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EBS/83/24

CONFIDENTIAL

January 31, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Philippines - Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is a request from the Philippines for a stand-by arrangement equivalent to SDR 315 million. A draft decision appears on page 29.

This subject, together with the request from the Philippines for a purchase under the compensatory financing facility (document to be issued shortly), has been tentatively scheduled for discussion on Friday, February 25, 1983.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

PHILIPPINES

Request for Stand-by Arrangement

Prepared by the Asian and Exchange and
Trade Relations Departments

(In consultation with the Fiscal Affairs, Legal, Research
and Treasurer's Departments)

Approved by Tun Thin and Manuel Guitian

January 31, 1983

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I. Introduction

In the attached letter dated December 31, 1982, the Government of the Republic of the Philippines requests a stand-by arrangement for a period of one year in an amount of SDR 315 million, or 100 per cent of quota.

Financing of the proposed stand-by arrangement would be SDR 164.7 million from ordinary resources and SDR 150.3 million from borrowed resources. It is proposed that purchases be made available in five installments as indicated in Table 1, with the bulk of the purchases becoming available after a mid-term review. A waiver of the limitation in Article V, Section 3(b)(iii) of the Articles of Agreement is required.

The Philippines has also requested a purchase under the Compensatory Financing Facility in an amount of SDR 188.5 million, or 59.8 per cent of quota. If the Philippines makes the requested CFF purchase, draws the full amount requested under the stand-by arrangement, and makes repurchases as scheduled, the Fund's holdings of pesos would increase from 340 per cent of quota as of December 31, 1982, to 449 per cent of quota by the end of the stand-by period.

The 1982 Article IV consultation discussions were held in Manila during January 19-February 4, 1982, and the reports (SM/82/55 and Supplement 1; SM/82/66 and Correction 1) were discussed by the Executive Board at EBM/82/61 and EBM/82/62 (April 30, 1982). Discussions on a possible stand-by arrangement were held in Manila (April 11-22, 1982), Helsinki (May), Washington (August), and Manila (October 11-15 and November 4-27, 1982).1/

II. Economic Background

1. Economic trends and the international setting

The Philippine economy has been severely affected in recent years by a series of adverse external developments. The pronounced deterioration in the terms of trade associated with the second round of oil price increases in 1979-80 has been substantially aggravated in subsequent years by sharp reductions in the prices of most of the major commodity exports (Chart 1). Furthermore, the volume of exports has been depressed by the international recession in 1981-82 and by increased protectionism. Compounding the impact of these developments on the balance of payments, the cost of borrowing funds in international capital markets reached post-war highs in 1981 and remained at unusually high levels during the first half of 1982. Reflecting these developments, as well as some contributory domestic problems, the current account deficit has risen substantially in recent years, while the growth in real GNP has decelerated sharply.

1/ The staff teams included Messrs. Tun Thin, Salgado, Healy, Itam, Kincaid (all ASD), Jones (IBRD), Lipsky (ETR), Pettersen (FAD), Miss Allen and Miss Job (secretaries, ASD).

Table 1. Philippines: Projected Changes in Fund Holdings of Pesos Under Stand-by Arrangement, December 1982-February 1984

	1982	1983				1984
	Dec. 31	Jan. 1-Apr. 30	May. 1-Aug. 14	Aug.15-Oct. 31	Nov. 1-Jan. 31	Feb. 1-Feb. 28
			(In millions of SDRs)			
Total purchases		238.5	50.0	65.0	65.0	85.0
Stand-by program		50.0	50.0	65.0	65.0	85.0
Ordinary resources		(50.0)	(50.0)	(64.7)	(--)	(--)
Borrowed resources		(--)	(--)	(0.3)	(65.0)	(85.0)
CFF		188.5	--	--	--	--
Scheduled repurchases		31.7	41.2	39.3	47.0	--
CFF and Oil Facility		8.9	20.7	17.2	17.2	--
CFF		(5.5)	(17.2)	(17.2)	(17.2)	(--)
Oil Facility		(3.4)	(3.5)	(--)	(--)	(--)
EFF and stand-by program 1/		22.8	20.5	22.1	29.8	--
EFF		(--)	(9.1)	(6.3)	(9.1)	(--)
Stand-by program 1/		(22.8)	(11.4)	(15.8)	(20.7)	(--)
Outstanding use of Fund resources	755.3	962.1	970.9	996.6	1,014.6	1,099.6
CFF and Oil Facility	133.4	313.0	292.3	275.1	257.9	257.9
CFF	(126.5)	(309.5)	(292.3)	(275.1)	(257.9)	(257.9)
Oil Facility	(6.9)	(3.5)	(--)	(--)	(--)	(--)
EFF and stand-by program 1/	621.9	649.1	678.6	721.5	756.7	841.7
EFF	(127.2)	(127.2)	(118.1)	(111.8)	(102.7)	(102.7)
Stand-by program	(494.7)	(521.9)	(560.5)	(609.7)	(654.0)	(739.0)
			(As per cent of quota)			
Purchases under stand-by program		15.9	15.9	20.6	20.6	27.0
Repurchases under EFF and Stand-by arrangements		7.2	6.5	7.0	9.5	--
Outstanding use of Fund resources under EFF and stand-by arrangements	197.4	206.1	215.4	229.0	240.2	267.2
Fund holdings of pesos	339.8	405.4	408.2	416.4	422.1	449.1

