37.01	5.83
Second	60.65	34.52	26.13	0.65
Third	105.67	57.47	48.20	28.67
Fourth	82.38	48.84	33.54	27.38
Total	**325.53**	**180.65**	**144.88**	**62.53**

Box Article 3

ISSUES FACING THE PHILIPPINE BOND MARKET

Government securities comprise the bulk of the Philippines' domestic bond market. Over the past decade, public debt issues have captured more than 90 percent of the market for debt instruments. Private bonds issues are rare, in part, because of stringent issuance requirements in the Corporate Code of the Philippines and also, to some extent, because of the absence of an organized venue for trading private debt securities.

Over the years, reforms were put in place to further the development of the Philippine domestic bond market. In particular, the reform process enabled the government bond market to evolve as a major venue for mobilizing long-term funds.

The BSP, as the monetary authority and supervisor of the banking system, is firmly committed to the prioritization of domestic capital market development. A robust capital market complements the banking system in financial intermediation by providing an alternative means of financing the economy. At the same time, it provides greater flexibility in managing and re-distributing the risks in the banking system. A well-functioning financial market also supports the effective conduct of monetary policy by efficiently providing more market-based tools to fine-tune economic activity and enhance price stability consistent with the goals of the inflation targeting framework of the BSP.

Impediments to Bond Market Development and Policy Responses

Despite the progress achieved in promoting the development of the domestic bond market, some issues remain. Concerns that need to be addressed in order to facilitate bond market development and recent measures to address these include:

Improvement of credit risk pricing

The insufficient credit ratings capacity in the Philippines is an impediment to bond market development. A reliable credit rating system is essential for growth of the bond market because it contributes to improving the price discovery process through the following: 1) it provides investors with unbiased opinions on relative credit risks which are essential tools for making sound investment and financing decisions; 2) it serves the functions of information search and analysis; 3) it is a mechanism for transparency and disclosure to all investors of credit rated securities; and 4) it gives investors an updated body of opinion on the credit quality of debt issuances and issuers.

Thus far, PhilRatings is the only domestic credit rating agency recognized by the BSP for bank supervisory purposes. To address this concern, the BSP issued the guidelines for the recognition/derecognition of domestic credit rating agencies to meet the growing needs for credit rating services by both the financial industry and regulators. The need evolved following the introduction of new financial products in the local market. The new rules also laid down the grounds for derecognition of rating agencies, under certain circumstances, including involvement in insider trading, unfair competition and ratings blackmail.

Enhancing market efficiency and liquidity

The prevailing dearth of corporate bond issues in the market stems largely from the lack of a critical market infrastructure to facilitate primary and secondary market trading. The establishment of the Fixed Income Exchange (FIE) is expected to boost market liquidity and the price discovery mechanism for the secondary trading of domestic debt and other fixed income securities. To date, the FIE has yet to commence actual operations pending the completion of other regulatory requirements (i.e., submission of rules on interbank market trading, rules on the retail market investor).

Designing more innovative instruments

The lack of innovative and diversified financial products in the market leaves investors and intermediaries with limited investment choices. The availability of a wide array of financial products is expected to stir market activity by way of greater market depth, breath and liquidity. It also enables the market to broadly satisfy investors' diversified appetite for risk. The development of the capital market, therefore, should embody the introduction of new financial products and investment instruments to deepen the market and transfer risk to entities best placed to bear them. To support greater use of new and improved financial products, the BSP has issued directives to govern the financial derivatives activities of banks, non-banks with quasi-banking functions and their subsidiaries/affiliates. In particular, Circular No. 297 dated 17 September 2001 outlined the scope and pre-qualification requirements for the grant of authority to engage in derivatives activities with due emphasis on adequate risk management systems of applicant institutions.

Broadening the investor base to attract a wider array of investors

The Philippine domestic bond market is characterized by a narrow investor base limited to a few institutional investors. As an initial step to address this issue, the Revised Investment Company Act (RICA) has been included in the proposed legislative and regulatory reform agenda of the 13th Congress. The RICA aims to further diversify the investor base in the Philippines by eliminating restrictions over foreign ownership of investment companies. It also opens the mutual fund business to foreigners by allowing a foreign mutual fund to sell securities provided that a portion of the funds raised from any public offer shall be invested in the Philippines. The enhancement of investor base in the corporate bond market will help decrease the cost of finance and increase the depth of the market.

Taxation

The friction cost of issuing debt instruments associated with documentary stamp taxes (DST) presents a significant impediment to the investing public. Their imposition not only reduces the expected yields or returns to investment but also presents a market hindrance to prospective investors/bondholders from buying/selling their securities in the secondary market.

On 17 February 2004, R.A. No. 9243 was passed into law which paved the exemption from the DST of all frequently traded instruments. Prior to the enactment of the law, the DST is paid according to the frequency of transactions of capital market instruments. Such imposition creates a cascading effect that distorts pricing and makes financial intermediation costly, creating a disincentive to secondary trading. The removal of the DST on secondary trading is expected to encourage the development of the secondary market for traded instruments and increase tax revenues with more transactions and capital market instruments issued and traded in the market.

Recent Initiatives of the BSP

To complement earlier initiatives on capital market development, the BSP pushed for several measures to assist in building the necessary infrastructure to help deepen the Philippine capital market:

- The BSP required banks and non-bank financial institutions under its supervision to entrust securities of their clients to a BSP-accredited third party custodian who will have sole responsibility in the handling and safekeeping of debt securities. This is intended to ensure that all transactions being undertaken in the market are backed-up by corresponding debt instruments. The BSP has accredited 5 banks and 1 non-bank financial institution to act as third party custodians.

- To align the operation of pooled funds under management by trust entities with international best practices and enhance their credibility with retail investors, the BSP issued a directive paving the way for the creation of unit investment trust funds (UITFs) by authorized trust entities. Under the new rules drawn up by the BSP, funds accepted as investments in trust can only be placed in liquid investments and tradable financial instruments. To promote UITFs, the directive exempts UITFs from the provisions on reserves, single borrower's limit and DOSRI requirements.

- To allow greater portfolio diversification, banks have been allowed to invest in innovative financial products that include structured debt, collateralized debt obligations and credit derivatives.

- The BSP is intensifying coordination with other financial regulators to promote consistency in financial regulations. To this end, the Financial Sector Forum (FSF) was established in July 2004 composed of the BSP, the Securities and Exchange Commission (SEC), the Insurance Commission (IC) and the Philippine Deposit Insurance Corporation (PDIC). The financial regulators have agreed to coordinate and issue uniform regulations or circulars in order to effectively improve supervision and regulation among their constituencies especially on areas where their functions overlap.

- To help develop domestic as well as regional bond markets in Asia, the BSP, together with ten other central banks and monetary authorities in the East Asia and Pacific region comprising the Executives' Meeting of East Asia and Pacific Central Banks (EMEAP)[14] launched the second stage of the Asian Bond Fund, the ABF2, in December 2004. The ABF2, which will invest in domestic currency bonds issued by sovereign and quasi-sovereign issuers in EMEAP economies (except Australia, Japan and New Zealand), builds further on the successful launch of the ABF1 in June 2003, which invested in US dollar-denominated bonds issued by sovereign and quasi-sovereign issuers in the eight markets. The BSP believes the ABF2 will play a catalytic role in promoting new products, improving market infrastructure and minimizing regulatory impediments.

[14] The EMEAP comprises the following: Reserve Bank of Australia, The People's Bank of China, Hong Kong Monetary Authority, Bank Indonesia, Bank of Japan, Bank of Korea, Bank Negara Malaysia, Reserve Bank of New Zealand, Bangko Sentral ng Pilipinas, Monetary Authority of Singapore and Bank of Thailand.

Conclusion

The importance of bond market development cannot be overemphasized. Its development is deemed a critical pre-condition to achieving stability in the financial system. More importantly, building a strong domestic bond market is essential in mobilizing stable large scale financing to support a growing economy through more sustainable savings and investments. In the face of the evolving trends in bond market development, it is important that appropriate policy responses be instituted to harness its growth as well as address remaining impediments.

External Sector

The overall balance of payments (BOP) position reversed to a deficit, as the capital and financial account remained weak owing mainly to the net repayments of maturing loans. The performance of the current account, however, remained strong, particularly due to OFW remittances reflected in both the income and current transfers accounts, sustained growth in exports of goods and the reduced net outflow in the services account. It maybe noted, however, that the end-2004 BOP deficit at US$280 million was significantly lower than the November 2004 forecast of US$516 million deficit for the year. As a result, the GIR during the year remained adequate and even surpassed the targeted level for the year.

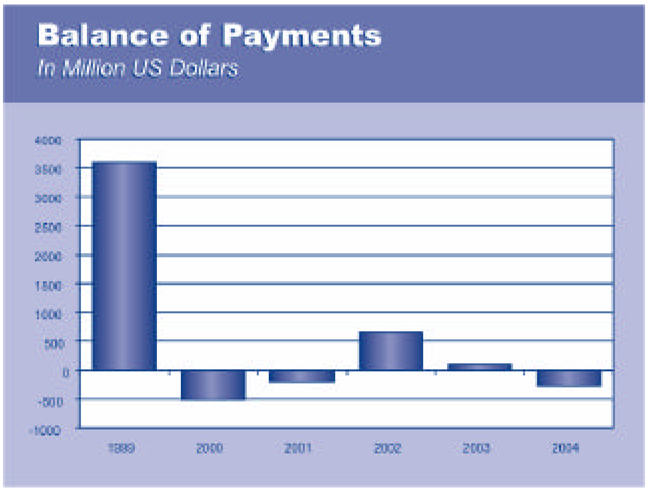
Meanwhile, the country's external debt declined due to the net transfer of credit exposures from non-residents to residents and net repayments of maturing obligations.

Balance of payments

Overall BOP yields a deficit

Net outflow in the capital and financial account brings the full-year BOP to a deficit

The country's overall balance of payments in 2004 posted a deficit of US$280 million, a reversal from the US$115 million surplus registered in 2003, as the capital and financial account continued to post a net outflow (Table 11). The current account, however, posted a higher surplus.



Strong income flows and current transfers mainly from OFW remittances as well as travel receipts strengthen the current account

Current account posts a higher surplus.

Current account transactions in 2004 resulted in a surplus of US$2.0 billion, higher than the surplus posted in 2003. The reversal of the income account to a surplus, the robust performance of the current transfers account, arising largely from inflows of OFW remittances, as well as the lower deficit in the services account lent support to the strong performance of the current account, offsetting the weak performance of the trade-in-goods account.[15]

Shipments of electronics and machinery and transport propel growth in exports of goods

The trade-in-goods account ended the year with a higher deficit of US$6,381 million from the US$5,455 million registered a year ago as the growth in imports of goods surpassed that of exports. Imports rose by 10.6 percent to reach US$45,109 million while exports expanded by 9.6 percent to US$38,728 billion (Tables 11a and 11b).[16] Shipments of electronics and machinery and transport equipment remained the export growth drivers. In contrast, garments exports, (second largest export earner) were generally weak during most part of the year. Combined with electronics and machinery and transport equipment, these key exports accounted for 81.4 percent of total exports (Tables 11a and 11b).

Imports of almost all major commodity groups increase

The growth in imports of goods during the year was propelled by the expansion in almost all major commodity groups except capital goods. Imports of mineral fuels and lubricants posted the highest growth at 25.2 percent. Similarly, imports of consumer goods and raw materials/intermediate goods remained on the uptrend, expanding by 11.1 percent and 9.0 percent, respectively. As percent of total imports, raw materials comprised about 58.2 percent; capital goods (bulk of which was electronic-related equipment and machines), 19.4 percent; mineral fuels, 10.4 percent; and consumer goods, 6.7 percent.

Services account improves following the increase in travel receipts

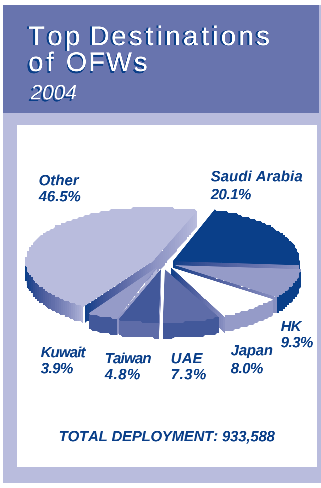
The services account remained a net outflow at US$1,282 million in 2004 but was better compared to US$1,725 million deficit in 2003 due mainly to the significant improvement in net travel receipts. The combined

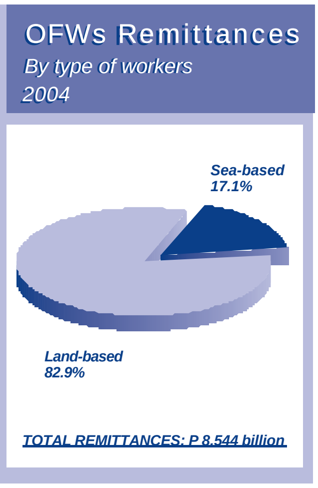
[15] Under the BPM5, the residency of seasonal workers such as OFWs is classified according to the length of their stay in the host economy. OFWs who are working for one year or less are classified as Philippine residents and their remittances reflected under the Income Account. Meanwhile, OFWs who are working for more than one year are classified as non-residents (or migrants) and their remittances are reflected under the Transfers Account.
[16] Per BPM5 concept

government and private sector tourism campaigns supported the industry to sustain its strong performance as shown by the increasing number of visitor arrivals from the U.S., Japan, Korea, Taiwan and Singapore. The decrease in net outlays for royalties and license fees, construction and miscellaneous business, professional and technical services also contributed to the improvement of the services account (Table 11).

Higher compensation income from OFWs with short-term contracts reverses the income account to surplus

The income account reversed to US$147 million surplus in 2004 from US$226 million deficit due largely to the increase in compensation income particularly from sea-based OFWs which rose by 4.1 percent to US$2,673 million relative to the year-ago level of US$2,568 billion.[17] Compensation income of OFWs continued to rise due to: (a) the growing demand for Filipino workers abroad; and b) preference for highly skilled, educated and professional OFWs.[18] Another contributory factor was the 6.0 percent increase in the deployment of sea-based OFWs in 2004 which compared favorably with the 3.1 percent growth a year ago.





[17] Under the BPM5, remittances of seasonal workers such as OFWs are reflected either under the Income Account or Current Transfers Account depending on their length of stay in the host economy (See footnote 15). Remittances of performing artists and sea-based workers, who generally enter into a contract 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. Of the 933,588 Filipino workers deployed in 2004, based on data from the Philippine Overseas Employment Administration (POEA) on new hires and rehires, 71,355 were performing artists and 229,002 were sea-based workers and the rest are other land-based workers.

[18] Data on remittances from OFWs reflect only those that are coursed through the banking system.

Higher remittances from other land-based OFWs boost the current transfers account

The current transfers account posted a higher surplus of US$9,596 million in 2004 due primarily to the increase in remittances of other land-based OFWs which rose by 9.3 percent to US$8,961 million relative to the year-ago level of US$8,199 million.[19] The rise in OFW remittances reaffirmed the continued demand and preference for highly skilled, educated and professional OFWs.

Capital and financial account posts a higher deficit due to the combined effect of lower net direct investment inflows and higher net outflows in the portfolio investment account

Capital and financial account deficit widens

The capital and financial account ended with a net outflow of US$1.7 billion in 2004, higher than last year's deficit by 12.7 percent. This was traced largely to lower net direct investment inflows and increased net outflows in portfolio investments even as other investments accounts improved (Table 11).

Higher non-residents' equity capital investments mirror improving investor sentiment

Direct investments posted a lower net inflow of US$57 million following higher equity capital placements abroad by resident corporates. Non-residents' net investments in equity capital at US$745 million rose by more than twofold reflecting improved global economic conditions and the conclusion of the domestic political exercise in May. This level, however, was negated by the net repayments in other capital, particularly intercompany loans and unremitted profits of local branches of foreign banks. Classified by industry, a greater portion of the equity capital investments was channeled to the manufacturing, trading and services sectors. The major sources of foreign direct investments during the year were U.S., Japan and Singapore.

Increased non-residents subscription to sovereign bond issuances mitigates the net outflow in portfolio investments

The portfolio investments account remained in deficit as residents' investments abroad in foreign debt securities ended higher than last year's level. The net outflow was tempered by the increased non-residents' subscription to the bond issuances by both the public sector (e.g., National Government, Manila Water Sewerage System) and commercial banks.

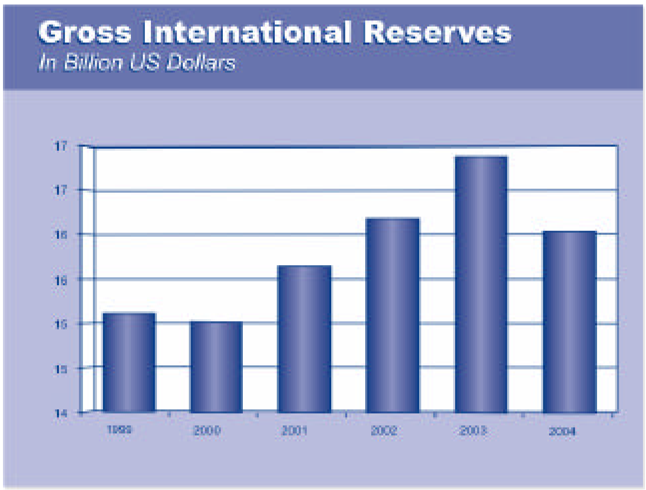
[19] See footnote 15. Consist of remittances in cash (US$8,374 million) and in kind (US$587 million) from other land-based workers.

Meanwhile, the net outflow in the other investments account narrowed to US$265 million in 2004 from US$305 million a year ago. The substantial improvement was due mainly to: a) the reversal from withdrawal to placement of deposits by non-residents in local banks; and b) the reversal from net repayment to net availment of short-term loans by domestic banks.

International reserves

Gross international reserves (GIR) level ends lower

The BSP's GIR, including the reserve position in the IMF, stood at US$16.23 billion as of end-December 2004 (Table 12). This was 5 percent lower compared to previous year's level but far exceeded the US$14-$15 billion target for the year. The end-December level was adequate to cover about 3.7 months' worth of imports of goods and payment of services and income. Alternatively, the level of reserves is 3.2 times the amount of the country's short-term foreign liabilities based on original maturity and 1.6 times based on residual maturity[20] (Table 12).



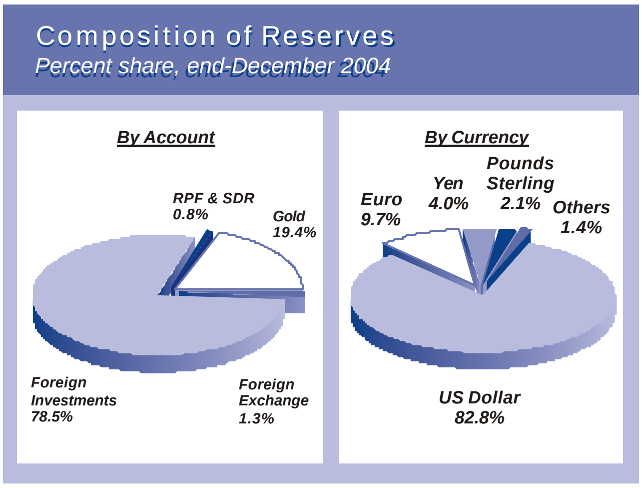
Reserves decline on account of NG's debt servicing and BSP's foreign exchange requirements

The end-December 2004 GIR level declined from last year's level mainly due to servicing of the NG's maturing foreign debt obligations and the BSP's foreign exchange requirements. These were partly offset, however, by major inflows from the following sources: a) deposit by the NG of the proceeds from its bond and note issuances and other borrowings; b) BSP's term loan to refinance its maturing

[20] 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.

foreign exchange obligations; and c) investment income of the BSP.

