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CONSUMER SPENDING DRIVES GROWTH

The Philippine economy has been resilient in the face of domestic and external challenges. In 2003, inflation rates remained benign at 3.1% and interest rates only rose moderately. GDP rose by 4.5%, up from 4.4% in 2002, while real per capita GDP growth increased from 2% in 2002 to 2.1% in 2003.

Consumer spending drove growth in 2003, largely propelled by Filipino workers (OFW) remittances from workers overseas. The robust 18.9% growth in net factor income from abroad (NFIA) further propped up the economy. Personal consumption expenditure growth (5.1%)—driven by the remittances, consumer confidence and stable prices, among other things—has been the key driver of GDP growth. This was offset, to an extent, by a fall in government expenditure (–2.8%) and poor fixed capital formation growth (0.8%). Exports remain an important factor, growing by 3.3% in 2003. Imports also grew in 2003 at 10.3%, mostly because of increased merchandise imports and non-factor services grew by 5.9%, the major drivers being transport, communications and storage, trade and finance. Industrial growth fell back to 3% in 2003. Construction was a prime influence, actually contracting by 5.9%.

EXPORTS: CHIEF SOURCE OF STRENGTH

Exports remain a chief source of strength for the economy, even though their growth rate fell to 3.3% in 2003. The semiconductor industry continues to lead exports, despite a relatively weak growth rate in 2003.

In contrast, imports grew by 10.3%, driven by the growth of both merchandise imports and non-factor services.

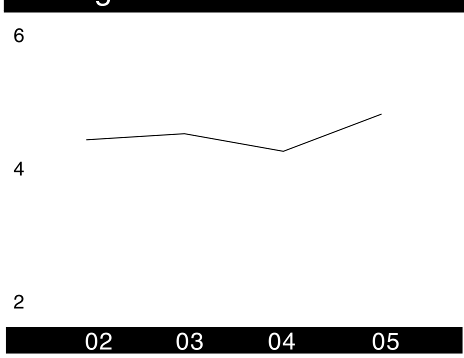
STEADY GROWTH OF SERVICES

Services put in a hefty contribution of 2.7 percentage points to GDP growth with the boom in call centres and wireless communication. Chiefly propelled by transportation, communication and storage (TCS), trade, and finance, services posted a growth of 5.9% in 2003, up from 5.4% in 2002. Services have been growing steadily and have been driving economic growth since 2000, indicating a consumption-based GDP growth.

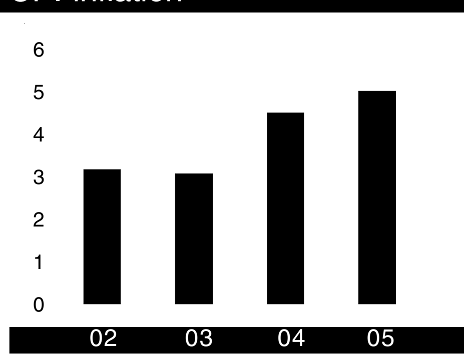
The agriculture, fishery and forestry (AFF) sector, although only accounting for 0.8 percentage points of the total GDP growth, grew by 3.9% in 2003, up from 3.3% in 2002. The 7.4% hike in fishery production, the highest since 1986, largely drove the growth in AFF.

Industry suffered a setback as it recorded lower growth at 3% in 2003 *vis-à-vis* the 3.7% gain in 2002. The

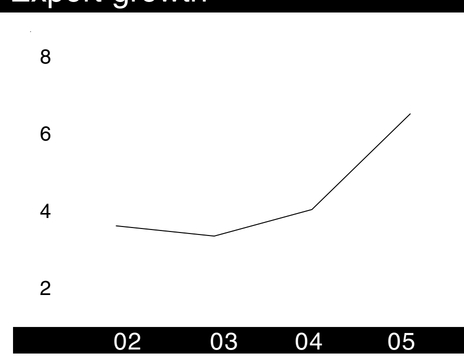
GDP growth



CPI inflation



Export growth



further contraction in construction to –5.9% watered down the positive growth exhibited by the rest of the industry sub-sectors, particularly manufacturing and mining and quarrying.

RISKS

The Philippines economy suffers when oil prices rise and a consistently weakening peso has an upward push on domestic fuel costs. Higher input costs, associated with more expensive oil, have slowed down the Philippine economy preventing the take off that has seemed imminent for the last five years.

THE RISING FISCAL DEFICIT

The Philippine national government's outstanding debt to GDP ratio rose from roughly 56% in 1997 to nearly 70% in 2002. Confidence in the Philippines' ability to manage its large public and external debt rests on the ability of the government to address the problem of the budget deficit.

In 2003, total revenues stood at P626.6 billion, above the P584.1 billion target. The government claims that increased revenue collection in 2003, coupled with fiscal discipline, has kept the deficit in a substantial position. An assessment of the revenue effort and tax effort, which both measure collection efficiency, suggests otherwise. Revenue effort in 2003 is barely up at 14.38% from 14.10% in 2002, but still feeble compared to the revenue effort registered in the 1990s. Tax effort is slightly down from 12.34% in 2002 to 12.33% in 2003.

The deficit is still a problem. Government spending reached P826.5 billion in 2003 leaving the deficit at P199.9 billion. The budget deficit is influenced to a great extent by interest payments on government debt.

Market uncertainty and investor confidence, reflected in the movements in the exchange rate, are the difference between a crisis and sustainability. A speculative attack on the Philippine currency could bring about a debt crisis. If the large external debt makes the Philippines vulnerable to default should the currency depreciate too significantly.

Unless the administration improves the country's fiscal position, the Philippines, given its high external debt–GDP ratio and low primary surplus, would be very vulnerable to external shocks and shifts in market sentiment.

Philippines' debt sustainability

Since 1997, the sustainable interest rate has been less than the actual interest rate (the t-bill rate), making it more difficult for the Philippines to pay its debt in the long run. With negative primary surpluses, the gap between the actual and sustainable interest rates has been widening. Unless there are more direct corrective measures, Philippines could find itself in a crippling crisis.