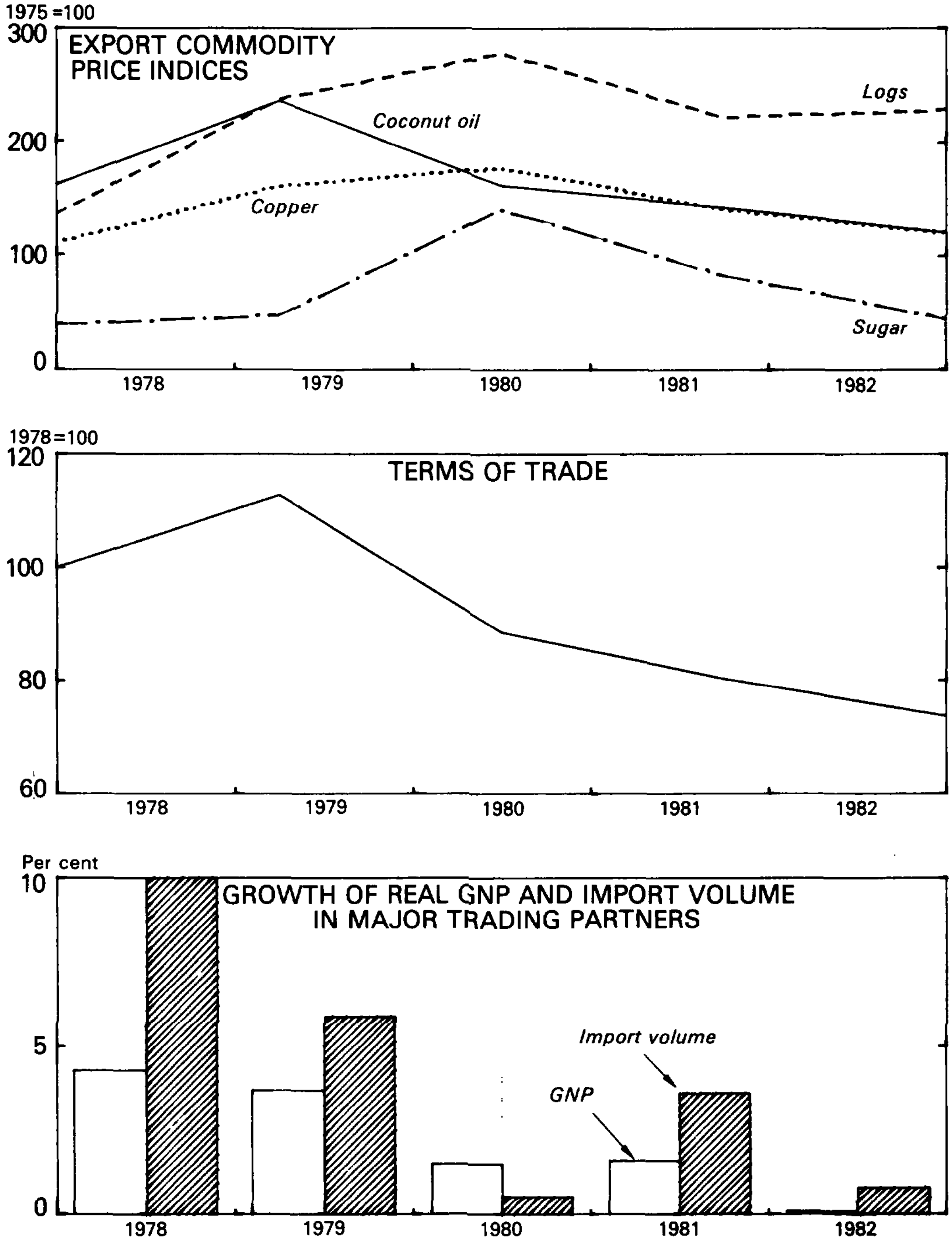
Source: Fund staff estimates.

1/ Includes drawings made under 1980-81 stand-by arrangement from Supplementary Financing Facility.

CHART 1

PHILIPPINES

SELECTED EXTERNAL FACTORS AFFECTING DOMESTIC ECONOMY



Sources: Data provided by the Philippine authorities; IMF, *International Financial Statistics;* and staff estimates.

The total volume of non-oil imports in the Philippines' major trading partners was virtually stagnant in 1980 and 1982 and rose only modestly in the intervening year. Reflecting the weakness in external markets, the prices of Philippine commodity exports declined sharply during 1981-82. The prices of coconut, sugar, copper, and timber products, which account for about half of total exports, experienced sharp declines during 1981-82. In 1982, the price of coconut oil, traditionally the most important export, was about 25 per cent lower than the 1980 level. This decline partly reflected an abundant supply of substitutes for coconut oil, especially soybean and other vegetable oils. The drop in sugar prices has been even more pronounced, falling from about $0.29 per pound in 1980 to a low of $0.06 per pound during 1982. Copper and timber prices also fell sharply during 1981-82, mainly because of weak economic activity in industrial countries. As a result, the value of primary exports fell by over 30 per cent during 1981-82.

In contrast to falling export prices, import prices continued to rise during the period, albeit at a moderate pace. As a result, the terms of trade worsened by about 35 per cent during 1980-82, with the deterioration in 1982 being about 8 per cent.

Interest rates in international capital markets rose sharply during 1981-82, thereby aggravating the effects on the balance of payments of the slowdown in the market growth and the drop in commodity prices. The London interbank rate (LIBOR) on six-month deposits rose from an average of 14 per cent in 1980 to over 16 per cent in 1981. During the first half of 1982, LIBOR continued to fluctuate at levels high by historical standards, before falling substantially in the latter half of the year. Reflecting these developments, interest payments on the Philippines' floating rate debt increased sharply. High international interest rates also have had the adverse effect of raising inventory costs of primary commodities, thereby further reducing the demand for exports.

Under the 1980-81 stand-by program, the authorities tried to adjust to the deteriorating external situation, while implementing structural reforms to improve export competitiveness and the efficiency of resource allocation.1/ Demand management policies were designed to reduce inflation and to contain the balance of payments deficits. While maintaining the original thrust of the policy objectives, however, monetary and fiscal policies were modified to cope with a severe domestic financial crisis in early 1981.2/ Although large-scale emergency assistance was extended by the Central Bank to restore confidence in the financial system, the growth in total liquidity decelerated in 1981. Fiscal policy, which was mildly expansionary during 1980, became more stimulative in 1981 as expenditures were adjusted to respond to the sluggishness of the economy and to the financial disruption. Revenues, however, did not keep pace because of the depressed economy and problems in tax administration.