About 78 percent of reserves consisted of foreign investments. By currency composition of reserves (excluding gold), 82.8 percent were in US dollars.



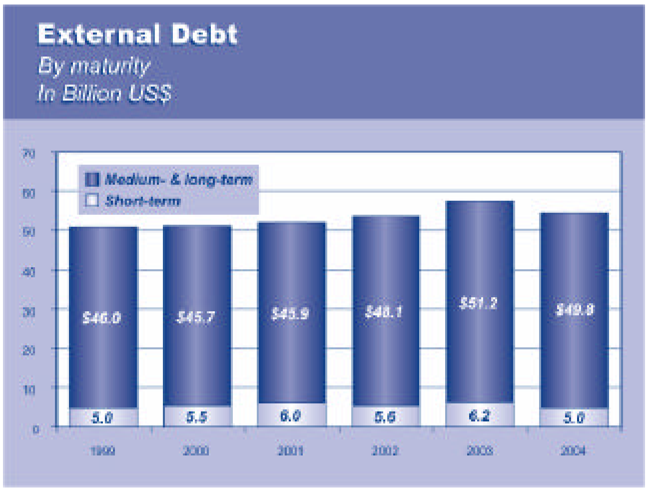
The net international reserves (NIR) level rose to US$14.56 billion as of end-December 2004 from the previous end-year NIR level of US$14.06 billion.

External debt

External debt declines

Residents' purchases of Philippine debt papers issued abroad bring down the stock of foreign debt.

The external debt declined by 4.4 percent to US$54.8 billion as of end-December 2004 from US$57.4 billion as of end-December 2003 due largely to the net transfer of credit exposures from non-residents to residents amounting to US$2.8 billion (Table 13). Residents' holdings of Philippine debt instruments that were originally issued abroad rose to US$10.0 billion as of end-December 2004 from only US$7.0 billion as of end-December 2003. Net repayments as well as adjustments to account for late reports /audit findings on prior periods' transactions also caused further reduction in the debt stock by US$603 million and US$118 million, respectively (Table 13).



Foreign exchange revaluation loss amounting to US$1.0 billion arising from the depreciation of the US dollar against third currencies, particularly the Japanese yen, however, offset the reduction coming from the transfer to residents. The medium- and long-term (MLT) loans during the year were used largely for budgetary support; refinancing of maturing obligations; and funding of communication, transportation and other infrastructure projects, sewerage and sanitation projects, and power and energy development.[21]

Bulk of external debt have long maturities spread out over a period of 17.4 years

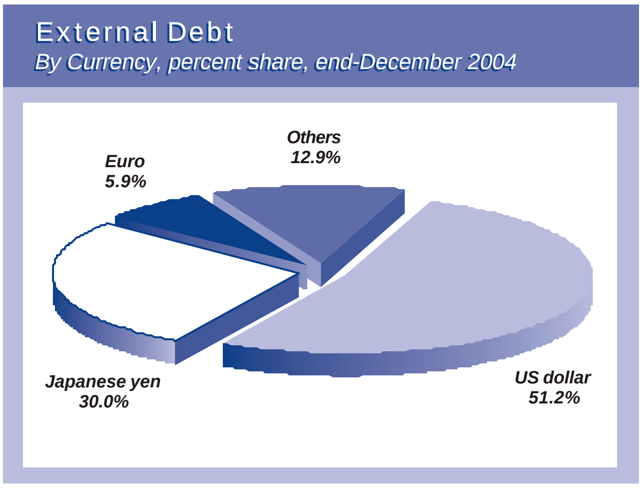
Liabilities to non-residents' remained dominated by MLT debt accounting for more than 90 percent of total external debt. All MLT debt have a weighted average based on original maturity of 17.4 years, with public sector debt averaging at 19.6 years and private sector debt at 10.9 years.[22] More than 61 percent of MLT liabilities carried fixed rates, 35 percent had variables rates and the remaining 4 percent were non-interest bearing.

[21] These included the following major borrowings of the public sector: (a) the NG's US$1.284 billion Global Bonds issued in February in exchange for some outstanding Global and Brady Bonds (US$1.164 billion) and the balance (US$120 million) representing new money component; US$500 million 11-year Global Bonds in March; US$188 million proceeds from the US$200 million 550-day Zero Coupon Bonds in April; reopening of 2011 and 2014 bonds aggregating US$400 million in May for on-lending to or investment in securities of the National Power Corporation/Power Sector Assets and Liabilities Management Corporation (NPC/PSALM); reopening of 2017 bonds in the amount of US$250 million in July for investment in securities of NPC/PSALM; reopening of 2010 Eurobonds valued at EUR350 million (US$421 million) in August; reopening in September of 2015 and 2025 bonds aggregating US$1.0 billion, of which US$750 million was intended for investment in NPC/PSALM securities; and US$75 million drawings from Asian Development Bank's 15-year loan for the Second Non-Bank Financial Governance Program; (b) Metropolitan Waterworks and Sewerage System's US$150 million proceeds from Tranche I of its US$220 million 7-year Fixed Rate Notes; (c) Development Bank of the Philippines' (DBP) US$70 million 3-year syndicated loan; US$85 million partial drawing under the 23rd Yen Credit Package and JPY10.0 billion (US$92 million) final availment on its 10-year JPY32.5 billion loan both from the Japan Bank for International Cooperation (JBIC); (d) the BSP's US$500 million term loan facility in April, of which US$229 million was funded by offshore creditors; and (e) PNOC-Energy Development Corporation's US$55 million offshore portion of the US$75 million syndicated term loan facility.
[22] The weighted average maturity of MLT debt as of end-December 2003 was 17.2 years.

Weighted Average Based On Original Maturity of MLT Debt As of end-December 2004	
	No. of years
Total MLT Debt	17.4
Public sector	19.6
Private sector	10.9

Official creditors (multilateral and bilateral institutions) provided bulk of foreign financing, accounting for 46.0 percent of total credits. Meanwhile, foreign holders of bonds and notes continued as the next major source of external funds at 28.9 percent share. Holdings of debt papers by non-residents consisted mostly of sovereign-issued bonds. Since 1999, the NG has been raising funds from external sources largely through bond issuances to fund part of its financing requirements.

External borrowings remained denominated largely in the currencies of the country's major trading partners, namely, in US dollars (51.2 percent) and Japanese yen (30.0 percent).



Debt servicing capacity improves

The ratio of debt service to exports of goods and receipts from services and income (including workers' remittances) declined significantly to 13.8 percent in 2004 from 16.9 percent in 2003 (Table 14). The improvement in the debt service ratio resulted from the combined effects of lower principal and interest payments and higher export receipts.[23]

[23] Workers' remittances used to compute the ratio are based on foreign exchange receipts coursed through and reported by banks only.

PART THREE: THE BANK'S OPERATIONS

Monetary Stability

BSP left its policy interest rates unchanged in 2004 as inflation was driven by supply-side factors

The BSP kept policy interest rates on hold in 2004 despite inflation rising above the target range. Due to the supply-side nature of ongoing inflation pressures such as the jump in meat and fish prices, and followed by the surge in world oil prices and the hike in transportation and utilities charges, authorities refrained from using policy interest rates to protect the inflation target, opting instead to support the use of non-monetary intervention measures by other government agencies to directly address the supply-side risks to prices.

Policy interest rates

In 2004, the BSP left its policy interest rates unchanged at 6.75 percent for overnight reverse repurchase rate (RRP) and 9.0 percent for the overnight repurchase rate (RP).[24] However, concerns about the inflationary impact of exchange rate volatility early in the year prompted the Monetary Board to raise the liquidity reserve requirement ratio in February 2004 by 2 percentage points to 10 percent while keeping the regular reserve ratio at 9 percent. This move helped siphon off any excess liquidity from the banking system that would have otherwise found its way into the foreign exchange market.

Monetary stance was based on assessment that inflationary pressures were supply-side related

The Monetary Board's decision to keep policy interest rates unchanged during the year was based on its assessment that both ongoing and prospective pressures on inflation were primarily related to supply-side sources rather than demand-side factors. These supply-side factors included the worldwide increase in oil prices that fed into higher cost of producing goods and services, and other domestic supply constraints that led to higher prices of specific food items. The Monetary Board believed that these price pressures were transitory in nature and would have no lasting impact on the long-run path of inflation. This analysis is consistent with past experience which suggests that headline inflation has a tendency to quickly revert to trend following episodes of supply-side pressures. This view is also consistent with the BSP's outlook for inflation, which indicated that inflation is likely to decelerate over the policy horizon after a brief surge. This was particularly crucial given that monetary policy actions normally require a time lag (currently estimated at 15-21 months) to

[24] These key interest rates were last changed on 2 July 2003.

exert their full impact on inflation. Because of this transmission lag, monetary actions undertaken in 2004 would primarily affect inflation in 2006 and have only a minimal impact on 2004-2005 inflation.

Monetary authorities also held the view that the lack of a broad-based upsurge in demand conditions argued against an increase in the BSP's policy rates. The Monetary Board noted in particular that demand expansion has been driven mostly by consumption rather than capital spending, and the expansion has continued to be accompanied by high unemployment and a moderate pace of lending activity, which suggest the continued presence of slack in the economy.

Authorities supported the use of non-monetary measures to address supply-side risks

Given the dominant role of supply-side developments in the inflationary process, the Monetary Board believed that inflation would be best mitigated by appropriate non-monetary policy measures that would, among other things, facilitate the timely importation, distribution and delivery of certain commodities. Accordingly, the BSP actively supported the use of non-monetary government intervention measures to address supply-side risks more directly, particularly with regard to food prices. The BSP coordinated with government agencies such as the Department of Agriculture (DA) and the Department of Trade and Industry (DTI) in identifying measures to fill the gaps in domestic food supply, such as encouraging the timely importation of meat and corn.

However, the BSP remains ready to undertake policy action if necessary

Nevertheless, the BSP also recognized the risk of spillover demand-side effects from supply shocks, and emphasized its readiness to take appropriate action when the evidence begins to point more strongly to the following conditions: (1) the emergence of demand-side pressures on consumer prices; (2) the emergence of inflationary pressures that are over and above those generated by ongoing supply shocks; and (3) an increased risk of exchange market pressures, arising from narrowing interest rate differentials, which could feed into inflation and inflation expectations.

Open Market Operations

Open market operations (OMOs) were conducted in line with the BSP's supportive monetary policy stance, which aimed to ensure adequate liquidity in the financial system that is consistent with the economy's growth and inflation paths. Such operations consisted mainly of outright purchases/sales of BSP's holdings of T-bills as well as lending and borrowing under the RRP and RP facilities of the BSP. The BSP's conduct of OMO in 2004 contributed to the net expansion of liquidity in the system by ₱34.5 billion, alongside the two percentage-point hike in banks' liquidity reserve requirements in February which prompted a decline in banks' placement with the BSP under the BSP's RRP window.

Transparency Measures

In terms of policy communication, the BSP also set about informing the public of the potential breach of the inflation target in 2004 and 2005 as soon as the BSP's inflation forecasts began to show strong indications of the likely breach. Communications with the public concerning the monetary policy stance, through press releases, the BSP Inflation Report, press conferences and public briefings, emphasized the predominant role of supply-side factors in the inflation outlook and noted that overall economic conditions do not warrant a tightening of monetary policy settings through an increase in BSP policy interest rates.

The BSP also sent a letter to the President on 3 September 2004 apprising Her Excellency of the inflation developments, outlining the reasons behind the rising inflation and indicating the measures being undertaken by the BSP and other government agencies to mitigate the impact of higher inflation. On 6 January 2005, following the release of official data confirming that the 2004 average inflation rate exceeded the government target of 4-5 percent, the BSP submitted an Open Letter to the President to explain the deviation from the inflation target as well as clarify the results and reasons behind BSP's monetary policy decisions.

Financial Stability

BSP Maintains Financial System Stability

BSP gives priority to addressing asset quality issue

The BSP sustained its reform initiatives to further strengthen the financial system. During the year, policy measures implemented by the BSP were aimed at making the banking system more resilient, dynamic, competitive, and stable. Addressing the asset quality issue of banks topped its list of priorities. Regulations were issued to address the gradual clean-up of banks' balance sheets and deal with the fundamental weaknesses in the management of credit risk. Simultaneous with efforts to maintain the health of the banking system, were moves to develop the domestic capital market as a financing alternative. Towards this end, the BSP pursued the institutionalization of third party custodianship to lay the foundation for a deeper and broader secondary debt market activities.

Other prudential regulatory standards were continually strengthened and aligned with international standards. These changes sought to address four vital areas of concern: enhancing risk management, strengthening corporate governance, upgrading prudential regulations, and improving banking services.

Addresses asset quality concerns

Grants regulatory relief for asset transfers

The BSP supplemented the fiscal incentives under the SPV Law with regulatory relief measures to jump-start the clean up of the enormous inventory of NPAs in banks' books. These measures essentially allowed banks to spread out the impact of losses that may arise from the sale or transfer of NPAs at deep discounts. Banks were allowed to stagger loss recognition over a 10-year period for purposes of compliance with regulatory capital requirements, subject only to full disclosure for financial transparency.

Strengthens credit risk management

Improvement in credit risk management to prevent NPA build up

Various initiatives were undertaken by the BSP to address the asset quality issue at the source. By dealing with fundamental weaknesses in the management of credit risk, the recurrence of the NPA problem may be avoided after the books are cleaned up.

The BSP issued guidelines for managing large exposures and credit risk concentrations. The rules require that the board and senior management of a bank should ensure that adequate systems and controls are in place to identify, measure, monitor, and report large exposures and credit risk concentrations of the bank in a timely manner. Large exposures of banks would also be kept under regular review.

Universal and commercial banks were also required to develop and implement an internal credit risk rating system. The BSP Circular prescribes the minimum operational requirements and minimum technical standards that banks must consider in developing their own credit risk rating systems. Banks were also required to develop and maintain an appropriate, systematic and uniformly applied process in determining the amount of reserves for bad debts or doubtful accounts.

Supports Development of Domestic Securities Market

BSP issues standards on accreditation of third-party custodians

The BSP's initial contributions to the much-needed development of the country's domestic capital market included active nurturing of domestic rating agencies which play an important role in guiding the public to make sound investment decisions and in enforcing effective market discipline on issuers. In 2004, the BSP established a third-party custodianship system for securities by setting accreditation standards for third-party custodians. The new regulation seeks to activate a deeper and broader secondary debt market through the development of a properly regulated securities borrowing and lending mechanism. An independent securities custody system is expected to improve investor protection, defeat market malpractices such as multiple selling of securities and undocumented transactions, and reduce systemic risk overall.

Strengthens Corporate Governance

BSP revises rules to strengthen corporate governance

The BSP revised the disqualification and watchlisting procedures for director/officer or employee of banks and non-bank financial intermediaries to ensure that officials are fit and proper for their jobs. The BSP shall maintain a watchlist of persons disqualified to be a director or officer of entities under its supervision.

Rules on interlocking officerships were strengthened to ensure that the interlocking positions do not involve any functional conflict of interests. Specific duties and responsibilities of the Board of Directors were also defined to ensure proper internal system.

Realizing the importance of external auditors on corporate governance, the BSP also rationalized the rules on the selection and inclusion of external auditors in the BSP list. The BSP will make an annual assessment of the performance of external auditors. Those external auditors who meet the requirements specified in this Circular shall be included in the list of BSP selected external auditors.

Enhances Risk Management

BSP issues guidelines to improve capital adequacy

The BSP issued the guidelines for the capital treatment of banks' investments in credit-linked notes (CLNs) and similar credit derivative products, such as credit-linked deposits (CLDs) and credit-linked loans (CLLs). Moreover, thrift banks operating FCDUs were required to comply with the regulatory minimum capital within two years. This requirement can be substituted by a capital build-up program for a period of not more than five (5) years or only up to 31 December 2007, approved by the Monetary Board.

Improves Banking Services

BSP issues rules to encourage shift from CTFs to UITFs

The BSP issued a directive paving the way for the creation, administration and operation of UITF. The regulations were intended to align the operation of pooled funds under management by trust entities with international best practices and to ensure differentiation from bank deposits and other direct liabilities of the financial institution. Under the new rules, the UITF, an improved version of the CTF, is exempted from the provisions on reserve requirement, single borrower's limit and DOSRI.

Guidelines were also issued to discourage unscrupulous collection practices of banks' subsidiary/affiliate credit card companies. Lastly, the BSP authorized the removal of the 30 days minimum term of time deposits accepted/offered by banks. Instead, time deposits shall be issued for a specific period of term.

On-Site Examinations and Off-Site Monitoring of Financial Institutions

BSP continues efforts to improve risk-based examination

The BSP made significant progress in its on-going efforts to develop and implement a risk-based approach to examination. The Manual on Supervision and Examination on Financial Institutions was revised to reflect the shift from the traditional checklist approach to the risk-focused examination of financial institutions. The new process provides examiners the flexibility and discretion in developing the appropriate examination strategy that will respond to existing and emerging risks of the institution.

Additionally, the BSP approved the appointing of "imbedded examiners" to supervise specific banks and quasi-banks. These examiners are designated as the "central point of contact" and are expected to know the institution they are in charge of including key developments and risk exposures.

To complement on-site examinations of banks, the BSP likewise conducted off-site surveillance functions. Periodic reports submitted to BSP were verified and analyzed, including a full review of the Consolidated Statement of Condition of banks. Various bank reports were also reviewed and evaluated to monitor any unusual movement in the accounts and to determine compliance with specific provisions of banking laws, rules and regulations. Off-site examination also included the processing of application for/renewal of authority to engage in derivatives and for Certificates of Eligibility (COE) under the SPV Act of 2002.

BSP enhances off-site surveillance system

Apart from existing regulatory reports, the BSP used early warning tools in its off-site surveillance. Bank Performance Reports (BPR) and comprehensive bank folders, which contain key performance indicators, trends and peer group comparisons, were used in monitoring the financial performance of supervised entities in between on-site examinations. The BSP also used a statistical model, the Bank Early Warning System (EWS) that generates one-year ahead forecasts of key bank performance variables, especially solvency and asset quality, to help prioritize on-site examinations.

Philippines' Delisting from the NCCT Progresses

AMLC intensifies efforts to remove the country from NCCT list

The Anti-Money Laundering Council (AMLC) submitted its anti-money laundering implementation plan to the FATF in January 2004 in line with moves to remove the country from the Financial Action Task Force's (FATF) list of Non-Cooperative Countries and Territories. A series of face-to-face meetings with the FATF's Asia Pacific Review Group were held in Hong Kong (May 2004), South Korea (June 2004), and Brunei (October 2004), specifically to update the FATF of the actual AML implementation.

