

PHILIPPINES

The first half of 2000 saw steady economic recovery. However, if it is to be fully consolidated, greater efforts are required to speed up the reform process and restore investor confidence. Redressing the fiscal imbalance by improving the efficiency of tax administration is urgently required to ensure macroeconomic stability.

Economic Indicator (percent)	1997	1998	1999	2000	2001
GDP growth	5.2	-0.5	3.2	3.8	4.3
Inflation rate	5.9	9.8	6.6	6.5	6.0
Current account/GDP	-5.3	2.4	9.4	6.5	5.6

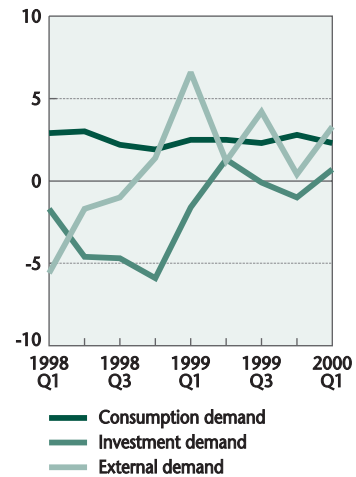
Economic Assessment. The performance of the Philippine economy in the first half of 2000 indicates that the recovery is continuing, albeit slowly. Following 3.2 percent growth in 1999, GDP registered higher growth of 3.9 percent in the first half of 2000. This reflects an upturn in the agriculture sector, continued growth in the service sector, particularly telecommunications, and recovery in manufacturing in the second quarter of 2000. In terms of aggregate demand components, personal consumption continued growing in the first half of 2000 at a steady 3.2 percent, while government consumption declined by 0.5 percent. Aggregate investments recorded negative growth of 2 percent; this was due to a sharp contraction in public sector construction, although private investment grew slightly.

While beginning to show an improvement, the growth of bank credit to the private sector remains weak and recorded a nominal increase of only 5.8 percent in May 2000 over May 1999. The banking sector is still burdened with a high rate of nonperforming loans (NPLs), although there are signs that the NPL ratio for all banks may have stabilized within the range of 14–15 percent. While exports of goods and services in the first five months of 2000 grew by 8 percent over the same period of the previous year, import growth remained virtually stagnant, further indicating only a weak revival of the domestic economy.

Inflation rates in the six months to July 2000 remained below 4 percent. The lack of a strong rally in aggregate demand and, possibly, a strong upturn in agricultural production in the second quarter of 2000 have helped keep inflation in check. Interest rates remained low with the benchmark 91-day Treasury bill rate at 8.9 percent in July 2000.

The unemployment rate stood at 13.9 percent in April 2000, representing a sudden upsurge from the 9.3 percent figure at the beginning of the year. A stronger economic recovery, and better performance in the agriculture sector in particular, are required to absorb the growing labor force and reduce the unemployment that is highest in rural areas. Variations in agricultural output have profound social and macroeconomic implications for the Philippine economy, highlighting the need to devise rural productivity-enhancing interventions.

Decomposition of GDP Growth by Quarter (percent)



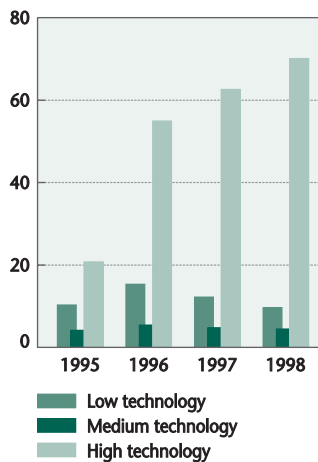
Structural Issues. The Government has targeted a fiscal deficit of P62.5 billion for 2000 compared with an actual deficit of P106 billion in 1999. However, remaining within this target will be extremely difficult. In the first seven months of 2000, the deficit had already reached P59.7 billion, which is close to the full-year target. This was partly due to lower than projected collection of tax revenues and privatization proceeds. Revenue collection was down by 23.5 percent compared with the budget target in the first seven months of 2000, while privatization proceeds amounted to only P1.9 billion as against a target of P15.5 billion for the whole year. Public expenditure levels have been maintained at budget levels, suggesting that the Government's higher than budgeted defense spending in the southern island of Mindanao may lead it to sacrifice vital social sector expenditures and other needs. Greater efforts at tax revenue mobilization will be needed if the fiscal deficit is not to rise significantly.

The Government's renewed attempts at accelerating structural reforms have begun to show some results. Amendments to the General Banking Act passed recently will considerably strengthen the Central Bank's supervisory authority. The Securities Act, which will improve the functioning of the stock market, has also recently been passed. A bill on power sector reforms is now in the final stages of deliberation by Congress. An act on electronic commerce, which will facilitate online commercial transactions and prevent abuse of the Internet, was also recently enacted. These measures, once implemented, are likely to considerably strengthen investor confidence, which at present is weak. There have been net capital outflows due to portfolio and foreign direct investment in the first few months of 2000, while the peso has come under pressure in recent weeks. These are due to the combined effects of investor perception of a lack of progress in structural reforms and the law and order situation in Mindanao.

The conflict in Mindanao is indeed a vital factor affecting the perceptions of foreign and domestic investors about the economy. Mindanao—the second largest island in the Philippines—lags behind the other major island groups in socioeconomic development and has the highest levels of poverty in the country. Unless an early resolution to the conflict is achieved, development prospects for the island will be harmed still further.

Forecast. The previous ADO forecasts (May 2000) of GDP growth of 3.8 percent in 2000 and 4.3 percent in 2001 continue to hold. The 2000 forecast is below the Government's own projected range of 4–5 percent. Factors that could stimulate stronger GDP growth in 2000 are: (i) a significant agricultural rebound in the rest of the year and continued improvement in the manufacturing and telecommunications subsectors; (ii) a vastly improved investment climate brought about by an accelerated reform process; and (iii) a peaceful resolution of the Mindanao issue. The previous inflation forecast still remains valid. Continued export growth and slower import growth will still yield current account surpluses in 2000 and 2001. The Government's current fiscal deficit target is unlikely to be achieved because of lower revenues mobilized to date and additional pressures on public expenditure. This issue needs to be urgently addressed by the Government.

Technology Exports as Share of Total (percent)



Ratio of Reserves to Short-Term External Debt (percent)