1/ For a detailed discussion of the 1980-81 program, see Annex IV.
2/ For details on the financial crisis, see EBS/81/160 and SM/82/55.

As a consequence, the overall budget deficit widened considerably. While structural reforms, including tariff readjustment, relaxation of import restrictions, energy diversification, and financial sector reform, tended to strengthen the economic base, some of them had an adverse short-term impact on the balance of payments and the government budget.

The stand-by program of 1980-81 was successful in achieving a substantial deceleration of inflation and in containing the current account deficit in the balance of payments within program targets. Although the current account deficit rose from \$1.6 billion in 1979 to \$2.3 billion in 1981, this increase was sharply lower than might have been expected given the increase in oil prices. The adjustment was achieved mainly by a sharp increase in exports in 1980 and by a decline in the volume of imports during 1981. At the same time, the rate of inflation fell from 19 per cent in 1979 to 12 per cent in 1981. Real growth during the period, however, fell considerably short of the annual program target of about 6 per cent because of the effects of the deterioration in the terms of trade on profits and private investment and, in 1981, the weakened external demand conditions and the adverse effects of the financial crisis.

The economic situation in the Philippines deteriorated in 1982. The international recession continued to deepen, export growth slackened, and international interest rates remained at historically high levels. Mainly as a consequence, there were sharp increases in both the current account and the overall balance of payments deficits in 1982, while real growth declined to its lowest level in more than a decade. There was a marked increase in external debt, particularly short-term debt, and a sharp rise in the medium- and long-term debt service ratio. The budget deficit in 1982 was the most prominent area of slippage in policy implementation. Although the 1982 budget had aimed at a significant reduction in the deficit to facilitate external adjustment, the deficit is estimated to have been larger both in absolute terms and as a per cent of GNP than in the preceding year. This slippage reflected a shortfall in revenues and unsuccessful attempts at expenditure restraint. Domestic bank financing of the budget deficit is now estimated to be about twice the earlier projection, which has probably resulted in some crowding out of private sector credit needs. Toward the end of the year, the authorities took additional policy actions to arrest the balance of payments and budgetary deterioration. These measures included a more flexible exchange rate policy and more stringent controls on government expenditures. The only major favorable development during 1982 was a further decline in the rate of inflation.

2. Developments in 1982

a. Output and prices

The annual rate of growth of GNP in real terms slowed to 2.5 per cent in 1982, compared with 3.8 per cent in 1981, as external and domestic demand conditions deteriorated (Appendix Table I). Exports of goods and nonfactor services, which account for about one fifth of GNP, declined by 3 per cent in real terms in 1982 as a result of the international recession, increased protectionism, and the adverse effects of low commodity prices on production. Domestic demand conditions also weakened considerably as the deterioration in the terms of trade adversely affected profits and investment, while real private consumption was depressed by a fall in export-related agricultural incomes and increased unemployment. The deceleration in economic activity was most marked in the industrial sector. In particular, the growth in manufacturing output, which increased by over 3 per cent in 1981, slowed to 1 per cent in 1982.

Domestic inflation continued to decelerate in 1982, with the consumer price index for the Philippines increasing by 10.2 per cent, compared with 12.4 per cent in 1981. This slowdown in inflation mainly reflected a marked reduction in the rate of increase of import prices, lower increases in agricultural commodity prices, and wage restraint. The combined minimum wage and living allowances remained unchanged during 1982, while partial indicators of movements in average wages point to increases well below the inflation rate.

b. Structural reforms

In 1982, the authorities continued to implement, on schedule, their program of structural reform. The second stage of the four-year tariff reform was implemented on January 1, 1982, whereby all tariffs higher than 50 per cent were lowered. Complementing this reform, the second stage of a three-year plan to liberalize import restrictions was implemented in 1982 with the removal of 610 items from a list of about 1,000 restricted items. The Government has also begun to implement sectoral restructuring and rehabilitation programs. A program for restructuring the cement industry is underway and, with World Bank support, a program for the textile industry was initiated in 1982. The authorities continued to take steps to strengthen and develop the financial system in 1982. To encourage greater maturity transformation, the Central Bank introduced in February a special rediscount facility for multipurpose banks engaged in medium- and long-term lending. At the same time, a facility to deepen secondary trading in the equity market was established, whereby promissory notes supported by approved high-grade shares of stock could be rediscounted with the Central Bank.

c. Public finance

Budgetary developments during 1982 showed a further weakening of revenues relative to GNP and unsuccessful efforts to contain the budget deficit through compensating expenditure restraint. In April, the authorities revised their budgetary projections, reducing the growth of revenues in 1982 from 14 per cent to 7 per cent and the growth of expenditures from 8 per cent to 1 per cent. The overall deficit target was thereby reduced from ₱ 10.5 billion to ₱ 10.0 billion (2.8 per cent of forecast GNP).1/ In the outturn, revenues are estimated to have increased about 6 per cent, implying a decline in the revenue/GNP ratio from 11.7 per cent in 1981 to 11.3 per cent in 1982--a decline for the

1/ The revised budgetary projections are discussed in SM/82/55, Philippines--Staff Report for the 1982 Article IV Consultation, Sup. 1. The revised budget was formally approved in May with some modifications.

third consecutive year.1/ Budgetary expenditure (defined as total expenditure and lending less repayments) is estimated to have increased by nearly 10 per cent, marginally less than the inflation rate. As a result, the overall deficit reached an estimated ₱ 14.4 billion (4.2 per cent of GNP) in 1982, compared with an actual deficit of ₱ 12.2 billion (4.0 per cent) in 1981 (Table 2). Domestic bank financing is estimated at ₱ 9.1 billion, about twice the April projection, while external financing is estimated to fall short of the projection.