During the Asia Pacific Group (APG) Annual Meeting in South Korea on June 2004, the APG Review Group adopted the Mutual Evaluation Report (MER) on the Philippines, which rated the Philippines as only non-compliant with FATF's 5 Recommendations out of FATF 40 Recommendations. However, due to the absence of an Anti-Terrorism Law, the Philippines was rated as largely compliant on only one out of the FATF 8 Special Recommendations.

The AMLC was able to freeze substantial amount of dirty money and properties in the course of investigation of big money laundering cases in 2004. Several initiatives were likewise undertaken to enhance the detection, prevention, investigation and prosecution of money laundering and terrorist financing cases as well as to enforce and further strengthen domestic and international cooperation.

Box Article 4

**Financial Soundness Indicators (FSIs) –
Tools for Ensuring Financial Stability**

Background

The international financial turmoil during the second half of the 1990's provoked much contemplation and analysis within the international community on ways to strengthen the international financial system, and accentuated the need for better tools to monitor financial risks and vulnerabilities considering their impact on the economy. A study by the IMF looked into the prevalence and severity of the financial crises among its member-countries from 1980 to 1994. The study found that financial sector crises or near-crises occurred in about three-fourth of member countries. These crises sometimes cost more than 10 percent of GDP and impaired the effectiveness of monetary policy as monetary tightening could not be imposed without further harming the financial sector.

In 1999, an initial consultative meeting of experts from central banks, supervisory agencies, academia, the private sector and international agencies lead by the IMF was held, followed by a survey of IMF-member countries in 2000, to assess the needs, existing practices and experiences in using, measuring and disseminating indicators of financial system soundness. And in June of 2001, the IMF Executive Board endorsed a list of macroprudential indicators (MPIs), subsequently renamed financial soundness indicators or FSIs, to promote risk assessment and transparency among financial systems, and consistency in published MPIs.

To encourage the compilation of FSIs by member countries, the IMF in 2003 issued a compilation guide, and is currently conducting a coordinated compilation exercise (CCE) being participated by 60 member-countries in support of their efforts in the compilation process. A meeting of coordinator/country compilers was held at the IMF headquarters in November 2004.

FSIs and Financial Stability Analysis

Sources of financial system vulnerability vary including poor asset quality, inadequate capitalization, excessive government borrowing that is beyond its paying capacity and a sharp depreciation in foreign exchange rate. Thus, the need for analyzing financial stability, monitoring macroeconomic conditions and analyzing debt sustainability.

Financial stability analysis encompasses the assessment and surveillance of the strengths and vulnerabilities of financial systems, with the objective of enhancing financial stability and limiting the likelihood of crisis. In doing so, the following dimensions of surveillance should be examined:

1. macroprudential surveillance using FSIs to monitor the impact of shocks in the financial sector;
2. financial market surveillance concerned with evaluating the risk of shocks occurring; and
3. surveillance of macro-financial linkages aimed at assessing the impact of shocks transmitted through the financial sector on macroeconomic conditions.

FSIs, therefore, act as tools for ensuring financial stability through effective macroprudential surveillance.

Philippine FSIs

Earlier work on macroprudential analysis led to an initial, relatively broad set of indicators comprising of aggregate microprudential indicators of the health of financial institutions, macroeconomic variables associated with financial system vulnerability, and market-based indicators. This was later on modified to distinguish between the core and the encouraged set of FSIs to indicate compilation priorities.

The core set of FSIs is considered to be highly relevant in a wide range of countries due to: (1) their importance for assessing risk to financial stability, (2) the clear understanding of how they should be used and (3) the underlying data are generally available. At present, these are all FSI for the banking sector, reflecting its central role in all financial systems.

The encouraged set includes FSIs for both financial and non-financial sectors (corporate, real and household) that are likely to be relevant in many countries, but requires further analytical work to clarify their role in financial system vulnerability.

The BSP, being the principal source of banking sector data necessary for the core set of indicators, has taken the lead role in compiling the Philippine FSIs. Bulk of the database of the core FSIs is nearly complete. Much work needs to be done, however, on the encouraged set. Collection of the underlying data requires certain changes in regulations and reporting requirements. To date, mapping of required with existing accounts is being done to identify the necessary improvements. Coordination with other agencies (i.e., Insurance Commission (IC), Securities and Exchange Commission (SEC), NSO, etc.) is also necessary to facilitate financial sector data consolidation and compilation of non-financial information.

Conclusion

Strengthening the financial system and detecting crises before they materialize require understanding of how vulnerabilities build up over time, as well as understanding of the mutually reinforcing dynamic interaction between the financial system and the real economy. Thus, the development of FSIs for macroprudential analysis.

The BSP has taken a proactive stance and has long been working with the private sector as well as with local and international agencies to help strengthen the Philippine financial system. For years, it has already been monitoring the core set of FSIs and is now preparing to build the database on the encouraged set.

References

International Monetary Fund, 2004, “Compilation Guide on Financial Soundness Indicators”
______, 2003, “Financial Soundness Indicators”
______, 2003, “Financial Soundness Indicators – Background Paper”
______, 2001, “Financial Soundness Indicators: Policy Paper”
______, 2001, “Macroprudential Analysis: Selected Aspects
______, 2001, “Macroprudential Analysis: Selected Aspects – Background Paper”
______, 2000, “Macroprudential Indicators of Financial System Soundness – Occasional Paper No. 192”
Krueger, Russel, The Statistical Foundations of Financial Soundness Indicators, International Monetary Fund, Undated

Payment and Settlement System

Enhancements for PhilPASS undertaken to align the country's financial infrastructure with global standards

PhilPASS implements DvP system for secondary trading of GS

In an effort to further align the country's financial infrastructure with global standards, the BSP's real time gross settlement (RTGS) system (the Philippine Payment and Settlement System or PhilPaSS) implemented the DvP system for transactions on secondary trading of GS during the year in review.[25] This is aimed at eliminating the settlement risks inherent to this transaction, encourage interbank debt trading, enhance market liquidity and spur the development of the capital market. Under the DvP system, banks' deposits with the BSP are checked alongside their GS holdings with the BTr's ROSS. The system transfers securities from the seller to the buyer's ROSS account only if a corresponding payment is deposited in the seller's BSP account. The implementation of the DvP system is also in line with the BSP's role as central custodian of banks' proprietary holdings of GS.

The development of the DvP system constituted the third phase of the BSP's RTGS project which became operational in December 2002 and is a joint undertaking of the BSP, the Money Market Association of the Philippines (MART) and the BTr.

To further enhance the safety and efficiency of the PhilPASS, the following initiatives were undertaken by the BSP in 2004:

? Collection of the revised PhilPASS fees
? Real time processing and settlement of Electronic Funds Transfer Instruction System (EFTIS) instructions
? On-line access of the BTr and Security Plant Complex (SPC) to their Demand Deposit Account with the BSP
? Automation of entries relative to withdrawals coursed through Integrated Regional Information System (IRIS)
? Exemption from PhilPASS fees of transactions with values less than or equal to ₱100
? Improve handling of rural and thrift banks' withdrawals for credit to designated banks

During the year in review, the number of transactions through the PhilPASS stood at 258,394 with a total value of ₱33.6 trillion, an increase of 61.3 percent in volume and 1.2 percent in value over the previous year. The BSP's PhilPASS has 89 registered member-banks since it was launched in December 2002 composed of 42 commercial banks, 39 thrift banks and eight non-banks with quasi-banking functions.

[25] Under the DvP mechanism, the delivery of securities occurs only if the corresponding transfer of funds occurs.

The Bank's Other Key Operations

Loans and Credit

Section 81 of R.A. No. 7653 (or the BSP Charter) authorizes the BSP to extend rediscounts, discounts, loans and advances to banking institutions in order to influence the volume of credit consistent with the objective of price stability. Thus, the BSP refinanced credits extended by banking institutions through its rediscounting facility.[26] The BSP also granted loans or advances to banking institutions in precarious financial condition or under serious financial pressures, subject to certain conditions provided under Section 84 of the BSP Charter.[27] Moreover, the BSP provided loans for the purpose of meeting the liquidity requirements of financial institutions through the Philippine Deposit Insurance Corporation (PDIC), pursuant to Section 13 of the PDIC Law (R.A. No. 3591 dated 22 June 1963, as amended by R.A. No. 7400 dated 13 April 1992).

Towards this end, BSP adhered to sound credit policies including: strict compliance with the rediscounting budget; close monitoring, through periodic examination, borrowers' compliance with the terms and conditions of their loans; aggressive collection campaign; institutionalizing legal action against delinquent borrower-banks using pre-defined threshold criteria on arrearages; and, recently, the adoption of the Credit Information System (CRIS), a credit scoring system which determines a bank's rediscounting ceiling with the BSP.[28]

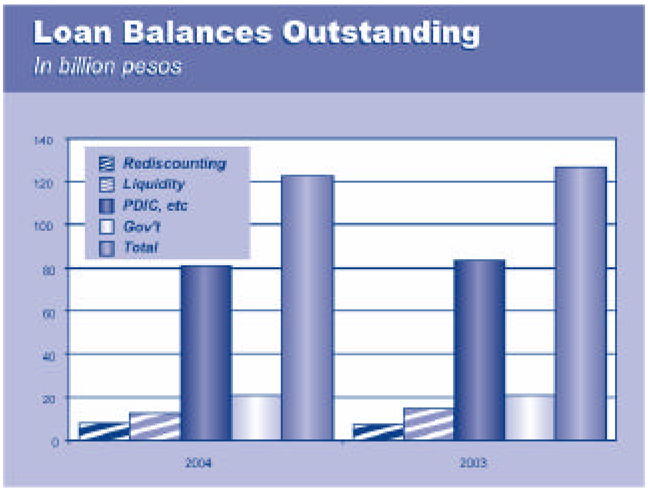
As of 31 December 2004, the total loan portfolio of the BSP amounted to ₱122.6 billion.

---

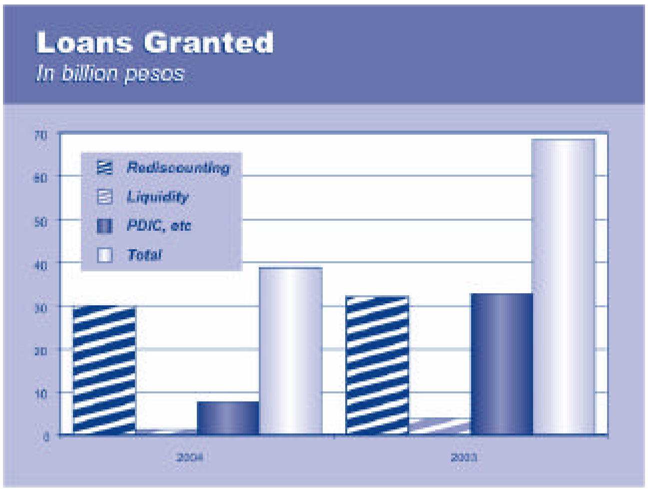
[26] Section 82 of R.A. No. 7653 authorizes the BSP to carry on the following credit operations with banking institutions operating in the Philippines: commercial credits, production credits, and other credits. These credits are provided under the BSP's peso and dollar -yen rediscounting facility.

[27] Section 84 of R.A. No. 7653 authorizes the BSP to grant extraordinary loans or advances to banking institutions, even during normal periods, for the purpose of assisting a bank in precarious financial condition or under serious financial pressures brought about by unforeseen events, or events, which though foreseeable, could not be prevented by the bank concerned: provided, however, that the Monetary Board has ascertained that the bank is not insolvent and has the assets defined in this section to secure advances: provided further, that a concurrent vote of at least five (5) members of the Monetary Board is obtained.

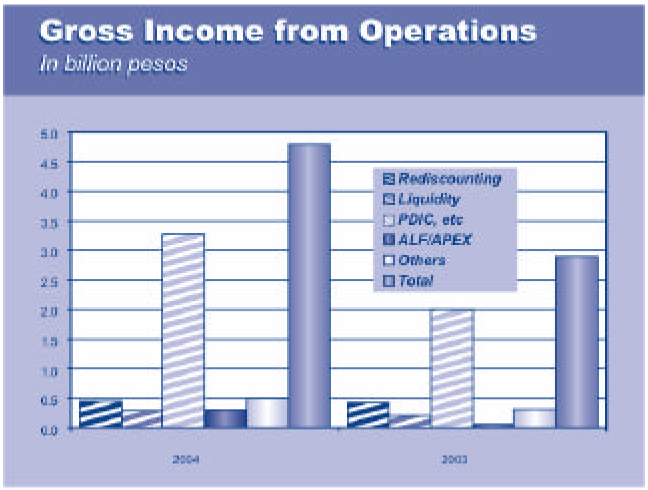
[28] As approved by the Monetary Board on 6 January 2005



During the year, total loans granted amounted to ₱38.9 billion. The bulk of loans granted amounting to ₱30.0 billion came from the rediscounting window. Loans extended to PDIC totaled ₱7.6 billion. Total rediscounting loans granted to commercial banks for both peso and the Exporters' Dollar and Yen Rediscount Facility (EDYRF) increased by 61.4 percent to reach ₱22.8 billion. Only thrift and rural banks obtained liquidity assistance in the amounts of ₱1.2 billion and ₱0.01 billion, respectively. Regular rediscounts of ₱30.0 billion granted during the period were channeled mainly to export/import financing activities (₱22.3 billion).



Total gross income from lending operations of the Head Office reached ₱4.8 billion. This was ₱1.86 billion or about 63 percent higher than the previous year's level. More than two-thirds of the income generated came from PDIC loans.



Asset Management

The BSP ensured that its foreclosed assets were administered, preserved and disposed of properly. As of end-December 2004, the book value of acquired assets increased by 1 percent year-on-year to ₱11.56 billion. Meanwhile, the number of real property titles declined by 4 percent to 16,963 units due to redemption and sale of some acquired assets.

To improve the administration of foreclosed properties, the BSP implemented new guidelines on managing acquired assets in 2004. These included the revision of the consolidated set of guidelines on the redemption of assets foreclosed by the BSP and approval of policy guidelines on the disposal of real properties through auction and negotiation.

Reserves Management

In 2004, the BSP continued to manage its GIR at a level and mix that allowed the BSP to meet any unforeseeable demand for foreign currencies. The BSP adhered to a strategy of yield enhancement, optimal utilization and diversification in the investment of the country's GIR. The BSP engaged in spot and options trading to shift US dollar-denominated foreign investments to Euro. It also took advantage of the significant increase in gold prices, thereby improving its income position.

The BSP likewise implemented in 2004 a number of new measures in order to enhance yield, foster regional cooperation and improve existing procedures in reserves management. These included the: (1) resumption of investment in credit-linked securities; (2) implementation of daily gold and silver price setting that is more reflective of market prices; (3) launching of the local currency Asian Bond Fund (ABF) II in December 2004; and (4) acquisition of a middle office risk management system (RMS) that will serve as a useful mechanism in identifying, measuring and controlling risks in the BSP's management of reserves.

International Operations

The BSP evaluated foreign borrowing proposals with the view to ensuring that foreign obligations incurred are for priority projects and are within the country's capacity to pay. It also actively participated in loan negotiations of the Government and provided financial advisory services to both public and private sector borrowers to assist them in securing reasonable terms and conditions on their borrowings.

In 2004, the total MLT foreign loans approved by the BSP amounted to US$8,317 million reflecting a 5.8 percent increase from the US$7,857 million approved in 2003. About 75.4 percent of the total pertained to the public sector while 24.6 percent were for the private sector.

Meanwhile, private sector loan approvals amounted to US$2,049 million reflecting a decline of 14.7 percent from preceding year's approvals. Banks and financial institutions provided 57.4 percent, followed by bond/note holders, which accounted for 24.9 percent of the total private sector loans approved. The loans were mainly for refinancing maturing obligations, relending and financing telecommunication, transportation and power projects.

In addition, the BSP also registered foreign direct investments amounting to US$680 million, 54.3 percent less than the US$1,488 million registered investments in 2003. This was traced mainly to the sharp declines in the registered FDIs for the communication and non-bank financial intermediation sectors. Under BSP's consolidated foreign exchange rules, the registration of foreign investments with BSP is not mandatory. It is only required if the foreign exchange needed for servicing the remittance of dividends/profits/earnings which accrued thereon and repatriation of capital shall be obtained from the banking system.

Notes and Securities Printing

The BSP printed a total of 942.0 million notes for 2004 representing 89 percent of the year's target of 1,059.8 million pieces. The total delivery to the Cash Department (CD) for the year was 792.6 million pieces equivalent to 84 percent of the total available notes. Included in the delivery were 569 live 200-Piso 4-out sheets and 300 live 20-Piso 4-out sheets and 300 live 20-Piso 32-out sheets with microcredit logo.

Currency Issuance and Retirement

Currency Issuance

The BSP issued to the banking system ₱286.91 billion worth of currency notes and coins, 13.97 percent higher than the previous year's total of ₱251.75 billion. New and reissued fit notes in 2004 amounted to ₱285.51 billion, or an increase of 14.05 percent from ₱250.34 billion notes issued in 2003.

Currency Retirement

Processed/verified canceled notes, which were retired through the Security Engineer Machine (SEM) Disintegrator and on-line thru the Currency Verification, Counting & Sorting (CVCS), totaled 482.23 million pieces amounting to ₱75.96 billion in 2004. This was 11.9 percent higher in value compared to the ₱67.88 billion notes retired in 2003.

Mint and Refinery

The BSP sustained its mint and refinery operations in 2004. It produced circulation coins as well as special coinage and medals in the most economic, efficient and secure way. It also manufactured and supplied presidential medals and state decorations; purchased gold from small-scale miners in accordance with Section 17 of R.A. No. 7076, "People's Small-Scale Mining Act of 1991" and from other sources; and refined the gold purchased to forms acceptable in the international bullion markets. In 2004, the BSP purchased 1.01 million troy ounces (tr. oz.) of panned gold, which contained 979.0 thousand tr. oz. of fine gold. Gold purchases declined slightly by 6.8 percent in 2004 from 1.05 million tr. oz. in 2003. The BSP has four existing buying stations located in Quezon City, Baguio City, Davao City and Zamboanga City. Most of the gold purchased were sold and delivered to the Mint and Refinery Operations Department (MROD) and the BSP regional office in Davao, which accounted for 64.3 percent and 24.5 percent, respectively, of the total gold procurement.

The production of refined gold totaled 2,993 "good delivery" gold bars which contained 1.2 million tr. oz. of fine gold. Each bar had a minimum assay of 99.6 percent. The refined gold production in 2004 was higher than the 2003 level and the target for 2004 by 69.9 percent and by 70.8 percent, respectively.

The BSP Mint produced 1.195 billion circulation coins in 2004, consisting of 10-Piso, 5-Piso, 1-Piso, 25-Sentimo, 10-Sentimo and 5-Sentimo denominations. The output in 2004 was lower by 11.5 percent compared to the previous year's output of 1.35 billion coins.

Economic Research, Statistical, and Information Dissemination Activities

The BSP continued to conduct economic research and prepare policy studies in the areas of monetary, banking, credit and foreign exchange policies as mandated by the New Central Bank Act. These studies assisted monetary authorities in the formulation, implementation and review of monetary and financial policies as well as the determination of the appropriate stance of the BSP on relevant international issues. Moreover, the BSP continued to undertake activities to improve its efficiency in data generation and ensure the integrity of its database.