The shortfall in total revenues of about 1 per cent, compared with the April projections, reflected shortfalls in all major categories of domestic-based taxes because of lower growth in the tax bases due to the sluggish economy. In addition, income taxes appear to have been adversely affected by temporary factors related to the transition to the system of gross income taxation for individuals that was introduced at the beginning of the year. Receipts from import duties, on the other hand, exceeded the projection, reflecting the faster depreciation of the peso.

The overrun in budgetary expenditure was mainly due to problems in controlling equity contributions and net lending, which exceeded the April estimate by 47 per cent. These problems stemmed from an expenditure control system with limited flexibility for implementing cutbacks during the year and from errors in assumption related to the timing of disbursements.2/ Current and capital expenditures conformed to the program, with current expenditures increasing by 17 per cent and capital expenditures declining by 19 per cent.

As in previous years, the public corporations accounted for most of the investment undertaken by the public sector. The 12 major corporations, which account for the bulk of this investment, increased their capital outlays by an estimated 34 per cent in 1982 to ₱ 17.3 billion (Appendix Table II). With their internal cash generation amounting to less than ₱ 3.0 billion, their investment-savings gap widened substantially to about ₱ 14.3 billion (4.2 per cent of GNP). About half of this gap was covered by government equity contributions and net lending.

Reflecting the above developments in the National Government budget and in the corporations' accounts, the deficit of the nonfinancial public sector increased from ₱ 14.4 billion (4.7 per cent of GNP) in 1981 to

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1/ Since discretionary measures on average had a neutral revenue impact, the fall in the revenue ratio corresponds to a built-in elasticity of about 0.60 with respect to GNP.

2/ Public entities entered into expenditure commitments--on the basis of releases of allotments (spending authorizations) made by the end of April--much sooner than the authorities expected. By July, actual disbursements already exceeded the full-year estimate. Although releases of equity allotments were sharply curtailed in the second half of the year, it proved virtually impossible to withhold disbursements on commitments already made by public corporations on the basis of earlier allotments.

Table 2. Philippines: National Government Cash Budget, 1980-83

	1980	1981	1982 April estimate	1982 Latest estimate	1983 Program 1/
	(In billions of pesos)				
Revenue	34.7	35.9	38.6	38.2	43.5 2/
Tax revenue	30.5	31.4	34.1	33.7	38.0 2/
Nontax revenue	4.2	4.5	4.5	4.5	5.5
Expenditure and lending less repayments	38.1	48.1	48.6	52.6	52.9
Current expenditure	24.5	26.4	29.0 3/	30.8	36.1
Capital expenditure	8.4	12.7	11.8 3/	10.3	10.4
Lending less repayments 4/	5.2	9.0	7.8	11.5	6.4
Overall deficit (-)	-3.4	-12.2	-10.0	-14.4	-9.4 5/
Foreign financing	2.1	6.0	4.8	2.2	3.0
Gross borrowing	3.0	6.7	5.8	3.1	4.7
Amortization	-0.9	-0.7	-1.0	-0.9	-1.7
Domestic financing	1.3	6.2	5.2	12.2	6.4 5/
Banking system	1.2	5.3	4.5	9.1	4.5 5/
Nonbank sector	0.1	0.9	0.7	3.1	1.9
Memorandum items:	(Ratios in per cent of GNP)				
Revenue	13.1	11.7	10.9	11.3	11.2 2/
Tax revenue	11.5	10.3	9.6	10.0	9.8 2/
Nontax revenue	1.6	1.4	1.3	1.3	1.4
Expenditure and lending less repayments	14.4	15.7	13.7	15.5	13.6
Current expenditure	9.2	8.6	8.2	9.1	9.3
Capital expenditure	3.2	4.1	3.3	3.0	2.7
Lending less repayments 4/	2.0	3.0	2.2	3.4	1.6
Overall deficit	-1.3	-4.0	-2.8	-4.2	-2.4 5/
Foreign financing	0.8	2.0	1.4	0.6	0.8
Domestic bank financing	0.5	1.7	1.3	2.7	1.2 5/

Source Data provided by the Philippine authorities.

1/ "Program" refers to the budget outlined by the authorities to the staff mission in November 1982, which was predicated on a 1 per cent import duty surcharge.

2/ With a 3 percentage point import duty surcharge, it is likely that tax revenue will exceed the program estimate.

3/ In May, the estimate for current expenditure was increased to ₱ 30.8 billion to provide for higher maintenance requirements and interest payments, with an equivalent reduction in the estimate for capital expenditures to ₱ 10.0 billion.

4/ Consists of government equity contribution and loans less repayments.

5/ With a 3 percentage point import duty surcharge, it is likely that the overall deficit and domestic bank financing will be lower than the program estimates.

an estimated ₱ 18.7 billion (5.5 per cent) in 1982 (Appendix Table III).1/ Local governments and social security institutions are estimated to have had a combined surplus of ₱ 3.0 billion in 1982, about the same level as in the previous year.

d. Money and credit

The dominant feature of monetary developments during 1982 was the rapid expansion of net bank credit to the public sector. For the year as a whole, this expansion is estimated to have been equivalent to about 14 per cent of the stock of liquidity at end-1981, or roughly twice the corresponding expansion in the previous year (Table 3). During the first three quarters, over 50 per cent of domestic credit expansion went to the public sector, mainly to the National Government.

Credit to the private sector is estimated to have increased in 1982 by an amount equivalent to 17 per cent of the end-1981 liquidity stock, compared to an 18.5 per cent increase during 1981. The deceleration of private sector credit growth during 1982 reflected both the slowdown in investment activity and an effort by the monetary authorities to contain liquidity expansion in the face of the large budgetary credit requirements. Rediscounting was limited to only ₱ 1.4 billion during the first three quarters, compared with ₱ 3.6 billion and ₱ 2.1 billion during the corresponding periods in 1981 and 1980, respectively. The sharp reduction in rediscounting was required in order to more than offset the expansionary impact of a one percentage point reduction in commercial bank reserve requirements on deposits in July--a step designed to improve the profitability of banking operations.

Total liquidity is estimated to have increased by about 16 per cent, the same rate as in the preceding year. The increase in liquidity was almost entirely due to an increase in time and savings deposits and deposit substitutes, partly reflecting the maintenance of positive real interest rates and the growing interest sensitivity of depositors. The weighted average nominal interest rate on money market instruments is estimated to have averaged 14 per cent during 1982, implying a real interest rate of approximately 3 per cent. Nominal interest rates on bank deposits averaged over 12 per cent during the year, or roughly about the same nominal rates as in the preceding year, despite the two percentage point reduction in inflation.

e. External sector

Balance of payments developments in 1982 were characterized by a sharp decline in the value of exports, stagnant imports, and a large increase in interest charges on external indebtedness. Reflecting these developments, the current account deficit is estimated to have widened to nearly $3.4 billion (8.5 per cent of GNP), compared to $2.3 billion (6.0 per cent) in 1981 (Table 4). Both the trade deficit and the deficit

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1/ The nonfinancial public sector, as defined in Appendix Table III, comprises the National Government, local governments, social security institutions, and 12 major public corporations.

Table 3. Philippines: Monetary Survey, 1980-83
(In billions of pesos)

End of period	1980 1/ Dec.	1981 Dec.	1982 June	1982 Sept.	1982 Nov.	1982 Dec. 2/	1983 Projections Mar.	1983 Projections June	1983 Projections Sept.	1983 Projections Dec.
Net international reserves	-5.6	-10.4	-16.7	-17.8	-23.3	-22.1	-23.9	-25.6	-26.8	-27.5
Net domestic assets 3/	73.4	92.5	104.3	107.4	115.0	117.3	122.7	127.2	131.1	136.5
Domestic credit	92.9	113.4	124.9	129.8	132.9	139.1	145.1	150.2	154.8	160.9
Public sector credit	6.9	12.2	17.6	20.6	19.4	23.9	26.8	28.6	29.5	31.6
National Government, net	4.2	9.7	14.2	16.5	15.2	18.9	21.1	21.7	21.9	23.4
Social security institutions, net 4/	-1.7	-1.9	-1.9	-2.0	-2.0	-1.9	-1.7	-0.9	-0.5	-0.3
Other public entities	4.4	4.3	5.4	6.0	6.2	7.0	7.4	7.7	8.1	8.5
Private sector credit	86.0	101.3	107.3	109.2	113.5	115.2	118.3	121.6	125.3	129.4
Medium- and long-term foreign liabilities	-4.5	-5.2	-5.3	-5.5	-6.1	-6.1	-6.3	-6.5	-6.8	-7.0
Other items, net	-15.0	-15.7	-15.3	-16.8	-11.8	-15.7	-16.1	-16.5	-16.9	-17.4
Total liquidity	67.8	82.1	87.6	89.6	91.7	95.2	98.8	101.6	104.3	109.0
Narrow money	22.5	23.5	22.5	21.0	21.3)	76.8	80.2	82.8	85.3	
Time and savings deposits	32.9	42.1	47.6	50.6	52.9)					
Deposit substitutes	12.4	16.5	17.5	18.1	17.5	18.4	18.6	18.8	19.0	19.3
(Annual percentage changes) 5/										
Net domestic assets	23.4	23.0 6/	28.9	28.9	31.1	30.2	25.6	26.1	26.4	20.2
Credit to public sector	3.0	7.5 6/	9.7	14.5	9.0	14.3	13.1	12.5	10.0	8.1
Net credit to National Government	3.2	7.9 6/	9.3	13.0	7.0	11.1	9.5	8.6	6.0	4.8
Credit to private sector	24.5	18.5 6/	20.6	18.4	19.8	17.0	16.2	16.3	18.0	14.9
Total liquidity	18.2	16.0 6/	17.0	18.3	15.9	15.9	15.5	16.0	16.3	14.6

Source: Data provided by the Philippine authorities.

1/ Data for 1980 are not comparable with the data for subsequent years due to mergers of nonbank financial institutions into banking system during 1981.

2/ Projection.

3/ In the stand-by program for 1983, medium- and long-term foreign assets have been added to net domestic assets to facilitate financial programming.

4/ Defined as outstanding bank credit less holdings of Central Bank Certificates of Indebtedness (CBCIs).

5/ In relation to liquidity stock outstanding on corresponding date in previous year.

6/ Adjusted for mergers of nonbank financial institutions into banking system during 1981.

Table 4. Philippines: Summary Balance of Payments, 1980-83

	1980	1981	Staff Estimate 1982	Staff Proj. 1983
	(In millions of U.S. dollars)			
Goods, services, and transfers	-2,051	-2,293	-3,364	-2,460
Trade balance	-1,939	-2,224	-2,805	-2,400
Exports, f.o.b.	(5,788)	(5,722)	(4,995)	(5,516)
Imports, f.o.b.	(-7,727)	(-7,946)	(-7,800)	(-7,916)
Services and transfers (net)	-112	-69	-559	-60
Investment income (net)	(-732)	(-1,130)	(-1,768)	(-1,826)
Other services (net)	(186)	(589)	(766)	(1,246)
Transfers (net)	(434)	(472)	(443)	(520)
Capital movements	1,699	1,807	2,175	1,862
Long-term capital (net)	1,098	1,739	1,732	1,762
Direct investment (net)	(45)	(407)	(259)	(244)
Borrowing (net)	(1,053)	(1,332)	(1,473)	(1,518)
Short-term capital (net)	765	188	423	--
Errors and omissions	-350	-621	-204	--
Monetization of gold	128	400	278	100
Allocation of SDRs	29	27	--	--
Valuation adjustment	29	74	-54	--
Changes in net international reserves of the banking system	-352	-486	-1,189	-598
Memorandum items: (end-of-period)				
Net international reserves of the banking system	-778	-1,264	-2,453	-3,051
Gross official reserves	3,155	2,707	2,543	2,543
Medium- and long-term external debt 1/	8,554	10,028	11,701	13,219
Public external debt 2/	6,583	7,767	9,106	10,259
	(In per cent of GNP)			
Current account deficit	5.8	6.0	8.5	6.2
Merchandise exports	16.3	14.8	12.6	13.9
Merchandise imports	21.8	20.5	19.7	19.9
Debt service 3/	3.6	4.3	5.4	6.1
Interest	(1.9)	(2.3)	(3.0)	(3.2)
Amortization	(1.7)	(2.4)	(2.8)	(2.9)

Sources: Data provided by the Philippine authorities and Fund staff estimates.