Inflation Targeting

The BSP continued to implement inflation targeting, which is a forward-looking approach in the conduct of monetary policy that was formally adopted by the monetary authorities in January 2002. The BSP announced its commitment to attain an annual inflation target of 4.0 to 5.0 percent in 2004.

The National Statistical Coordination Board (NSCB) in June 2003 adopted an official definition and methodology for computing core inflation in the Philippines. This is the output of the inter-agency technical discussions in 2003 participated in by the BSP, together with other government agencies. In line with the BSP plans to use the official measure of core inflation as a supplementary indicator of consumer price movements under the inflation targeting framework, the BSP published a Primer on Core Inflation in 2004 to familiarize the public with the concept of core inflation.

Preparation of Policy Papers and Conduct of Special Studies

The BSP prepared policy papers and special studies which served as bases for the Advisory Committee's recommendation to the Monetary Board on monetary policy stance. These papers and studies included views and perspectives on capital flows, foreign exchange intervention, monetary implications of borrowings by the NG, asset price bubbles, money laundering, risk-based supervision framework, monetary transmission mechanism, EWS, and the impact of the entry of foreign banks on the Philippine banking system.

The BSP also prepared position papers on various issues raised and/or required by multilateral/international and regional institutions/fora including the IMF, the World Bank (WB), the Bank for International Settlements (BIS), the South East Asian Central Banks (SEACEN), the Executives Meeting of East Asia and the Pacific (EMEAP), the Association of South East Asian Nations (ASEAN) and the Japan-Philippine Economic Partnership Agreement (JPEPA).

Participation in Inter-Agency Discussions on Economic, Monetary and Financial Development Issues/ Negotiations on Multilateral, Regional and Bilateral Financial and Economic Cooperation

The BSP participated in inter-agency committee meetings that were tasked to draw the Philippines' macroeconomic programs and formulate the stance of the Philippine government on various proposals under the World Trade Organization (WTO), the ASEAN and bilateral economic and financial matters, among others. Foremost among these inter-agency committees are the Development

Budget Coordinating Committee (DBCC), the Committee on Tariff and Related Matters (CTRM), the Philippine Council on ASEAN and APEC Cooperation (PCAAC), the Inter-Agency Committee on Trade in Services (IAC-TCS), the TRM Inter-Agency Sub-Committee on Trade and Investment Agreements (IAC-TIA), and the Philippine Coordinating Committee on the Japan-Philippine Economic Partnership Agreement (PCC-JPEPA). The BSP also participated in negotiations on financial services liberalization under the ASEAN Framework Agreement on Services (AFAS) and the proposed Japan-Philippine Economic Partnership Agreement.

Information Dissemination Activities

As part of the BSP's communication mechanism to the general public, the BSP continued the publication of the quarterly BSP Inflation Report, the quarterly Report on Economic and Financial Developments (Fourth Quarter 2003 and First, Second and Third Quarters 2004 issues), A Status Report on the Philippine Financial System (Second Semester 2003 and First Semester 2004) and the 2003 BSP Annual Report. The preparation of these reports was in compliance with the required submission of reports and publications to the President of the Philippines and to Congress under Sections 39 and 40 of The New Central Bank Act.

The Bangko Sentral Review continued to be published as a major vehicle for in-depth research output. The research articles in this publication are also intended to increase public awareness of the activities of the BSP and its views on relevant economic issues. The January and July 2004 issues of the Bangko Sentral Review covered such topics as official measure of core inflation in the Philippines, asset price bubbles, disclosure practices of Philippine universal banks, efficiency of fiscal and monetary policies in the Philippines, macroeconomic implications of migrant remittances, money laundering, implementation of the risk-based supervision framework, monetary transmission mechanism, impact of the entry of foreign banks on the Philippine banking system and the role of the IMF in multilateral trade liberalization.

Generating Timely Economic Data and Other Information

The Electronic Database (EDB) System—the central repository of the various macroeconomic and financial data—was continuously enhanced to improve the efficiency and flexibility in processing, analyzing and presenting the data series being monitored by the BSP. The EDB is also linked to the BSP's Intranet and Internet websites and allows generation of data for the Special Data Dissemination Standard (SDDS) of the IMF and various BSP publications.

The BSP likewise continued to enhance its data generation and information gathering capability by conducting the following surveys regularly:

1. Monthly survey on intercompany/offsetting accounts with non-residents for member companies of the Semiconductor and Electronics Industries of the Philippines, Inc.;
2. Monthly survey on positions and transactions with non-resident banks;
3. Monthly survey on transactions of Build-Operate-Transfer (BOT) companies;
4. Cross border transactions survey;
5. Annual coordinated portfolio investment survey; and
6. Quarterly business expectations survey (BES).

To complement the BES and to feel the pulse of the consumers, the BSP initiated the quarterly Consumer Expectations Survey (CES) in coordination with the NSO in 2004. Starting in the third quarter of 2004, the CES survey questionnaires were distributed as a rider to the NSO's quarterly Labor Force Survey (LFS).

Supervisory Policy Development and Banking Statistical Activities

The Monetary Board in June 2004, created two specialized offices to conduct studies on supervisory policy developments and banking data management.[29] The task of supervisory policy development shall involve the conduct of studies on the dynamics of the financial system, monitoring and analysis of developments in the financial sector, determination of potential crises affecting the

[29] The MB, through its Resolution No. 829 dated 10 June 2004 created two specialized offices in place of the old Supervisory Reports and Studies Office—the Office of the Supervisory Policy Development (OSPD) and the Supervisory Data Center (SDC).

system, and development and review of policies, standards and guidelines on the governance of financial institutions. Banking data management shall involve the establishment of a central supervisory data center tasked with banking data collection, reports enforcement, validation, storage and statistical reporting.

Policy Issuances

Twenty-nine major regulatory issuances were completed during the year. These issuances focused on the attainment of strong corporate governance, improvement of risk management systems in banks, promotion of safe and sound banking practices, improvement of banking regulations and services, and promotion of electronic banking.

The BSP also released reports on the Philippine financial system and on the implementation of laws on liberalization of foreign bank entry and on barangay micro business enterprises (BMBE). It also completed the reports on the monitoring of Top 500 Borrowers, the performance of Foreign Currency Deposit Units (FCDUs) and Offshore Banking Units (OBUs). Periodic stress tests to anticipate potential problems in banks were conducted.

Banking Statistical Data Activities

Among the major banking statistics projects undertaken during the year included the following: 1) implementation of the transmission program of thrift banks' data base file for the Philippine Deposit Insurance Corporation as part of the BSP-PDIC information sharing system; 2) adoption of the General Ledger (GL)/Subsidiary Ledger (SL) Reporting System of Banks/Non-Banks with Quasi Banking Functions (NBQBs); and 3) full implementation of the application systems to include restructured accounts of credit card receivables and of the centralized e-mail addresses for reports that are transmitted electronically.

Branch Operations

The three (3) regional offices and eighteen (18) branches continued to upgrade the delivery of vital central banking services in the regions in 2004. Regional offices and branches serviced the cash deposits from 503 provincial cash centers and cash withdrawals of 400 branches of banks. The regional offices and branches also played a proactive role in the conduct and implementation of the various advocacies of the BSP, particularly: inflation targeting, microfinance, anti-money laundering, clean note policy, anti-counterfeiting, anti-pyramiding and text-messaging scams, and good governance.

Advocacy Programs

Microfinance

The BSP took significant strides in promoting microfinance within the banking sector in 2004.[30] Under the General Banking Law (GBL) of 2000, the BSP was mandated to recognize the peculiar characteristics of microfinance and establish the rules and regulations for its practice within the banking sector. Taking this task at hand, the BSP declared in 2000 that microfinance will be its flagship program for poverty alleviation. The initiatives and programs of the BSP covered the areas of: 1) Policy and Regulatory Environment; 2) Training and Capacity Building within BSP and the banking sector; and 3) Promotion and Advocacy.

Policy and Regulatory Environment

The BSP issued circulars, in the period between 2001-2004, to provide incentives to engage in microfinance in a substantial and prudential manner. Incentives include partial lifting of the moratorium on bank establishment for those engaged in microfinance activities; opening of a rediscount facility for microfinance loans; lifting of the one-year profitability requirement before microfinance-oriented banks can set up new branches subject to certain conditions.

Training and Capacity Building

Two phases of training on the proposed modification of the examination procedures and CAMELS instrument to include microfinance were conducted for nearly 300 bank examiners. For the banking sector, the BSP included microfinance as part of the Basic Rural and Thrift Banking Courses offered by the BSP Institute reaching nearly 1,500 participants. In June 2004, the BSP launched the series of

[30] Microfinance loans are small loans (principal not exceeding ₱150,000) granted to the basic sectors as defined in R.A. No. 8425 (Social Reform and Poverty Alleviation Act of 1997) and other loans granted to the poor and low-income households for their micro-enterprises and small businesses to enable them to raise their income levels and improve their living standards.

seminars for banks engaged in microfinance. The seminars focused on the importance of internal controls, performance standards and best practices for sound microfinance operations.

Promotion and Advocacy

The BSP undertook a regional advocacy program where basic seminars were conducted in strategic regions of the country for potential practitioners. From January 2003 to October 2004, seminars were conducted in ten regional sites—Cebu, Davao, La Union, Pampanga, Quezon, Legaspi, Cagayan de Oro, Iloilo, Tuguegarao and Tacloban, reaching nearly 1,500 participants. The BSP also conducted briefings for big corporations, foundations and international organizations toward the end of 2004. Furthermore, the BSP will be Chair of the National Committee to facilitate, coordinate and oversee the Philippine participation in the year-long celebration of the 2005 United Nations (UN) International Year of Microcredit.

Economic Information

In 2004, the BSP continued the public information campaigns (PICs) outside Metro Manila in line with the effort to increase public awareness on the role of the BSP in the economy and the financial system and to further enhance the transparency of monetary policy. Topics include the BSP's role in the economic and financial system, recent economic developments, inflation targeting, core inflation, implementation of the anti-money laundering law, rediscounting, microfinance and the Special Purpose Vehicle Act and its implementing guidelines. The BSP conducted the PICs in the cities of General Santos, Surigao, Vigan, Zamboanga, Iligan, Ozamis, Cotabato, Cebu, Davao and Baguio. During the last quarter of 2004, the BSP also conducted users' forum on BSP-generated statistics with the objective of making the public understand the meaning of the numbers shown in the statistical tables, statements and reports produced and published by the BSP. The topics covered in the forum include monetary and financial statistics, balance of payments, core inflation, and business and consumer expectations surveys. Three users' fora were held in October 2004 in General Santos, Iloilo and Naga cities to coincide with the celebration of the National Statistics Month held in October every year.

Financial Literacy

The BSP took a proactive stance in embarking on a consumer education program that aims to improve the basic financial literacy of the public. In line with this program, the BSP approved in January 2004 the creation of the BSP Consumer Education Committee. The Committee initially addressed the basic financial literacy needs of consumers of financial products and services. This involved familiarizing the public on the various banking products and services that they usually encounter in ordinary financial transactions. The Committee's objective is carried out through the establishment of an internet website and the publication and distribution of booklets and primers that contain basic information.

Moreover, the BSP promoted consumer rights awareness and protection through its linkage with an inter-agency group, ConsumerNet.[31]

Institutional Development

Corporate Planning

The BSP undertook significant initiatives in strategic management, spearheaded by its Corporate Planning Office (CPO).

One major initiative was the conduct of the BSP Strategic Planning Conference (BSP-SPC) in three parts. Part I served as the venue for direction setting in policy and strategy from the MB to guide Management in the conduct of its operations. Part II updated the Governor on the various actions that were undertaken in response to the MB directives in Part I. The approval of Management was also sought on the proposed operational plans for presentation to the MB in the Plenary Conference (Part III). Part III provided the forum for Management to report back to the MB on the various action plans related to the MB's directives in Part I, particularly on issues that needed to be further discussed or approved.

[31] In an effort to protect consumers from unscrupulous businessmen, a group of national government agencies have banded together to facilitate the resolution of consumer complaints and disseminate information regarding consumer rights. These government agencies are: (1) DTI thru Bureau of Trade Regulation and Consumer Protection (BTRCP), (2) Department of Education, Culture and Sports (DECS), (3) BSP; (4) DA, (5) Department of Interior and Local Government (DILG); (6) Energy Regulatory Board (ERB); (7) Department of Health (DOH); (8) SEC; (9) National Telecommunications Commission (NTC); (10) Housing Land Use Regulatory Board (HLURB); (11) IC (12) BIR; (13) Land Transportation Office (LTO); and (14) Department of Justice (DOJ). The ConsumerNet can be reached at www.i-reklamo.ph.

A significant aspect of the planning process, particularly on major projects that cut across sectors/departments/ offices, is the proper coordination among departments. To enhance coordination, a set of project initiation guidelines were drafted. The guidelines are expected to ensure: (a) proper prioritization and synchronization of operating plans/activities bankwide; (b) more effective allocation of existing resources; and (c) smooth implementation of operating plans and attainment of corporate goals.

The Bank intensified its campaign to instill its vision of becoming a world class monetary authority and its mission of promoting a balanced sustainable growth through stable prices and a sound financial system. To further impress the Bank's vision and mission on the employees, the Bank installed the following: (1) BSP Vision Statement Markers in Filipino in all elevators of the 5-Storey, Multi-Storey and EDPC buildings; (2) BSP wallpaper and screensaver in PCs and laptops in the head office, regional offices and branches; and, (3) framed poster of the BSP vision and mission statements in conspicuous places in each of the BSP's departments/offices including regional offices and branches. In addition, the cascade of the BSP's Vision and Mission Statements was incorporated in the quarterly Induction Course for New Employees of the Bank. As a follow-through activity on the cascade of the BSP vision and mission statements, BSP pins were awarded to all employees in the regional offices/branches. This helped raise employee discipline, particularly for BSP staff in the regional offices/branches, as well as foster unity in the organization.

During the year, the Bank institutionalized the use of a standard format for its internal and external communications in line with its initiatives to promote a safe and sound financial system. The approved standard forms reflected the new BSP slogan "Pananalaping Matatag, Bansang Panatag".

Human Resource Management

In 2004, the BSP's activities on human resource focused on improving employee benefits and enhancing effective supervisor-subordinate relations. During the year, the BSP implemented the System Application and Products (SAP) HR System that integrated the HR Information System to provide real time and accurate data viewing.

In line with its objective of promoting physically healthy employees, the BSP put up the Physical Fitness Center and fully implemented the no-smoking policy in the Bank.

To reward its deserving employees, the BSP continued to give its Program on Awards and Incentives for Service Excellence (PRAISE) awards, which include the Outstanding Department Award, Outstanding Regional Award, Academic Achievement Award, Perfect Attendance & Punctuality Award and Loyalty Award.

Bankwide reorganization was initiated, covering key departments such as the Supervisory Reports & Studies Office, Medical & Dental Clinic, Corporate Affairs Office, Administrative Services Department, Information Systems & Technology Department, Office of Special Investigation and the Department of Economic Research.

Competency-based programs were also pursued, including team-building activities and lecture series for professional enrichment of staff covering work attitude, grief and crisis management, Philippine culture, food painting, yoga and medical updates.

Conferences, Seminars and Workshops

The Bank promoted positive values and upgraded the knowledge and skills of its officers and staff and kept its external clients informed by providing training programs benchmarked against global practices. Officers and staff were kept abreast with recent economic and financial trends and honed their analytical skills through continuing access to global training programs.

In-house development programs were conducted based on a comprehensive curriculum for behavioral and technical programs for various professional, occupational and managerial groups. Training programs were linked with performance improvement. The Bank also facilitated skills certification of BSP staff in core/specialty functions such as Chartered Financial Analyst (CFA) and Certified Information System Auditor (CISA).

The BSP hosted international conferences and seminars and participated abroad in such fora organized by multilateral and regional bodies and financial institutions. These conferences and seminars covered monetary policy and macroeconomic management, treasury management and operations, supervision and examination, payments and settlements systems, central banking, accounting and auditing, and risk-based management among others.

The BSP also co-hosted 7 regional training events:

1. Risk-Based Supervision for Financial Sector Regulators

2. FSI-SEANZA Forum on Banking Supervisors Regional Seminar on the New Basel Capital Accord – Practical Application

3. 4th SEACEN-Toronto Centre Leadership Seminar for Senior Management of Central Banks on Financial System

4. IMF-STI Course on Financial Programming and Policies

5. FBI-IFRS Training Course on Terrorism Financing and Money Laundering

6. SEACEN-BIS Seminar on Structural Changes in the Financial Sector: Challenges for Central Banks

7. 25th SEANZA Central Banking Course

In order to have a balanced view and understanding of central banks' functions, operations and reactions to critical issues, the BSP also invited resource speakers from other central banks (e.g. Bank of England, Monetary Authority of Singapore, Bank of Korea, Bank of Japan, Hong Kong Monetary Authority, Bank Negara Malaysia) and the IMF and the BIS to lecture on topics such as Monetary Policy and Operations and Financial Programming, Supervisory Practices and Financial Stability.

Attendance in these trainings/seminars, meetings, conferences, workshops afforded the BSP staff the opportunity to exchange views, gain insights from the participants of other central banks, as well as keep track of economic and financial developments in the region allowing participation in various activities of the different working groups that were formed to address jointly specific issues.

Information Technology

Service delivery and access to required information and communication technology resources were improved with the development and maintenance of application systems, expansion and increased efficiency and security of the network infrastructure.

Application systems development and maintenance.

The BSP completed 7 of 8 modules of the Human Resource Management System covering organizational management, trainings and event management, time management, recruitment, retirement, personnel administration and personnel development.

Network infrastructure.

Network availability to users reached 99.87 percent with network problems being responded to within an hour. These levels met the medium-term target standard on network availability and response to network problems. Furthermore, the local area networks of the BSP regional offices/branches in Cebu, La Union and Iloilo were upgraded, which enabled users to run the IRIS application, send and receive emails, and access the Internet and Intranet.

Security, reliability and resiliency measures.

The BSP completed two disaster recovery tests, attained 100 percent prevention of unauthorized users in host computers, and secured 100 percent virus protection for its computers.

International Economic Cooperation

The BSP actively participated in international cooperation initiatives particularly on monetary and financial matters under the various programs and projects of multilateral and regional bodies and foreign financial institutions.

Association of South East Asian Nations (ASEAN)

Pursuant to the country's commitment in the ASEAN to promote closer economic and financial cooperation in the region, the BSP participated in various ASEAN initiatives on finance cooperation as follows:

Renewal of the ASEAN Swap Arrangement (ASA). Under the Chiang Mai Initiative (CMI)[32] of the ASEAN + 3, the BSP, as the agent bank for ASA in 2002-2004, coordinated the renewal of the ASA in 2004 through the signing of a Supplemental MOU on the ASA as the mode of legal execution of the renewal for a period of two years.

Renewal of the Bilateral Swap Arrangement (BSA) between the Bangko Sentral ng Pilipinas (BSP) and Bank of Japan (BOJ). The BSP and the BOJ agreed on the extension of the BSA on 27 August 2004 for a period of eighteen (18) months or until 27 February 2006 based on the same terms and conditions provided under the existing BSA. The BSA is intended to provide short-term financial assistance in the form of swaps to the participating party which is in need of balance of payment support or short-term liquidity support and shall supplement existing international financing facilities such as those of the IMF and the ASA.