1/ Excludes IMF.
2/ Includes publicly guaranteed debt of the private sector.
3/ On medium- and long-term external debt; includes IMF.

on services and transfers are estimated to have widened substantially. The increased deficit on services and transfers is almost entirely attributable to an increase of over 50 per cent in net investment income payments to a total of nearly $1.8 billion. The overall balance of payments deficit reached $1.2 billion in 1982, more than double the deficit in the preceding year, as higher capital inflows were insufficient to offset the enlarged current account deficit.

Merchandise exports declined by almost 13 per cent in 1982 (Appendix Table IV), with two thirds of the decline being attributable to lower export prices. The principal primary exports fell in value by about 23 per cent, mainly reflecting depressed prices. Nontraditional exports, which had recently been the most dynamic element in the export performance, grew by less than 1 per cent in 1982. This growth was entirely due to a 23 per cent increase in the exports of electronic and electric goods; practically all other categories of nontraditional exports suffered declines, in some cases reflecting increased protectionism.1/ The slight decline in total imports was mainly due to an 8 per cent decline in oil imports as the inventory stock was reduced. Non-oil imports grew by about 1 per cent in value as well as in volume.

Although detailed final data on external debt in 1982 are not yet available, it is estimated that medium- and long-term debt outstanding grew by nearly 17 per cent in 1982 to $11.7 billion (Table 4). Both amortization and interest payments on medium- and long-term external borrowing increased sharply during 1982, and the debt service ratio 2/ rose to 27.1 per cent from 20.1 per cent in 1981 (Table 5). The stock of short-term debt outstanding at end-1982 is estimated at $4.2 billion, a $600 million increase during the year (Appendix Table V).3/

Between end-1981 and end-1982, the peso depreciated by 10.6 per cent vis-a-vis the U.S. dollar, with nearly half of the depreciation occurring in the final three months of the year (Appendix Table VI). This resulted in a 6 per cent depreciation of the peso in nominal effective terms during the year (Chart 2). The staff estimates that a 7 per cent appreciation of the peso in real effective terms from December 1981 to August 1982 was reversed by the end of the year.4/

1/ As one instance, the European Economic Community adopted a ban on textile imports from ASEAN countries pending negotiations with individual countries to set limits on textile shipments.

2/ Defined as amortization and interest payments on medium- and long-term external debt (excluding prepayments but including payments to the IMF) expressed as a per cent of exports of goods and services.

3/ The Philippine official short-term debt statistics include revolving trade credits, fixed maturity short-term loans, and import financing through use of Open Accounts (O/As) and Documents Against Acceptance (D/As). However, short-term debt classified as an international reserve liability of the banking system is not included. At end-1982, net international reserves of the banking system amounted to negative $2.5 billion.

4/ Actual data on price movements required for the calculation of the real effective exchange rate are currently available only through August.

Table 5. Philippines: Selected Program Indicators, 1980-83

	1980	1981	1982 Estimates	1983 Program
Main targets		(Percentage change)		
Real GNP growth	4.4	3.8	2.5	2.0
CPI (annual average) 1/	17.6	12.4	10.2	11.0
		(In millions of U.S. dollars)		
Balance of payments				
Current account	-2,051	-2,297	-3,364	-2,460
(Per cent of GNP)	(-5.8)	(-6.0)	(-8.5)	(-6.2)
Overall balance	-352	-486	-1,189	-598
(Per cent of GNP)	(-1.0)	(-1.3)	(-3.0)	(-1.5)
Policy indicators		(In billions of pesos)		
Budget - Revenues	34.7	35.9	38.2	43.5 2/
- Expenditures	38.1	48.1	52.6	52.9
- Overall deficit	-3.4	-12.2	-14.4	-9.4 2/
(Per cent of GNP)	(-1.3)	(-4.0)	(-4.2)	(-2.4)
		(Percentage change)		
Net domestic assets 3/	23.4	23.0	30.2	20.2
Net credit to public sector 3/	3.0	7.5	14.3	8.1
Exchange rate: US$/₱ 4/	-1.8	-5.2	-8.1	...
NEER 4/	-1.7	-1.2	-3.5	...
REER 4/	4.1	1.8	...	...
		(In billions of U.S. dollars)		
External borrowing approvals (1-12 years) 5/	1.2	1.5	1.0	1.6
Net inflow of short-term capital	0.8	0.2	0.4	--
Assumptions and projections		(Percentage change)		
Terms of trade	-21.3	-9.4	-8.0	3.2
Total liquidity	18.2	16.0	15.9	14.6
Gross domestic savings) per cent of GNP	24.8	24.5	22.1	23.9
Gross domestic investment) per cent of GNP	30.6	30.5	30.5	30.1
Debt service (per cent of exports of goods and services) 6/	16.0	20.1	27.1	27.3