Review of the CMI. As a participating country under the CMI, the BSP is involved in the CMI review which started in 2004 to explore ways of enhancing its effectiveness. The BSP provided inputs to a survey conducted by the Committee on the CMI Review on the views of the ASEAN +3 member countries concerning CMI issues such as the swap activation mechanism, the terms of the BSAs, including appropriate interest rate, the structure and size of the BSA and the surveillance mechanism.

Launching of the Asian Bonds Online Website (ABW). The BSP provided relevant information as input to the Asian Bonds Online Website (http://asianbondsonline.adb.org), which was launched in May 2004 to help improve risk management in the region by increasing information flows. The ABW is an Internet-based clearinghouse for information on sovereign and corporate bond market activities in ASEAN+3 countries.

Implementation of the Road Map for Integration of ASEAN (RIA) in Finance. As part of the financial services

[32] The CMI is a regional financing arrangement through currency swaps adopted by the ASEAN + 3 Finance Ministers in Chiang Mai, Thailand on 6 May 2000. The CMI includes the following components: the ASEAN Swap Arrangement, bilateral swap and repurchase agreement facilities among the ASEAN countries, China, Japan and Korea, and the network of repurchase agreement facilities among the ASEAN countries, China, Japan and Korea.

liberalization initiatives in the ASEAN, the BSP participated in the implementation of the RIA in Finance, specifically on the roadmap on capital account liberalization.

The BSP submitted a report on the Philippines' capital account regime at the 27 August 2004 Meeting of the Working Committee on Capital Account Liberalization in Bangkok, Thailand and agreed to upload the Philippines' matrix on existing measures and restrictions in the capital account in the ASEAN Secretariat website.

Preparation of the Vientiane Action Plan (VAP). The BSP reviewed and provided inputs in the preparation of the draft VAP which was approved by the ASEAN Leaders during the Tenth ASEAN Summit held on 29 November 2004 in Vientiane, Laos. The VAP in financial cooperation (VAP-fin) defines the steps to be undertaken over the next six years (2004-2010) toward achieving the ASEAN Vision 2020 and the ASEAN Community.

Implementation of the Technical Assistance Coordination Program. The BSP collaborated with the Nomura Research Institute (NRI) commissioned by the Working Group on Technical Assistance Coordination to develop the work program for the Philippines. The BSP provided support for the TA project proposed by NRI on the development of primary market for corporate bond in the Philippines.

Preparation of the 9th ASEAN Surveillance Report. Under the ASEAN Surveillance process, the BSP prepared the following inputs for the 9th ASEAN Surveillance Report (ASR): (1) Country report on the Philippines, (2) Discussion on policy issues on the Philippines and (3) ASEAN Surveillance data template.

In 2004, the BSP participated in the following ASEAN Meetings: (1) ASEAN+3 Finance and Central Bank Deputies Meeting (AFDM+3) held in Singapore on 5 April 2004; (2) ASEAN+3 Finance Ministers Meeting (AFMM+3) held on 15 May 2004 in Jeju, Korea; (3) Meeting of the Working Committees on ASEAN Financial Services Liberalization and Capital Market Development held on 19-29 February 2004 in Bangkok, Thailand; (4) Meeting of the Working Committees on Capital Market Development and on Financial Services Liberalization under the AFAS on 22-23 July 2004 in Jakarta, Indonesia; (5) Meeting of the ASEAN + 3 ABMI Focal Group on 12 November 2004 in

Tokyo, Japan and (6) Meetings of the Chiang Mai Initiative Review Working Group on 4 August 2004 in Shanghai, China, 15-16 October 2004 in Singapore and 11-12 November in Tokyo, Japan.

Executives' Meeting of East Asia Pacific Central Banks (EMEAP)

In 2004, the BSP continued to actively participate in the various activities of the EMEAP, in support of the organization's primary objective of enhancing regional cooperation among Asia Pacific central banks.

The BSP hosted the 20th Meeting of the EMEAP Working Group on Financial Markets (WG/FM) held on 19 March 2004 in Cebu during which issues on the Asian Bond Funds (ABFs) and latest developments in financial markets were discussed. The BSP also hosted the 27th Deputies' Meeting held in Manila on 25 September 2004, which focused on issues related to ABF2. In December 2004, the BSP, together with the ten (10) other EMEAP countries, launched the second stage of the ABF initiative or the ABF2. This initiative, which will invest in domestic currency bonds issued by sovereign and quasi-sovereign issuers in EMEAP economies (except Australia, Japan and New Zealand), builds on the successful launch of the first stage of the Asian Bond Fund (ABF1) in June 2003, which invested in US dollar-denominated bonds issued by sovereign and quasi-sovereign issuers in the eight EMEAP markets. All the 11 EMEAP members will invest in ABF2. As a member or the WG/FM, the BSP contributed to the development of the ABF2 including its design and mechanism as well as in the assessment of the benefits of the ABF2 to regional bond market development.

The BSP participated in other EMEAP meetings as follows: (1) the 9th Governors' meeting in Singapore on 15 July 2004 which handled among others, issues discussed pertains to the future of EMEAP as a forum;(2) the 1st Informal Governors' Meeting on 9 November 2004 in Basel held back-to-back with the BIS Bimonthly Meeting. Issues discussed during the meeting included the status of implementation of Basel II in Asia and the future of the EMEAP-Eurosystem seminars; (3) the 26th Deputies' Meeting was hosted by the Hong Kong Monetary Authority in April 2004 (4) the EMEAP working group meetings.

Bank for International Settlements (BIS)

A significant step toward the global integration of the country's financial system is the BSP's membership in the BIS in 2003. To familiarize BSP officials on the activities of the BIS as well as the benefits that the BSP can derive from this membership, a BIS mission, headed by Mr. Gunter Baer, BIS Secretary General, visited the BSP on 17 February 2004.

The activities of the BIS, which currently has 55 member central banks, focus on the promotion of cooperation among central banks and other financial institutions and the provision of financial services to central bank clients.

The BIS provides an institutional framework for cooperation in the monetary and financial area and serves as a venue for exchange and sharing of information for central banks, but also for other financial and regulatory authorities.

A core activity of the BIS is organizing meetings and producing analytical and statistical background papers. The Bank also supports other meetings of senior central bank officials, either regular (such as the biannual Economists' Meetings or the annual meeting of Deputy Governors from emerging market economies) or on an *ad hoc* basis (i.e., whenever special developments merit consideration). Topics of discussion are not limited to financial or economic issues, but can also include legal, governance, information technology and human resource issues of interest to central banks.

The BSP participated in the Special Governors' Meeting in Hong Kong on 8-9 February 2004, which discussed the global external imbalance and the role of central banks and foreign exchange reserve adequacy.

The Asian Consultative Council (ACC) comprised of the Governors of the BIS member central banks in the Asia-Pacific region was established in 2001 to provide a vehicle for communication between the Asian central banks and the BIS Board and Management on matters of interest and concern to the Asian central banking community. The BSP was represented in the two ACC meetings organized in 2004. The BSP also participated in the Working Party for Monetary Policy in Asia.

International Monetary Fund (IMF)

Following the end of a stand-by arrangement in December 2000, the BSP, as the representative of the Government of the Philippines in the IMF Board of Governors, maintained a close dialogue with the IMF within the framework of post-program monitoring (PPM). The PPM arrangement involved program assessments by the Fund, based on a regular review of economic developments and policies rather than on the attainment of specific quantitative targets. The arrangement did not involve a financing component. In 2004, two IMF-PPM missions were conducted in June and November 2004.

Towards the adoption of international norms, the Philippines has agreed to be benchmarked against the standards and codes in the areas of corporate governance, accounting and auditing, and insolvency and creditor rights. The Corporate Governance Assessment of the Philippines is part of the joint World Bank-IMF program of Report on the Observance of Standards and Codes (ROSC), which aims to strengthen the international financial structure. The ROSC assesses the extent of a country's observance of internationally recognized standards and codes that are relevant to the effective functioning of its economic and financial system. The BSP participated in the preparation of the data module under ROSC as part of its continuing efforts to promote transparency and adopt best practices in statistical data compilation and dissemination.

Japan-Philippine Economic Partnership Agreement (JPEPA)

On the bilateral front, the Philippines and Japan reached an agreement in principle on the major elements of the JPEPA, which aims to promote freer transborder flow of goods, persons, services and capital between Japan and the Philippines. The BSP is part of the negotiating panel for the Philippines in the negotiating sessions held starting February 2004. The BSP helped in the formulation of the stance of the Philippines relative to market opening measures on financial services, specifically on commercial banking as well as in developing the framework of financial services cooperation between the two countries.

Memorandum of Understanding (MOU) on Cooperation between the BSP and the State Bank of Vietnam

Another bilateral initiative involving the BSP is the MOU on Cooperation between the BSP and the State Bank of Vietnam which was concluded in December 2004. The drafting of the MOU was first agreed upon during the 3rd Meeting of the Vietnam-Philippines Joint Commission for Bilateral Cooperation held in Manila on 26-28 February 2003 with the end in view of creating a formal structure to enhance the cooperative relationship between the two central banks.

South East Asian Central Banks (SEACEN) Research and Training Center

As part of its commitment to the SEACEN Centre, the BSP hosted the Second Meeting of the SEACEN Executive Committee (EXCO) on 16-17 January 2004 in Manila. The BSP likewise participated in the SEACEN Board of Governors' Meeting on 12-13 February 2004 held in Colombo, Sri Lanka for the Governors to decide and finalize the programs and activities of the SEACEN for Operating Year 2004-2005. To exchange views and share experiences on common issues relating to banking supervision, the BSP participated in the 6th Conference of Directors of Supervision of Asia-Pacific Economies on 23-25 August 2004 and the 17th Meeting of SEACEN Directors of Supervision on 24 August 2004 in Kuala Lumpur, Malaysia. On 13-15 October 2004, the BSP Directors of Research and Training attended the 26th Meeting of SEACEN Directors of Research and Training (DORT) in Bangkok, Thailand. The directors reviewed the progress of research and training activities of the SEACEN Center and helped the Center formulate the programs of research and training activities for OY 2005-2006.

To facilitate cooperation among central banks and monetary authorities in the area of training, the BSP hosted two SEACEN seminars in Manila. The seminar on structural changes in the financial sector was jointly sponsored with the BIS while the other seminar on financial system oversight was co-sponsored by the Toronto Center Leadership Seminar.

The BSP continued to provide inputs to the annual SEACEN Trends and Outlook as well as in the annual Guide to SEACEN Bank Watch—a collation of how monetary policy is formulated and implemented in the SEACEN member banks. The BSP also helped in the preparation of the country paper on the Role of Central Banks in Promoting Small and Medium Scale Enterprises.

South East Asia New Zealand and Australia (SEANZA)

Central banks from the South East Asia New Zealand and Australia (SEANZA) held a meeting in 1956 to jointly run a course that would develop promising officers in central banks for further advancement. From just 5 members, SEANZA's membership grew to 20. Since 1956, members have taken turn in hosting the central banking course and the Governor's symposium. The Bangko Sentral hosted these events first in 1970 and after 34 years it was the BSP's turn to again host the events in 2004. The two-week Central Banking Course was conducted 22 November -3 December 2004 but the Governors' Symposium and Meeting which is to cap the course was deferred to February 2005 in view of inclement weather.

Asia Pacific Economic Cooperation (APEC)

The BSP participated in the APEC Finance and Central Banks Deputies' Meetings on 31 August -1 September 2004 and the 11th APEC Finance Ministers' Meeting on 2-3 September 2004 in Santiago, Chile. The Meetings focused on the following themes: (1) Fiscal Policies for Growth and Stability in an Open APEC Region; and (2) Institution Building in a World of Free and Volatile Capital Flows: Looking Forward to APEC 2020.

As part of the commitment of the Philippines as an APEC member country, the BSP participated in the preparation of the Individual Action Plan (IAP) required under the APEC Peer Review Process. The IAP is updated annually by each member recording therein specific actions that are deemed important in realizing the APEC goal, set down in Bogor, Indonesia, of free and open trade and investment in the APEC region by 2020 for developing economies. The BSP handled the financial services portion of the Chapter on Services of the IAP.

PART FOUR: FINANCIAL CONDITION OF THE BSP

Financial Condition

BSP Balance Sheet

Based on preliminary and unaudited financial statements, BSP net worth at end-December 2004 reached ₱221.6 billion, 9.5 percent higher than the year-ago level (Table 15).

Total assets contracted by ₱76.7 billion or 5.7 percent following decreases in BSP's holdings of domestic securities; international reserves and loans and advances. BSP's holdings of domestic securities declined as banks purchased Treasury bills to comply with the increase in the liquidity reserve requirement by 2 percent in February 2004. BSP's holdings of international reserves fell by US$837 million mainly due to the servicing of the NG maturing foreign obligations and the BSP's foreign exchange requirements. Meanwhile, net loans and advances decreased as banks settled their loan obligations under the repurchase and liquidity loan facilities with the BSP. Banks similarly settled their obligations thru the Philippine Deposit Insurance Corporation (PDIC)

During the same period, BSP liabilities contracted by ₱96.0 billion or 8.5 percent. The decline in liabilities arose mainly from lower deposit liabilities, foreign borrowings, and open market operations. Deposit liabilities contracted as the deposit balances of the NG and the International Monetary Fund (IMF) declined on account of higher NG financing requirements and BSP's lower use of IMF credits, respectively. BSP foreign borrowings declined following settlements of foreign obligations under the gold repo deposit facility, term loan facility, and bonds payable. The decline in BSP domestic borrowings under the reverse repurchase facility indicated its continuing thrust to ensure that there is adequate liquidity in the financial system to support growth without compromising the price stability objective.

Results of Operations

BSP Net Income

Based on preliminary and unaudited data, the BSP's financial operations yielded a net profit of ₱2.1 billion for the year 2004, ₱1.4 billion lower than the net income in 2003 (Table 16). Total revenues at ₱51.2 billion was 0.3 percent higher despite a decline in interest income, which remained as the major source of revenue as lower levels of international reserves, domestic securities, and loans and advances were recorded during the year. The increase in income came mainly from gold trading as the BSP took advantage of higher gold prices. Expenses reached ₱47.1 billion, or 1.7 percent higher than the expenses recorded in 2003, as the cost of minting and printing currency increased by 84.08 percent.

List of Statistical Tables

1	Gross National Product by Industry
1a	Gross National Product by Expenditure
2	Selected Labor, Employment and Wage Indicators
3	Consumer Price Index
4	National Government: Cash Operations
5	Monetary Survey
6	Selected Domestic Interest Rates
7	Exchange Rates of the Peso, Average
7a	Effective Exchange Rate Indices of the Peso, Average
8	Banking System: Deposits Outstanding
9	Financial System: Total Resources
9a	Number of Financial Institutions
10	Stock Market Transactions
11	Balance of Payments
11a	Exports by Major Commodity
11b	Imports by Major Commodity
12	BSP: Gross International Reserves
13	External Debt
14	Foreign Debt Service Indicators
15	BSP: Balance Sheet
16	BSP: Income Position

1 GROSS NATIONAL PRODUCT BY INDUSTRY
In million pesos, at constant 1985 prices

	2004	2003	2002	Annual Percent Change (%) 04/03	03/02	02/01
Agriculture, Fishery and Forestry	225,483	215,031	207,154	4.9	3.8	3.8
Industrial Sector	381,149	361,845	348,677	5.3	3.8	3.6
Mining and Quarrying	18,619	17,856	15,285	4.3	16.8	51.0
Manufacturing	276,368	263,255	252,553	5.0	4.2	3.5
Construction	49,516	45,472	46,667	8.9	-2.6	-5.7
Electricity, Gas and Water	36,646	35,262	34,172	3.9	3.2	4.3
Services	541,371	504,621	477,138	7.3	5.8	5.1
Transportation,Communication & Storage	98,451	87,745	80,805	12.2	8.6	8.9
Trade	192,642	180,460	170,789	6.8	5.7	5.8
Finance & Housing	110,727	103,298	97,868	7.2	5.5	2.6
Other Services	139,551	133,118	127,676	4.8	4.3	3.9
Gross Domestic Product	**1,148,003**	**1,081,497**	**1,032,969**	6.1	4.7	4.3
Net Factor Income From Abroad	91,598	87,281	74,038	4.9	17.9	3.9
Gross National Product	**1,239,601**	**1,168,778**	**1,107,007**	6.1	5.6	4.3

Source: NSCB

1a GROSS NATIONAL PRODUCT BY EXPENDITURE

In million pesos, at constant 1985 prices

				Annual Percent Change (%)		
	2004	**2003**	**2002**	**04/03**	**03/02**	**02/01**
Personal Consumption Expenditures	903,217	853,572	810,753	5.8	5.3	4.1
Government Consumption Expenditures	72,402	72,972	72,608	-0.8	0.5	-3.7
Gross Domestic Capital Formation	237,418	210,638	210,488	12.7	0.1	-5.0
Fixed Capital Formation	228,987	217,878	211,677	5.1	2.9	1.4
Construction	97,698	92,010	94,744	6.2	-2.9	-2.3
Durable Equipment	113,939	109,138	100,593	4.4	8.5	4.8
Breeding Stock & Orchard Development	17,350	16,730	16,340	3.7	2.4	3.3
Increase in Stocks	8,431	-7,240	-1,189	216.5	-508.9	-109.3
Exports	530,394	465,288	445,786	14.0	4.4	3.6
Less: Imports	622,853	586,209	532,049	6.3	10.2	4.7
Statistical Discrepancy	27,425	65,236	25,383	-58.0	157.0	405.9
Gross Domestic Product	**1,148,003**	**1,081,497**	**1,032,969**	**6.1**	**4.7**	**4.3**
Net Factor Income From Abroad	91,598	87,281	74,038	4.9	17.9	3.9
Gross National Product	**1,239,601**	**1,168,778**	**1,107,007**	**6.1**	**5.6**	**4.3**

Source: NSCB

2 SELECTED LABOR, EMPLOYMENT AND WAGE INDICATORS

	2004	2003	2002	Annual Percent Change (%) 04/03	03/02
Employment Status					
Labor Force (In Thousands)	35,860	34,571	33,936	3.7	1.9
Employed	31,611	30,635	30,062	3.2	1.9
Unemployed	4,249	3,936	3,874	8.0	1.6
Employment Rate (%)	88.2	88.6	88.6		
Unemployment Rate (%)	11.8	11.4	11.4		
Overseas Employment (Deployed)	894,661 p	867,969	891,908	3.1	-2.7
Land-Based	669,539	651,938	682,315	2.7	-4.5
Sea-Based	225,122	216,031	209,593	4.2	3.1
Strikes					
Number of new strikes declared	25 p	38	24	-34.2	58.3
Number of workers involved (In Thousands)	11 p	10	8	12.0	25.0
		January-September			
Legislated Wage Rates[1]					
In Nominal Terms					
Non-Agricultural					
National Capital Region (NCR)	310.55	303.33	303.33	2.40	0.00
Regions Outside NCR (ONCR)	139.97-256.75	139.97-256.75	139.97-256.75	0.00	0.00
Agricultural					
Plantation	141.92-263.25	141.92-263.25	141.92-263.25	1.80	0.00
Non-Plantation	140.83-263.25	140.83-263.25	140.83-263.25	1.80	0.00
In Real Terms (at 1994 prices)					
Non-Agricultural					
National Capital Region (NCR)	170.51	173.28	180.06	-1.60	-3.77
Regions Outside NCR (ONCR)	51.46-161.19	53.12-169.72	55.13-171.68	-4.57	-1.75
Agricultural					
Plantation	52.18-147.94	53.86-150.41	55.90-156.26	-2.03	-3.72
Non-Plantation	51.78-147.94	53.45-150.41	55.47-156.26	-2.03	-3.72

[1] Includes Basic Minimum Wage, Cost of Living Allowance (COLA) and daily equivalent of 13th month pay.
[p] Preliminary

Source of basic data: BLES

3 CONSUMER PRICE INDEX
1994=100

Commodity Group	Philippines				Metro Manila				All Areas Outside Metro Manila			
			Percent Change				Percent Change				Percent Change	
	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003
All Items	**180.9**	**171.4**	**5.5**	**3.0**	**183.8**	**174.2**	**5.5**	**3.8**	**179.7**	**170.3**	**5.5**	**2.7**
Food, Beverages & Tobacco	166.3	157.5	5.6	2.0	161.9	153.7	5.3	2.7	167.6	158.6	5.7	1.8
Non-Food	198.7	188.6	5.4	4.1	202.1	193.0	4.7	4.6	197.0	187.1	5.3	3.9
Clothing	156.0	152.5	2.3	2.2	175.6	171.2	2.6	3.0	150.1	146.9	2.2	1.9
Housing & Repairs	207.7	201.0	3.3	2.9	192.6	187.1	2.9	1.6	218.9	211.3	3.6	3.8
Fuel,Light & Water	191.7	178.5	7.4	6.0	215.8	202.2	6.7	10.1	180.3	167.2	7.8	3.7
Services	246.7	226.9	8.7	6.1	246.4	224.1	10.0	7.2	246.9	228.3	8.1	5.5
Miscellaneous	137.1	134.1	2.2	1.7	139.8	136.2	2.6	1.9	136.2	133.5	2.0	1.8

Source: NSO

4 CASH OPERATIONS OF THE NATIONAL GOVERNMENT
in million pesos

	Program 2004	Actual 2003 p	Actual 2004 p	Actual Vs. Program (%)	Annual Change (%)
Revenues	**676,412**	**626,630**	**698,258**	**3.23**	**11.4**
Tax Revenues	596,408	537,361	597,715	0.22	11.2
Bureau of Internal Revenue	476,306	425,352	467,978	-1.75	10.0
Bureau of Customs	112,580	106,092	122,374	8.70	15.3
Other Offices	7,522	5,917	7,363	-2.11	24.4
Non-tax Revenues	80,004	89,269	100,543	25.67	12.6
of w/c: Bureau of the Treasury	40,735	56,657	63,054	54.79	11.3
Expenditures	**874,227**	**826,498**	**884,374**	**1.16**	**7.0**
of which:					
Allotments to Local Government Units	144,378	145,502	147,524	2.18	1.4
Interest Payments	265,845	226,408	260,901	-1.86	15.2
Equity and Net Lending	10,135	8,243	5,734	-43.42	-30.4
Surplus/Deficit (-)	**-197,815**	**-199,868**	**-186,116**	**-5.91**	**-6.9**
Financing	**197,815**	**199,868**	**186,116**	**-5.91**	**-6.9**
External Financing	-6,634	143,862	79,993	-1,305.80	-44.4
Domestic Financing	204,449	56,006	106,123	-48.09	89.5

p Preliminary

Source: BTr

5 MONETARY SURVEY
In million pesos

	LEVELS			FLOWS		GROWTH RATE	
	Dec-04 p	Dec-03	Dec-02	Dec 04-Dec 03	Dec 03-Dec 02	Dec 04/Dec 03	Dec 03/Dec 02
1. NET FOREIGN ASSETS	**715,560**	**662,450**	**541,411**	**53,110**	**121,039**	**8.02**	**22.36**
A. Bangko Sentral ng Pilipinas (BSP)	**678,998**	**625,943**	**537,909**	**53,055**	**88,034**	**8.48**	**16.37**
1. Net International Reserves (NIR)	809,103	770,817	683,523	38,286	87,294	4.97	12.77
Foreign Assets	903,069	937,492	861,632	-34,423	75,860	-3.67	8.80
Foreign Liabilities	93,966	166,675	178,109	-72,709	-11,434	-43.62	-6.42
2. Medium & Long-Term Foreign Liabilities	130,105	144,874	145,614	-14,769	-740	-10.19	-0.51
B. Deposit Money Banks	**36,562**	**36,507**	**3,502**	**55**	**33,005**	**0.15**	**942.46**
Foreign Assets	542,219	457,806	428,722	84,413	29,084	18.44	6.78
Foreign Liabilities	505,657	421,299	425,220	84,358	-3,921	20.02	-0.92
2. NET DOMESTIC ASSETS	**1,995,899**	**1,811,954**	**1,809,334**	**183,945**	**2,620**	**10.15**	**0.14**
A. Net Domestic Credits	**2,525,709**	**2,313,747**	**2,207,527**	**211,962**	**106,220**	**9.16**	**4.81**
Public Sector	**948,845**	**807,099**	**727,386**	**141,746**	**79,713**	**17.56**	**10.96**
National Government	756,530	619,909	589,833	136,621	30,076	22.04	5.10
Credits	923,251	807,093	749,390	116,158	57,703	14.39	7.70
Foreign Exchange Receivable	7,466	7,458	7,429	8	29	0.11	0.39
T-IMF Accounts	-64,939	-57,696	-49,899	-7,243	-7,797	-12.55	-15.63
Deposits	-109,248	-136,946	-117,087	27,698	-19,859	20.23	-16.96
Local Gov't & Others	191,350	183,539	131,937	7,811	51,602	4.26	39.11
Claims on CB-BOL	965	3,651	5,616	-2,686	-1,965	-73.57	-34.99
Private Sector	**1,576,864**	**1,506,648**	**1,480,141**	**70,216**	**26,507**	**4.66**	**1.79**
Other Financial Institutions	160,898	211,393	200,600	-50,495	10,793	-23.89	5.38
Others	1,415,966	1,295,255	1,279,541	120,711	15,714	9.32	1.23
B. Net Other Items	**-529,810**	**-501,793**	**-398,193**	**-28,017**	**-103,600**	**-5.58**	**-26.02**
3. TOTAL LIQUIDITY	**2,711,459**	**2,474,404**	**2,350,745**	**237,055**	**123,659**	**9.58**	**5.26**
A. M4	**2,649,303**	**2,401,454**	**2,298,110**	**247,849**	**103,344**	**10.32**	**4.50**
M3	**1,883,763**	**1,724,974**	**1,669,662**	**158,789**	**55,312**	**9.21**	**3.31**
Narrow Money	556,421	510,272	470,056	46,149	40,216	9.04	8.56
Quasi-Money	1,326,260	1,211,238	1,196,238	115,022	15,000	9.50	1.25
Deposit Substitutes	1,082	3,464	3,368	-2,382	96	-68.76	2.85
FCDU Deposits - Residents	**765,540**	**676,480**	**628,448**	**89,060**	**48,032**	**13.17**	**7.64**
B. Other Liabilities	**62,156**	**72,950**	**52,635**	**(10,794)**	**20315**	**-14.80**	**38.60**
Bills Payable	56,696	69,266	48,777	-12,570	20,489	-18.15	42.01
Marginal Deposits	5,460	3,684	3,858	1,776	-174	48.21	-4.51
Narrow Money	**556,421**	**510,272**	**470,056**	**46,149**	**40,216**	**9.04**	**8.56**
Currency in Circulation	259,573	238,614	220,042	20,959	18,572	8.78	8.44
Demand Deposits	296,848	271,658	250,014	25,190	21,644	9.27	8.66
Quasi-Money	**1,326,260**	**1,211,238**	**1,196,238**	**115,022**	**15,000**	**9.50**	**1.25**
Savings Deposits	1,075,159	1,073,232	1,092,877	1,927	-19,645	0.18	-1.80
Time Deposits	251,101	138,006	103,361	113,095	34,645	81.95	33.52

p Preliminary

Source: BSP

6 SELECTED DOMESTIC INTEREST RATES

In percent

	Nominal Interest Rates		Real Interest Rates [7]	
	2004	2003	2004	2003
Bank Borrowing Rates				
Interbank Call Loans	7.047	7.006	1.547	4.006
Savings Deposits [1]	4.246 [p]	4.212	-1.254	1.212
Time Deposits [1]				
(All Maturities)	6.427	6.408	0.927	3.408
Manila Reference Rates [2]				
(All Maturities)	8.125	7.250	2.625	4.250
Bank Lending Rates				
All Maturities[3]	9.957 [p]	9.479	4.457	6.479
High[4]	12.0764	10.754	6.576	7.754
Low[5]	10.068	8.918	4.568	5.918
Bangko Sentral Rates				
R/P (Overnight) [6]	9.000	9.101	3.500	6.101
R/P (Term) [6]	9.084	9.170	3.584	6.170
RR/P (Overnight) [6]	6.750	6.867	1.250	3.867
RR/P (Term) [6]	6.843	6.960	1.343	3.960
Rediscounting	6.640	4.905	1.140	1.905
Government Securities Rates				
Treasury Bills (All Maturities)	8.127	6.654	2.627	3.654
91-Days	7.340	6.028	1.840	3.028
182-Days	8.321	6.953	2.821	3.953
364-Days	9.218	7.489	3.718	4.489

[1] Of all commercial banks
[2] Refers to the New MRR based on combined transactions on time deposits and promissory notes of sample banks
[3] Refers to the weighted average interest rate of all commercial banks' interest incomes on their outstanding peso-denominated loans
[4] Refers to the average of all highs quoted by reporting commercial banks
[5] Refers to the average of all lows quoted by reporting commercial banks
[6] Weighted average of transacted rates
[7] Nominal interest rate less inflation rate
[p] Preliminary

Source: BSP

7 EXCHANGE RATES OF THE PESO, AVERAGE
Pesos per unit of foreign currency

	US Dollar	Japanese Yen	EMU Euro	Pound Sterling	Singapore Dollar	Hongkong Dollar	Malaysian Ringgit	Thailand Baht	Indonesian Rupiah	New Taiwan	South Korean
2003	**54.2033**	**0.4684**	**61.3506**	**88.6387**	**31.1237**	**6.9610**	**14.2659**	**1.3070**	**0.0063**	**1.5800**	**0.0456**
Jan	53.5635	0.4514	56.9117	86.6301	30.8771	6.8681	14.0975	1.2529	0.0060	1.5538	0.0456
Feb	54.0748	0.4524	58.2954	87.2692	30.9785	6.9334	14.2321	1.2610	0.0061	1.5605	0.0456
Mar	54.5909	0.4598	58.9136	86.4194	31.1408	7.0000	14.3679	1.2771	0.0061	1.5766	0.0443
Apr	52.8068	0.4410	57.3939	83.1946	29.7237	6.7708	13.8984	1.2311	0.0060	1.5213	0.0428
May	52.5072	0.4481	60.8437	85.2353	30.3170	6.7328	13.8195	1.2458	0.0062	1.5177	0.0438
Jun	53.3992	0.4514	62.3668	88.6143	30.8190	6.8475	14.0542	1.2830	0.0065	1.5465	0.0447
Jul	53.7138	0.4530	61.1613	87.3580	30.6257	6.8875	14.1370	1.2860	0.0065	1.5655	0.0455
Aug	54.9914	0.4628	61.5022	87.8297	31.3707	7.0512	14.4733	1.3199	0.0065	1.6053	0.0467
Sep	55.0235	0.4779	61.7914	88.6206	31.5044	7.0655	14.4819	1.3584	0.0065	1.6221	0.0472
Oct	54.9520	0.5017	64.3501	92.1346	31.7059	7.0998	14.4630	1.3847	0.0065	1.6275	0.0471
Nov	55.3718	0.5074	64.7408	93.5218	32.0318	7.1339	14.5733	1.3882	0.0065	1.6321	0.0468
Dec	55.4451	0.5140	67.9361	96.8369	32.3904	7.1417	14.5926	1.3957	0.0065	1.6316	0.0465
2004	**56.0399**	**0.5184**	**69.6852**	**102.6979**	**33.1644**	**7.1955**	**14.7489**	**1.3932**	**0.0063**	**1.6820**	**0.0490**
Jan	55.5261	0.5218	70.0342	101.2208	32.7177	7.1511	14.6141	1.4214	0.0066	1.6524	0.0469
Feb	56.0696	0.5270	70.8240	104.5592	33.2636	7.2129	14.7569	1.4356	0.0067	1.6923	0.0481
Mar	56.3029	0.5182	69.1198	102.9834	33.1184	7.2258	14.8185	1.4280	0.0066	1.6969	0.0483
Apr	55.9039	0.5201	67.0915	100.8454	33.2153	7.1709	14.7135	1.4185	0.0065	1.7012	0.0485
May	55.8453	0.4986	67.0831	99.7982	32.6348	7.1630	14.6980	1.3787	0.0062	1.6745	0.0475
Jun	55.9848	0.5116	68.0383	102.4578	32.6942	7.1805	14.7347	1.3735	0.0060	1.6723	0.0483
Jul	55.9527	0.5120	68.7022	103.1672	32.6984	7.1740	14.7261	1.3681	0.0062	1.6593	0.0484
Aug	55.8342	0.5060	68.0630	101.7145	32.5617	7.1579	14.6926	1.3465	0.0060	1.6433	0.0482
Sep	56.2132	0.5107	68.6651	100.7513	33.1440	7.2078	14.7941	1.3563	0.0061	1.6622	0.0490
Oct	56.3414	0.5170	70.3849	101.7539	33.5902	7.2335	14.8284	1.3643	0.0062	1.6682	0.0493
Nov	56.3221	0.5371	73.0577	104.5856	34.1032	7.2431	14.8236	1.3955	0.0062	1.7180	0.0517
Dec	56.1828	0.5411	75.1586	108.5372	34.2314	7.2255	14.7869	1.4315	0.0061	1.7430	0.0534

Source: Reference Exchange Rate Bulletin,BSP

7a EFFECTIVE EXCHANGE RATE INDICES OF THE PESO, AVERAGE
December 1980 = 100

	NOMINAL			REAL		
	Major Trading Partners [1]	Competing Countries		Major Trading Partners [1]	Competing Countries	
		Broad [2]	Narrow [3]		Broad [2]	Narrow [3]
2003	**12.60**	**28.57**	**54.95**	**56.94**	**98.80**	**143.93**
Jan	13.02	29.24	57.14	58.67	100.73	147.67
Feb	12.87	29.05	56.61	57.86	98.80	146.01
Mar	12.74	29.03	56.18	57.02	98.61	145.50
Apr	13.17	29.94	57.68	59.03	101.77	148.31
May	12.95	29.42	56.27	58.14	100.68	147.07
Jun	12.71	28.65	54.36	57.62	99.99	144.62
Jul	12.74	28.56	54.52	57.91	100.92	145.55
Aug	12.52	28.06	53.96	56.83	98.98	144.16
Sep	12.42	27.82	53.46	56.23	97.03	141.68
Oct	12.15	27.73	53.23	55.09	95.63	139.79
Nov	12.05	27.70	53.09	54.88	96.69	138.77
Dec	11.84	27.64	52.92	54.03	95.75	138.05
2004	**11.64**	**27.55**	**54.16**	**54.45**	**98.07**	**144.11**
Jan	11.67	27.38	52.31	53.64	95.93	135.95
Feb	11.54	27.04	52.00	52.99	93.54	134.74
Mar	11.63	27.12	52.39	53.37	94.13	136.43
Apr	11.77	27.24	52.91	54.07	94.61	136.61
May	11.88	27.89	54.61	54.66	97.54	143.49
Jun	11.75	28.15	56.05	54.74	100.52	150.24
Jul	11.72	27.86	54.82	55.32	100.99	148.43
Aug	11.79	28.16	55.76	55.87	102.23	151.83
Sep	11.71	27.84	55.21	55.55	100.66	149.99
Oct	11.59	27.63	54.75	54.84	99.20	147.55
Nov	11.38	27.15	54.25	54.23	99.01	146.23
Dec	11.28	27.11	54.81	54.08	98.43	147.83

[1] US, Japan, European Monetary Union, United Kingdom
[2] Singapore, South Korea, Taiwan, Malaysia, Thailand, Indonesia, Hongkong
[3] Indonesia, Malaysia, Thailand

Source: BSP

8 BANKING SYSTEM: DEPOSITS OUTSTANDING

As of end - December 2004 - 2003
In million pesos

Institutions	2004				2003				Percent Change (%)			
	TOTAL	Demand	Savings	Time	TOTAL	Demand	Savings	Time	TOTAL	Demand	Savings	Time
TOTAL	**2,722,275.1 p**	**352,479.4**	**1,515,222.9**	**854,572.8**	**2,439,324.8**	**321,445.6**	**1,471,094.1**	**646,785.1**	**11.60**	**9.65**	**3.00**	**32.13**
Commercial Banks [1]	2,439,089.0	336,879.0	1,298,971.0	803,239.0	2,178,920.0	307,303.0	1,270,008.0	601,609.0	11.94	9.62	2.28	33.52
Thrift Banks	214,596.0 [2]	14,141.8	168,697.6	31,756.6	198,137.0	12,790.8	158,639.3	26,706.9	8.31	10.56	6.34	18.91
Savings Banks	166,445.2 p	12,087.2	133,497.0	20,861.0	151,513.4	11,004.9	121,536.3	18,972.2	9.86	9.83	9.84	9.96
Private Development Banks	38,472.8 p	1,792.1	27,669.0	9,011.7	36,392.0	1,533.6	29,173.4	5,685.0	5.72	16.86	-5.16	58.52
Stock Savings and Loan Associations	9,635.5 p	262.5	7,489.1	1,883.9	10,185.9	252.3	7,884.0	2,049.6	-5.40	4.04	-5.01	-8.08
Microfinance Banks	42.5 p	0.0	42.5	0.0	45.7	0.0	45.6	0.1	-7.00	0.00	-6.80	-100.00
Rural Banks	68,590.1 [2]	1,458.6	47,554.3	19,577.2	62,267.8	1,351.8	42,446.8	18,469.2	10.15	7.90	12.03	6.00

[1] Includes DBP and AAIIBP
[2] As of September 2004
p Preliminary

Source: BSP

9 TOTAL RESOURCES OF THE PHILIPPINE FINANCIAL SYSTEM [1]

in million pesos

Institutions	2004	2003	% Change
Total	**5,059,502.5 [p]**	**4,676,467.4 [p]**	**8.2**
Banks	4,166,030.9 [p]	3,810,708.0	9.3
Commercial Banks [2]	3,760,602.0	3,425,593.0	9.8
Thrift Banks	305,183.2 [p]	292,722.5	4.3
Savings Banks	223,932.6 [a]	208,266.5	7.5
Private Development Banks	64,633.5 [a]	63,498.8	1.8
Stock Savings and Loan Associations	16,374.7 [a]	20,684.5	-20.8
Micro Finance Banks	242.4 [a]	272.7	-11.1
Rural Banks	100,245.7 [a]	92,392.5	8.5
Non-Bank Financial Institutions [3]	893,471.6 [a]	865,759.4 [p]	3.2

[1] Excluding the Bangko Sentral ng Pilipinas
[2] Beginning February 1996, specialized government banks were consolidated with commercial banks
[3] Includes Investment Houses, Finance Companies, Investment Companies, Securities Dealers/Brokers, Pawnshops, Lending Investors, Non-Stock Savings and Loan Assn., Mutual Building and Loan Assn., Venture Capital Corp. and others; also includes Private and Government Insurance Companies (i.e., SSS and GSIS). Beginning September 2003, Credit Card Companies were also included.
[a] As of end-September 2004
[p] Preliminary
Source: BSP

9a NUMBER OF FINANCIAL INSTITUTIONS [1]

Institutions	2004	2003	Percent Change (%)
T O T A L	19,336	18,644	3.7
Head Offices	6,912	6,687	3.4
Branches/Agencies	12,424	11,957	3.9
A. Banks	7,612	7,494	1.6
Head Offices	893	899	-0.7
Branches/Agencies	6,719	6,595	1.9
Commercial Banks [2]	4,329	4,296	0.8
Head Offices	42	42	0.0
Branches/Agencies	4,287	4,254	0.8
Thrift Banks	1,280	1,277	0.2
Head Offices	87	92	-5.4
Branches/Agencies	1,193	1,185	0.7
Savings and Mortgage Banks	784	747	5.0
Head Offices	32	31	3.2
Branches/Agencies	752	716	5.0
Private Development Banks	302	336	-10.1
Head Offices	24	29	-17.2
Branches/Agencies	278	307	-9.4
Stock Savings and Loan Associations	191	191	0.0
Head Offices	29	30	-3.3
Branches/Agencies	162	161	0.6
MicroFinance Banks	3	3	0.0
Head Offices	2	2	0.0
Branches/Agencies	1	1	0.0
Rural Banks	2,003	1,921	4.3
Head Offices	764	765	-0.1
Branches/Agencies	1,239	1,156	7.2
B. Non-Bank Financial Institutions [3]	11,724	11,150	5.1
Head Offices	6,019	5,788	4.0
Branches/Agencies	5,705	5,362	6.4

[1] Excluding the Bangko Sentral ng Pilipinas
[2] Beginning February 1996, specialized banks were consolidated with commercial banks.
[3] Includes Investment Houses, Finance Companies, Investment Companies, Securities Dealers/Brokers, Pawnshops, Lending Investors, Non-Stock Savings and Loan Assn., Mutual Building and Loan Assn., Venture Capital Corp. , and others; also includes Private and Government Insurance Companies (i.e., SSS and GSIS).