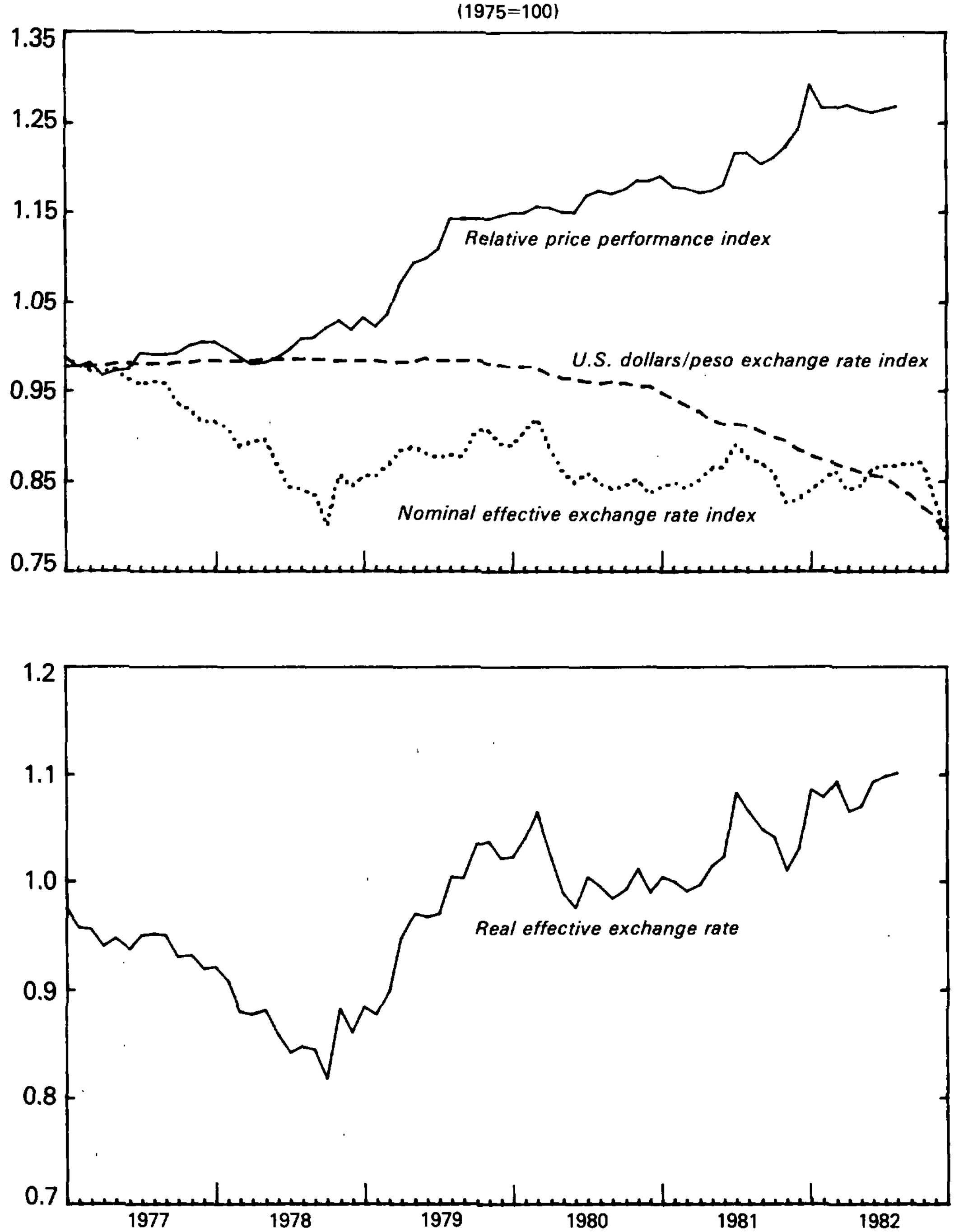
Sources: Data provided by the Philippine authorities and staff estimates.
1/ National coverage.
2/ With a 3 percentage point import duty surcharge, it is likely that revenue will exceed ₱ 43.5 billion and the overall deficit will be lower than ₱ 9.4 billion.
3/ As per cent of total liquidity outstanding at end of previous period.
4/ Annual averages: positive figure implies appreciation of the peso.
5/ Figures for 1980-82 are actual approvals, while for 1983 they are program limits.
6/ On medium- and long-term external debt; includes IMF.

CHART 2

PHILIPPINES

INDICES OF NOMINAL EFFECTIVE EXCHANGE RATE, RELATIVE PRICE PERFORMANCE, AND U.S. DOLLAR/PESO EXCHANGE RATE, 1977-82

(1975=100)



Sources: IMF, *International Financial Statistics;* and staff estimates.

III. Program for 1983

1. Overview

The program aims at achieving a substantial improvement in the balance of payments. The current account deficit, which amounted to about 8.5 per cent of GNP in 1982, is targeted to decline to 6.2 per cent of GNP in 1983 (Table 5 and Chart 3), despite the very moderate recovery projected in external demand. The overall balance of payments deficit is to be halved to 1.5 per cent of GNP, with no net increase in short-term debt.1/ The targets for inflation and real growth have been set at 11 per cent and 2 per cent, respectively, taking into account the policy measures required to bring about the desired external adjustment. To achieve these targets, the authorities have adopted a comprehensive set of policies entailing budgetary adjustment, cautious monetary policy, flexible exchange rate management, restrictions on foreign borrowing, and structural reforms.

Budgetary adjustment will play an important role in the external adjustment and will be effected through an austere expenditure program and significant discretionary revenue measures. Budgetary expenditures will be reduced in 1983 by an amount equivalent to 1.9 per cent of GNP, mainly through cutbacks in equity contributions and net lending to public corporations. These corporations will in turn adjust to the reductions in budgetary funding by adapting their pricing policies to increase internal cash generation or by cutting back on their investment programs, which tend to be import-intensive. The program envisaged measures to raise additional revenue sufficient to maintain total revenue as a per cent of GNP at nearly the 1982 level.2/ As a result of these policies, the budget deficit would decline from 4.2 per cent of GNP in 1982 to 2.4 per cent in 1983. However, since the program was formulated, the authorities have implemented a 3 per cent import duty surcharge in place of the programmed 1 per cent surcharge. As discussed below, this change is expected to result in reductions in the fiscal deficit and in credit expansion beyond those programmed.