Source: BSP

10 STOCK MARKET TRANSACTIONS [1]

Volume in million shares
Value in million pesos

	2004 p/		2003		Percent Change	
	Volume	Value	Volume	Value	Volume	Value
Total	**284,329.5**	**206,564.2**	**85,966.1**	**145,355.3**	**230.7**	**42.1**
Banking & Financial Services	1,048.5	29,855.5	927.0	16,382.0	13.1	82.2
Commercial and Industrial	81,173.9	144,985.4	38,786.9	107,967.2	109.3	34.3
Mining	156,357.3	4,027.1	23,762.8	435.3	558.0	825.1
Oil	35,176.9	225.6	14,929.0	68.3	135.6	230.3
Property	10,571.4	27,469.0	7,559.9	20,501.4	39.8	34.0
SME [2]	0.0	0.0	0.5	1.0	-100.0	-100.0
Composite Index (Average)	**1621.7**			**1,197.2**	**35.5**	

p/ Preliminary
[1] Based on the expanded composition of share price indices to include banks and financial services effective November 15, 1996.
[2] Small and Medium Enterprises (SME) were included starting July 20, 2001
Source: PSE

11 PHILIPPINES: BALANCE OF PAYMENTS
for periods indicated
in million U.S. dollars

	2,004 p/	2003 r/	Change (%)
Current Account	**2,080**	**1,396**	**49.0**
Goods and Services	-7,663	-7,180	-6.7
Export	42,829	38,641	10.8
Import	50,492	45,821	10.2
Goods	-6,381	-5,455	-17.0
Credit: Exports	38,728	35,342	9.6
Debit: Imports	45,109	40,797	10.6
Services	-1,282	-1,725	25.7
Credit: Exports	4,101	3,299	24.3
Debit: Imports	5,383	5,024	7.1
Income	147	-226	165.0
Credit: Receipts	3,549	3,340	6.3
Debit: Disbursements	3,402	3,566	-4.6
Current Transfers	9,596	8,802	9.0
Credit: Receipts	9,858	9,009	9.4
Debit: Disbursements	262	207	26.6
Capital and Financial Account	**-1,692**	**-1,501**	**-12.7**
Capital Account	-23	23	-200.0
Credit: Receipts	5	41	-87.8
Debit: Disbursements	28	18	55.6
Financial Account	-1,669	-1,524	-9.5
Direct Investment	57	150	-62.0
Debit: Assets, Residents' Investments Abroad	412	197	109.1
Credit: Liabilities, Non-Residents' Investments in the Phil.	469	347	35.2
Portfolio Investment	-1,434	-1,305	-9.9
Debit: Assets, Residents' Investments Abroad	1,951	1,458	33.8
Credit: Liabilities, Non-Residents' Investments in the Phil.	517	153	237.9
Financial Derivatives	-27	-64	57.8
Debit: Assets, Residents' Investments Abroad	-58	-54	-7.4
Credit: Liabilities, Non-Residents' Investments in the Phil.	-85	-118	28.0
Other Investment	-265	-305	13.1
Debit: Assets, Residents' Investments Abroad	1,581	-737	314.5
Credit: Liabilities, Non-Residents' Investments in the Phil.	1,316	-1,042	226.3
Net Unclassified Items	-668	220	-403.6
Overall BOP Position	**-280**	**115**	**-343.5**
Debit: Change in Reserve Assets	-1,637	-355	-361.1
Credit: Change in Reserve Liabilities	-1,357	-470	-188.7
Use of Fund Credits	-471	-608	22.5
Short-term	-886	138	-742.0

p/ preliminary
r/ revised to reflect: a) late reports; b) post audit adjustments; and c) final data from companies
Technical Notes:
1. Net balances in the current and capital and financial accounts are derived by deducting debit entries from credit entries.
2. Overall BOP position is determined by deducting change in reserve liabilities from change in reserve assets.
3. Net unclassifed items is an offsetting account to the overstatement or understatement in either receipts or payments of the recorded BOP components vis-à-vis the overall BOP position.
4. Change in KBs NFA as a BOP entry is derived by deducting foreign assets from foreign liabilities, consistent with the principle described in technical note No. 1
5. Basic balance represents a BOP position that excludes transactions that are volatile and are in the short run susceptible to being reversed. It is derived using the following formula: Overall BOP position less (Net portfolio investments + net short-term liabilities) less errors and omissions. In the old BOP series, all transactions in assets and liabilities of commercial banks were deemed to be long-term. With the refinements in the new series on the maturity structure of KBs' transactions, short-term financial transactions of KBs are now excluded from the basic balance.
Source: BSP

11a EXPORTS BY MAJOR COMMODITY GROUP

volume in 000 metric tons; unit price in U.S.$/m.t.; fob value in million U.S. dollars

Commodities	January-December 2004 Volume	2004 Price	2004 Value	2003 Volume	2003 Price	2003 Value	Growth Rates (%) 2004 Volume	2004 Price	2004 Value
Coconut Products			**716**			**640**			**11.9**
Copra	0	0	0	3	40	0	-100.0	0.0	-85.8
Coconut Oil	959	602	578	1184	426	505	-19.0	41.3	14.4
Desiccated Coconut	106	940	100	107	895	96	-0.8	5.0	4.2
Copra Meal/Cake	364	85	31	508	70	36	-28.2	21.6	-12.7
Others			8			4			90.9
Sugar and Products			**79**			**70**			**13.9**
Centrifugal & Refined	230	290	67	138	424	58	67.4	-31.6	14.5
Molasses	235	48	11	113	66	7	107.8	-26.5	52.7
Others			1			4			0.0
Fruits and Vegetables			**601**			**601**			**-0.1**
Canned Pineapple	208	426	89	197	428	84	5.6	-0.3	5.3
Pineapple Juice	64	212	14	57	211	12	13.3	0.8	14.2
Pineapple Concentrates	52	637	33	52	664	35	-0.8	-4.1	-4.9
Bananas	1785	181	324	1829	182	333	-2.4	-0.3	-2.7
Mangoes	47	662	31	36	867	31	31.3	-23.7	0.2
Others			110			106			3.5
Other Agro-Based Products			**476**			**470**			**1.4**
Fish, Fresh or Preserved	82	3285	271	93	3135	291	-11.2	4.8	-7.0
Of which: Shrimps & Prawns	15	7333	112	19	6578	125	-19.7	11.5	-10.5
Coffee, Raw, not Roasted	0	0	..	0	0	--	0.0	0.0	0.0
Abaca Fibers	29	494	15	16	643	10	87.1	-23.2	43.7
Tobacco,Unmanufactured	15	1209	18	12	1368	17	19.1	-11.6	5.3
Natural Rubber	43	796	34	55	593	33	-21.7	34.4	5.2
Ramie Fibers, Raw or Processed	..	908	..	..	976	--	0.0	-7.0	0.0
Seaweeds, Dried	32	1114	36	31	1056	33	2.7	5.4	8.3
Rice	..	731	0	0	162	0	0.0	350.5	0.0
Others			103			86			19.6
Forest Products 1/			**34**			**22**			**50.8**
Logs	2	34	..	..	74	0	0.0	-53.9	0.0
Lumber	126	84	11	120	105	13	4.9	-20.1	-16.1
Plywood	48	371	18	16	346	6	191.6	7.3	212.9
Veneer Sheets/Corestocks	7	491	3	3	854	3	129.2	-42.5	31.8
Others			2			2			33.7
Mineral Products			**796**			**614**			**29.6**
Copper Concentrates	27	527	14	36	339	12	-25.5	55.4	15.8
Copper Metal	159	2580	411	167	1606	269	-4.8	60.6	53.0
Gold 2/	319	153	49	1857	63	117	-82.8	141.2	-58.6
Iron Ore Agglomerates	4556	18	83	4149	15	63	9.8	19.0	30.7
Chromium Ore	79	72	6	32	92	3	148.4	-21.6	94.8
Nickel			0			0			0.0
Others			234			150			56.2
Petroleum Products			**380**			**536**			**-29.0**
Manufactures			**35444**			**32022**			**10.7**
Electronic Products			26644			24168			10.2
Electonic Eqpt and Parts			1143			821			39.2
Garments			2172			2265			-4.1
Textile Yarns/Fabrics			238			250			-5.0
Footwear			35			46			-24.1
Travel Goods and Handbags			39			62			-37.3
Wood Manufactures			122			131			-6.8
Furnitures & Fixtures			294			278			5.8
Chemicals			456			394			15.8
Non-Metallic Mineral Manufactures			165			128			28.5
Machinery & Transport Equipment			1565			1298			20.6
Processed Food and Beverages			502			476			5.6
Iron & Steel			58			18			220.4
Baby Carr., Toys, Games & Sporting Goods			128			127			0.7
Basketwork, Wickerwork, & Other Articles of Plaiting Materials			67			69			-4.1
Misc. Manufactured Articles, n.e.s.			233			256			-9.0
Others			1583			1234			28.3
Special Transactions			**1071**			**1255**			**-14.6**
TOTAL EXPORTS, as per NSO Foreign Trade Statistics			**39598**			**36231**			**9.3**
Add : Coverage Adjustments			36			23			56.5
Less : Conceptual Coverage			907			911			-0.4
TOTAL EXPORTS, BPM5			**38728**			**35342**			**9.6**
Memo Items:									
Goods for processing (on consignment)			**13671**			**12458**			**9.7**
Iron Ore Agglomerates			83			63			30.7
Petroleum Products			0			0			0.0
Elect. & Elect. Eqpt/Parts & Telecom			12083			10823			11.6
Garments			911			982			-7.3
Footwear			7			10			-32.4
Wood Manufactures			0			0			0.0
Others			588			580			1.3
Non-monetary gold			**69**			**131**			**-47.3**
Held as a store value			40			102			-60.8
Other industrial gold			29			29			0.0
Repairs on goods			**358**			**427**			**-16.2**

.. Less than one thousand metric tons
-- Less than one million US$

1/ Volume in 000 cubic meters; unit price in US$/cu.m.
2/ Volume in 000 troy ounces; unit price in US$/oz t.

Source: NSO

11b IMPORTS BY MAJOR COMMODITY GROUP

volume in 000 metric tons; unit price in U.S.$/mt; f.o.b. value in million U.S. dollars

Commodities	January-December 2004 Volume	Price	Value	2003 Volume	Price	Value	Growth Rates (%) 2004 Volume	Price	Value
Capital Goods			**8742**			**8777**			**-0.4**
Power Generating & Specialized Machines			1999			1883			6.2
Office & EDP Machines			3361			3364			-0.1
Telecommunication Eqpt. & Elect. Mach.			2103			2133			-1.4
Land Transport Eqpt. excl. Passenger Cars & Motorized Cycle			608			840			-27.6
Aircraft, Ships & Boats			153			115			33.0
Prof. Sci. & Cont. Inst.; Photo-graphic Eqpt. & Optical Goods			518			442			17.2
Raw Materials & Intermediate Goods			**26273**			**24096**			**9.0**
Unprocessed Raw Materials			1502			1362			10.3
Wheat	2155	156	336	2752	153	422	-21.7	2.0	-20.4
Corn	23	523	12	99	211	21	-76.8	147.9	-42.9
Unmilled cereals excl. rice & corn			0.00			1			0.0
Crude materials, inedible			987			832			18.6
Pulp & waste paper			75			65			15.4
Cotton	34	1461	49	32	1064	34	6.3	37.3	44.1
Syn. fibers	67	1443	97	63	1282	81	6.3	12.6	19.8
Metalliferous ores			397			297			33.7
Others			369			355			3.9
Tobacco, unmanufactured			167			86			94.2
Semi-Processed Raw Materials			24771			22734			9.0
Feeding stuffs for animals	1479	281	416	1459	221	323	1.4	27.1	28.8
Animal & vegetable oils & fats			105			62			69.4
Chemical			3181			2878			10.5
Chemical compounds			725			669			8.4
Medicinal & pharmaceutical chemicals			421			395			6.6
Urea	543	142	77	720	137	99	-24.6	3.6	-22.2
Fertilizer excl. urea	830	135	112	773	129	100	7.4	4.7	12.0
Artificial resins			879			762			15.4
Others			967			853			13.4
Manufactured goods			3489			3245			7.5
Paper & paper products	604	632	382	606	596	361	-0.3	6.0	5.8
Textile yarn, fabrics & made-up articles			740			727			1.8
Non-metallic mineral mftures.			160			157			1.9
Iron & steel	2750	443	1218	3286	324	1063	-16.3	36.7	14.6
Non-ferrous metals			453			387			17.1
Metal products			320			336			-4.8
Others			216			214			0.9
Embroideries			240			288			-16.7
Mat/Acc for the mftr. of elect. eqpt.			17265			15863			8.8
Iron ore, not agglomerated	3851	19	75	3976	19	75	-3.1	0.0	0.0
Mineral Fuels & Lubricant			**4714**			**3765**			**25.2**
Coal, Coke	4258	32	137	4088	25	102	4.2	28.0	34.3
Petroleum Crude [1/]	72.27	34.87	2520	91.67	27.53	2524	-21.2	26.7	-0.2
Others [1/]	47.42	43.38	2057	34.36	33.15	1139	38.0	30.9	80.6
Consumer Goods			**3027**			**2725**			**11.1**
Durable			1288			1155			11.5
Passenger cars & motorized cycle			480			409			17.4
Home appliances			227			181			25.4
Misc. manufactures			581			565			2.8
Non-Durable			1739			1570			10.8
Food & live animals chiefly for food			1603			1345			19.2
Dairy products	344	1405	484	319	1214	387	7.8	15.7	25.1
Fish & fish preparation	82	439	36	97	516	50	-15.5	-14.9	-28.0
Rice	1001	232	232	886	173	153	13.0	34.1	51.6
Fruits & vegetables			102			103			-1.0
Others			749			652			14.9
Beverages & tobacco mfture.			74			171			-56.7
Articles of apparel, access.			62			54			14.8
Special Transactions			**1965**			**1380**			**42.4**
Articles temporarily imported & exported			1403			779			80.1
Others			562			601			-6.5
TOTAL IMPORTS, as per NSO Foreign Trade Statistics			**44721**			**40749**			**9.7**
Add: Coverage Adjustments			829			734			12.9
Less: Conceptual Coverage			441			686			-35.7
TOTAL IMPORTS, BPM5			**45109**			**40797**			**10.6**
Memo Items:									
Goods for processing (on consignment)			**18001**			**16657**			**8.1**
Raw Materials and Intermediate Goods			17580			16226			8.3
Embroideries			240			288			-16.7
Mat/Acc for the mfture of electrical equipment			17265			15863			8.8
Iron ore, not agglomerated			75			75			0.0
Special Transactions			421			431			-2.3
Non- monetary gold			**37**			**38**			**-2.6**
Held as store of value			0			0			0.0
Other industrial gold			37			38			-2.6
Repairs on goods			**80**			**88**			**-9.1**

[1/] Volume in million barrels; unit price in U.S.$/barrel
- - Less than one million US dollars
. . Less than one thousand metric tons
Note: General merchandise imports can be derived by deducting goods for processing and non-monetary gold from Total Imports, BPM5

Note: Components may not add up to total due to rounding

12 BSP: GROSS INTERNATIONAL RESERVES[1]
end of period
in million US dollars

		GIR	Reserve Position in the Fund	Gold	SDRs	Foreign Investments	Foreign Exchange	Import Cover [2]	Short-Term External Debt Cover (in percent) Original Maturity	Residual Maturity [3]
		(1=2 to 6)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
2003	Jan	16,605.72	120.14	3,071.75	10.29	12,943.67	459.87	4.63	298.77	145.80
	Feb	16,323.92	119.64	2,958.18	2.09	12,765.83	478.18	4.46	293.70	135.45
	Mar	16,157.49	119.90	2,960.94	2.09	12,387.06	687.50	4.32	251.56	140.97
	Apr	16,392.34	121.47	3,006.99	16.04	12,768.91	478.93	4.37	247.51	124.51
	May	16,264.07	123.93	3,224.50	6.38	12,416.30	492.96	4.26	257.22	126.05
	Jun	16,043.57	122.26	3,031.99	8.00	12,269.01	612.31	4.19	257.07	124.41
	Jul	16,298.95	121.48	3,123.10	10.32	12,539.71	504.34	4.22	265.41	127.96
	Aug	16,354.11	120.32	3,280.30	1.94	12,533.18	418.37	4.23	253.91	126.03
	Sep	16,357.45	124.90	3,250.35	2.01	12,541.91	438.28	4.22	262.64	126.73
	Oct	17,068.56	125.08	3,308.71	9.17	13,047.83	577.77	4.35	283.15	137.64
	Nov	17,021.96	125.76	3,425.81	1.72	12,993.15	475.52	4.28	289.59	137.23
	Dec	17,063.06	129.81	3,408.19	1.77	12,945.40	577.89	4.22	276.15	140.66
2004	Jan	16,281.34	129.40	3,236.07	9.17	12,326.42	580.28	4.00	263.49	132.48
	Feb	15,931.47	129.30	3,100.40	2.19	12,268.69	430.89	3.88	256.79	136.97
	Mar	16,534.15	129.33	3,317.01	2.19	12,568.27	517.35	4.01	220.75	129.20
	Apr	16,604.10	126.83	3,050.15	7.23	13,201.13	218.76	3.99	229.34	135.99
	May	16,745.23	128.31	3,137.45	1.34	13,287.48	190.65	4.03	234.53	137.87
	Jun	16,378.04	128.09	3,170.77	1.34	12,833.59	244.25	3.90	246.88	140.91
	Jul	16,152.29	127.45	3,216.25	7.89	12,538.04	262.66	3.81	243.48	139.77
	Aug	16,200.48	127.71	3,312.78	0.99	12,398.39	360.61	3.78	244.20	137.78
	Sep	16,140.04	128.44	3,400.98	1.00	12,336.79	272.83	3.72	282.22	151.86
	Oct	16,117.88	130.97	3,263.78	7.76	12,374.95	340.42	3.66	292.04	150.40
	Nov	16,071.39	134.29	3,239.53	0.99	12,399.76	296.82	3.63	291.20	149.43
	Dec	16,227.91	135.33	3,112.07	1.00	12,742.09	237.42	3.66	321.60	156.50

[1] Figures from 1994 to 2004 were revised to reflect the reclassification of released collaterals on Brady Bonds from non-IR to IR-eligible assets of the BSP. This is in line with the treatment of foreign investments under R.A. 7653 (New Central Bank Act), which allows investments in securities even for maturities over 5 years to be included as part of the GIR.
[2] Number of months of average imports of goods and payment of services and income that can be financed by reserves.
[3] Refers to adequacy of reserves to cover outstanding short-term external 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.
Source: BSP

13 TOTAL EXTERNAL DEBT [1]
as of dates indicated
in million US dollars

	December 31, 2004				December 31, 2003			
	Short-term		Medium & Long-		Short-term		Medium & Long-	
	Trade	Non-Trade	Term	Total	Trade	Non-Trade	Term	Total
Grand Total	**1,675**	**3,371**	**49,800** [a]	**54,846**	**1,299**	**4,879**	**51,216** [a]	**57,395**
Public Sector	_	981	36,914	37,895	16	2,119	37,363	39,498
Banks	_	956	4,994	5,950	16	1,829	5,594	7,439
Bangko Sentral ng Pilipinas	_	875	1,846	2,721	?	1,750	2,672	4,422
Others	_	81	3,148	3,229	16	79	2,922	3,018
Non-Banks	_	25	31,921	31,946	?	290	31,769	32,059
CB-BOL	_	?	101	101	?	?	182	182
NG and Others	_	25	31,819	31,844	?	290	31,586	31,876
Private Sector	1,675	2,390	12,886	16,951	1,283	2,761	13,853	17,897
Banks	239	2,110	1,351 [c]	3,700	398	2,484	924 [c]	3,807
Foreign Bank Branches	14	396	567	977 [b]	24	625	61	710
Domestic Banks	225	1,714	784	2,724 [e]	374	1,859	863	3,096
Non-Banks	1,435	281	11,534 [d]	13,250	885	277	12,929 [d]	14,090

1 Aggregate external debt data were revised from 1990 onwards to reflect the reclassification of offshore banking units (OBUs) from non-resident to resident entities for statistical purposes. Starting March 2004, debt stock is adjusted to exclude holdings of residents of Philipppine debt papers booked under the Trust Department of commercial banks. Total external debt covers BSP-approved/registered debt owed to non-residents, with classification by borrower based on primary obligor per covering loan/rescheduling agreement/document.

a Includes cumulative foreign exchange revaluation on US dollar-denominated multi-currency loans from Asian Development Bank and World Bank amounting to US$276 million as of 31 December 2003 and US$351 million as of 31 December 2004.

b Excludes "Due to Head Office/Branches Abroad" accounts of branches and offshore banking units of foreign banks operating in the Philippines which as of 31 December 2003 amounted to US$2,034 million and US$2,578 million as of 31 December 2004.

c Includes accounts restructured under CB Circular No.1179 amounting to US$43 million as of 31 December 2004.

d Excludes obligations under various capital lease agreements of US$ 1,446 million as of 31 December 2003 and US$1,323 million as of 31 December 2004. Also, excludes loans without BSP approval/registration amounting to US$1,916 million as of 31 December 2003 and US$2,408 million as of 31 December 2004.

e Includes US$9 million liabilities of private development bank and rural banks as of 31 December 2004.

Source: BSP

14 FOREIGN DEBT SERVICE INDICATORS
in million US dollars

	2004 p					2003 p				
	Total	**Q1**	**Q2**	**Q3**	**Q4**	**Total**	**Q1**	**Q2**	**Q3**	**Q4**
Debt Service Burden (DSB) [1]	**7,221**	1,931	1,606	2,087	1,597	**7,967**	1,976	1,642	2,021	2,328
Principal	**4,868**	1,303	1,110	1,409	1,046	**5,409**	1,286	1,053	1,366	1,704
Interest	**2,353**	628	496	678	551	**2,558**	690	589	655	624
Export Shipments (XS)	**38,728**	8,938	9,329	9,967	10,494	**35,342**	8,451	8,396	9,127	9,368
Exports of Goods and Receipts from Services and Income (XGSI) [2]	**52,247**	12,152	12,617	13,377	14,101	**47,055**	11,235	11,392	11,970	12,458
Current Account Receipts (CAR) [3]	**55,127**	12,808	13,302	14,113	14,904	**49,986**	11,932	12,158	12,649	13,247
Gross National Product (GNP)	**92,700**	21,042	22,264	23,012	26,382	**85,147**	19,655	20,970	20,723	23,799
Ratios (%) :										
DSB to XS	**18.65**	21.60	17.22	20.94	15.22	**22.54**	23.38	19.56	22.14	24.85
DSB to XGSI	**13.82**	15.89	12.73	15.60	11.33	**16.93**	17.59	14.41	16.88	18.69
DSB to CAR	**13.10**	15.08	12.07	14.79	10.72	**15.94**	16.56	13.51	15.98	17.57
DSB to GNP	**7.79**	9.18	7.21	9.07	6.05	**9.36**	10.05	7.83	9.75	9.78

[1] Debt service burden represents principal and interest payments after rescheduling. In accordance with the internationally-accepted concept, debt service burden consists of (a) Principal and interest payments on fixed MLT credits including IMF credits, loans covered by the Paris Club and Commercial Banks rescheduling, and New Money Facilities; and (b) Interest payments on fixed and revolving short-term liabilities of banks and non-banks but excludes (i) Prepayments of future years' maturities of foreign loans and (ii) Principal payments on fixed and revolving ST liabilities of banks and non-banks.

[2] Includes receipts from workers' remittances that were coursed through and reported by commercial banks.

[3] Based on the accounting principle under the Balance of Payments Manual, Fifth edition which (1) excludes temporary exports and returned goods for exports exports of goods and (2) excludes capital transfers in the computation of current account receipts.

p/ Preliminary

Source: BSP

15 BSP: BALANCE SHEET
In billion pesos

	2004 Dec [u]	2003 Dec	Percent Change (%)
Assets	**1,259.1**	**1,335.8**	**-5.7**
International Reserves	895.4	930.6	-3.8
Foreign Exchange Receivable	14.9	7.5	99.5
Domestic Securities	105.2	153.7	-31.5
Loans and Advances	121.2	130.4	-7.1
Bank Premises and Other Fixed Assets	11.5	12.1	-5.1
Other Assets	110.9	101.5	9.3
Liabilities	**1,037.5**	**1,133.5**	**-8.5**
Currency Issue	322.5	294.8	9.4
Deposits	280.0	330.4	-15.3
Reserve Deposits of Banks & Other FIs	95.3	86.1	10.7
of which:			
DMBs	88.1	79.8	10.4
Special Deposit Accounts	0.0	0.0	
Other Deposits of Banks & Other FIs	9.9	8.7	13.0
Treasurer of the Philippines [2]	60.3	104.2	-42.2
Other Foreign Currency Deposits	15.7	17.5	-10.5
Foreign Financial Institutions	97.8	110.4	-11.4
Other Deposits [3]	1.1	3.5	-67.8
Foreign Loans Payable	178.1	238.7	-25.4
Net Bonds Payable	85.4	92.4	-7.5
Allocation of SDRs	10.2	4.4	130.7
Net Revaluation of International Reserves [1]	100.0	92.6	8.0
BSP Debt Instruments	47.2	70.9	-33.4
Other Liabilities	14.1	9.3	52.0
Net Worth	**221.6**	**202.3**	**9.5**
Capital	10.0	10.0	0.0
Surplus/Reserves	211.6	192.3	10.0

Note: Breakdown may not add up to totals due to rounding.
[1] Total assets and liabilities appear different from previous reports due to the consolidation of the revaluation accounts beginning 2004
[2] Includes foreign currency deposits.
[3] Mostly GOCC deposits.
[u] Based on the unaudited BSP balance sheet as of end-December 2004 prepared by the Comptrollership Department of the BSP.

Source: BSP

16 BSP: INCOME POSITION

In billion pesos

	2004 [u]	2003	Percent Change (%)
Revenues	**51.22**	**51.06**	**0.32**
Interest Income	38.75	43.00	-9.88
International Reserves	23.29	29.00	-19.69
Domestic Securities	10.58	10.55	0.31
Loans and Advances	4.73	3.12	51.57
Others	0.15	0.32	-54.32
Miscellaneous Income	12.34	7.97	54.84
Net income from Branches	0.13	0.09	43.33
Expenses	**47.06**	**46.28**	**1.69**
Interest Expenses	28.24	28.05	0.69
Legal Reserve Deposits of Banks	2.58	2.31	11.60
Special Deposit Accounts	0.00	0.09	-95.51
National Government Deposits	5.76	4.03	42.77
BSP Debt Instruments	4.28	4.91	-12.89
Loans Payable	15.56	15.45	0.66
Other Foreign Currency Deposits	0.07	0.15	-55.78
Other Liabilities	0.01	1.11	-99.37
Cost of Minting	3.55	1.93	84.08
Other Expenses	15.27	16.30	-6.32
Net Income Before Gain/(Loss) on FXR Fluctuations	**4.15**	**4.78**	**-13.01**
Gain/Loss(-) on FXR Fluctuations	2.15	2.73	-21.10
Provision for Income Tax	1.06	0.91	16.08
Net Income	**5.25**	**6.60**	-20.51
Capital Reserves	3.10	3.10	0.00
Net Income Available for Distribution	**2.15**	**3.50**	**-38.67**

Note: Breakdown may not add up to totals due to rounding.
[u] Based on the unaudited BSP income statement as of end-December 2004 prepared by the Comptrollership Department of the BSP.

Source: BSP

17 BSP: CONDENSED STATEMENT OF CONDITION
In thousand pesos

Assets	As at December 31 2004	2003 [1]
Foreign Currency Financial Assets		
Deposit with Foreign Banks	207,388,674	162,160,180
Foreign Currency on Hand and in-transit	282,133	296,313
Securities Purchased under Agreement to Re-sell	31,575,422	15,925,389
Marketable Securities	325,517,129	410,421,499
Other Investments	151,753,027	147,809,638
Gold in Bullion Vault	30,287,582	11,797,812
Gold with Foreign Financial Institutions	145,049,614	177,650,005
International Monetary Fund Special Drawing Rights	56,283	98,517
Accrued Interest	3,534,356	4,404,836
Gross International Reserves	**895,444,220**	**930,564,189**
Loans and Advances - net	1,304,718	1,120,680
Accrued Interest	2,051,932	1,921,818
Other Foreign Currency Receivables	33,799,648	26,542,284
Total Foreign Currency Financial Assets	**932,600,518**	**960,148,971**
Local Currency Financial Assets		
Government Securities	105,222,161	153,702,700
Loans and Advances (net)	119,845,995	129,323,691
Accrued Interest	5,378,407	4,635,833
Due from Administrator of Funds	24,683,719	23,382,193
Accounts and Notes Receivables	26,049,977	19,969,172
Other Receivables (net)	1,626,476	1,333,161
Total Local Currency Financial Assets	**282,806,735**	**332,346,750**
Total Financial Assets	**1,215,407,253**	**1,292,495,721**
Other Assets		
Bank Premises, Furniture, Fixtures and Equipment - net	11,524,242	12,139,909
Acquired Assets - net	12,226,828	12,081,029
Inventories	19,820,789	18,714,764
Miscellaneous Assets	154,334	392,507
Total Other Assets	**43,726,193**	**43,328,209**
Total Assets	**1,259,133,446**	**1,335,823,930**

[1] Total assets appear different from previous reports due to the consolidation of the revaluation accounts beginning 2004.

17 BSP: CONDENSED STATEMENT OF CONDITION
In thousand pesos
(continuation)

Liabilities	As at December 31 2004	2003 [2]
Foreign Currency Financial Liabilities		
Short-term Deposits	23,257,714	60,815,208
Loans Payable	178,132,491	238,674,290
Bonds Payable	85,443,570	92,394,201
Allocation of International Monetary Fund Special Drawing Rights	10,167,883	4,407,268
Accounts Payable	884,654	1,191,875
Accrued Interest	2,675,279	3,190,778
Accrued Expenses	301,877	313,140
Other Liabilities	3,965,025	882,446
Total Foreign Currency Financial Liabilities	**304,828,493**	**401,869,206**
Local Currency Financial Liabilities		
Government Deposits	52,742,406	63,833,331
Deposits of Banks and quasi-banks	106,247,514	95,403,641
Deposits of the IMF and other Financial Institutions	97,774,019	110,370,158
Securities Sold under Agreements to Repurchase	47,191,000	70,909,000
Accrued Interest	970,971	262,551
Total Local Currency Financial Liabilities	**304,925,910**	**340,778,681**
Total Financial Liabilities	**609,754,403**	**742,647,887**
Other Liabilities		
Currency in Circulation	322,465,565	294,781,601
Miscellaneous Liabilities	5,298,638	3,432,844
Revaluation of foreign currency acoounts	100,012,222	92,631,149
Total Other Liabilities	**427,776,425**	**390,845,594**
Total Liabilities	**1,037,530,828**	**1,133,493,481**
Capital Accounts		
Capital	10,000,000	10,000,000
Surplus	37,124,623	34,721,503
Capital Reserves	174,477,995	157,608,946
Total Capital Accounts	**221,602,618**	**202,330,449**
Total Liabilities and Capital Accounts	**1,259,133,446**	**1,335,823,930**

[2] Total liabilities and capital appear different from previous reports due to the consolidation of the revaluation accounts beginning 2004.

18 BSP: CONDENSED STATEMENT OF INCOME AND EXPENSES with Budget Information[1]

In thousand pesos

Years ended December 31	Budget	Actual	
	2004	2004	2003
Operating Income:			
Income from Foreign Currency Financial Assets			
Interest Income	26,766,713	23,526,851	28,985,605
Fees & Miscellaneous Foreign Currency Income	4,610,857	9,909,150	5,870,671
Total Income from Foreign Currency Financial Assets	**31,377,570**	**33,436,001**	**34,856,276**
Expenses on Foreign Currency Financial Liabilities			
Interest Expense	16,722,543	15,966,460	15,804,110
Other Foreign Currency Expenses	2,361,616	7,131,219	1,854,938
Total Expenses on Foreign Currency Liabilities	**19,084,159**	**23,097,679**	**17,659,048**
Foreign Currency Income	**12,293,411**	**10,338,322**	**17,197,228**
Income from Local Currency Financial Assets			
Interest Income	17,162,787	15,319,171	13,660,638
Total Income from Local Currency Financial Assets	**17,162,787**	**15,319,171**	**13,660,638**
Expenses on Local Currency Financial Liabilities			
Interest Expense	16,559,949	12,276,546	12,245,251
Final Tax on Interest Income/Discounts	2,137,952	1,201,491	1,002,449
Total Expenses on Local Currency Financial Assets	18,697,901	13,478,037	13,247,700
Local Currency Income/(Loss)	**(1,535,114)**	**1,841,134**	**412,938**
Total Operating Income	**10,758,297**	**12,179,456**	**17,610,166**
Currency Printing and Minting Cost	**1,580,826**	**3,548,617**	**1,928,357**
Operating Expenses:			
Personnel Services, Development and Training	3,682,349	3,707,966	3,535,549
Traveling	104,314	236,944	135,622
Taxes and Licenses	141,811	559,412	571,694
Currency and Gold Operations	83,128	80,057	73,485
Other Services	2,259,356	1,467,398	1,366,800
Depreciation	591,793	645,237	625,926
Fidelity Insurance	45,522	35,427	66,872
Light, Fuel & Water	194,664	211,693	188,341
Repairs & Maintenance	249,418	155,729	111,350
Communication Services	126,990	99,383	76,734
Supplies	115,336	61,329	53,836
Others	935,633 [2]	258,600	243,740
Total Operating Expenses	**6,270,958**	**6,051,777**	**5,683,149**
Net Operating Income before FX Gains	**2,906,513**	**2,579,062**	**9,998,660**

[1] The statement presentation was restated for comparability with the budget format.

[2] Includes provisions for contingencies which when utilized are classified under the appropriate budget item

18 BSP:CONDENSED STATEMENT OF INCOME AND EXPENSES with Budget Information[1]

In thousand pesos

(continuation)

Years ended December 31	Budget 2004	Actual 2004	Actual 2003
Net Realized Gains on Fluctuation in FX rates		**2,153,929**	**2,734,949**
Net Income before Provisions	2,906,513	4,732,991	12,733,609
Provision for Probable Losses [3]	3,946,210	861,678	4,251,643
Provision for Market Decline of Acquired Assets [4]	593,330	26,582	622,533
Provision for Fidelity Losses [5]	0	3,097,862 [6]	2,879,938
Provision for Currency and Gold Insurance [7]	0	0	7,743
Net Operating Income (Loss)	**(1,633,027)**	**746,869**	**4,971,752**
Other Income	**2,251,180**	**2,462,846**	**2,539,175**
Net Income before Tax	**618,154**	**3,209,715**	**7,510,927**
Provision for Corporate Income Tax	274,227	1,060,755	914,302
Net Income after Tax	**343,926**	**2,148,960**	**6,596,625**
Capital Reserves		**0**	**3,100,000** [8]
Net Income for Distribution		**2,148,960**	**3,496,625**

[3] Represents additions to the contra-asset account Allowance for Probable Losses.

[4] Represents the difference between the book value and appraised value of Acquired Assets; accumulated in the contra-asset account Allowance for Market Decline of Acquired Assets

[5] Represents the amount set-up for self-insurance against losses that may arise from cash and gold accountabilities of employee-custodians in excess of PHP100 million.

[6] In 2004, addition to Provision for Fidelity Losses was recognized at year-end as an appropriation of net income before distribution. Its current presentation is made for comparative purposes only.

[7] Represents the Bank's self-insurance scheme to cover for losses arising from currency and gold shipments

[8] Represents capital reserves of PHP 2.300 billion for the rehabilitation of the Security Plant Complex , and PHP 800 million for Property Insurance under the Bank's self-insurance scheme.