The other main instruments of adjustment will be credit policy and external policy. A stringent credit policy will significantly reduce the expansion of net domestic assets of the banking system and, hence, the growth of liquidity in 1983, compared with 1982. The decline in overall credit growth will result primarily from reduced credit growth to the public sector which, in turn, will reflect a sharply lower credit expansion to the National Government. As regards external policy, the

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1/ Of nonbanks; excludes O/As and D/As.

2/ The staff estimates that the income elasticity of revenue is generally well below unity, and particularly so when the economy is depressed. Problems in tax administration, as well as the tax structure, account for the low elasticity. The authorities have recently introduced several measures to improve tax administration (see footnote on p. 16).

authorities will continue the flexible exchange rate policy pursued in recent months, guided by the objective of gradually improving the competitiveness of traded goods. In addition, the authorities have set limits on new approvals of external debt in the 1-12 year maturity range and will carefully monitor short-term debt.

Recognizing the need to improve the productivity of investment, the authorities attach importance to the continued implementation of structural reform measures. As part of their program for 1983, the authorities have already taken the major step of completing the deregulation of interest rates. During 1983, the authorities will continue to implement the phased programs of tariff reform and import liberalization and undertake a reform of fiscal incentives to encourage efficiency and competitiveness in the industrial sector. Energy policies will continue to aim at conserving overall energy use, expanding and diversifying domestic energy resources, and reducing the reliance on imported oil.

The marginal rise in inflation envisaged for 1983 takes into account the expected domestic pricing adjustments. To prevent these adjustments from fueling inflation, the authorities intend to complement their fiscal and credit policies by limiting minimum wage adjustments in 1983 to gains in productivity. The private sector, in conjunction with trade unions, will be encouraged to observe this guideline in wage negotiations.

2. Growth and supply policies

The authorities recognize that the weak international environment and the sharp external and budgetary adjustments planned for 1983 will preclude an immediate reversal of the declining trend in economic growth since 1980. The objective of supply policies in 1983 will therefore be to improve resource allocation and economic efficiency and thereby provide a strong foundation for accelerated economic growth in the medium term.

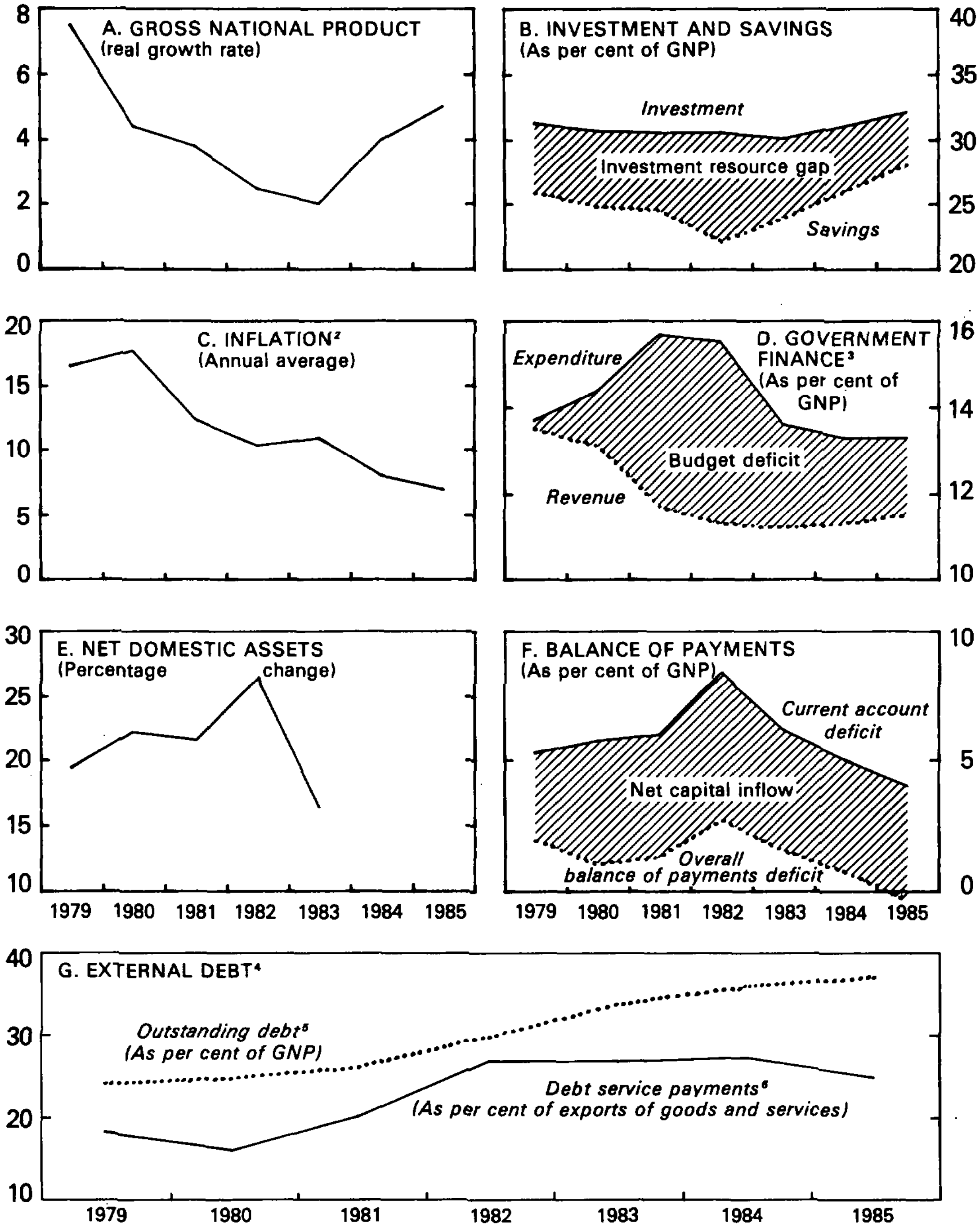
The expected growth of 2 per cent in real GNP in 1983 would reflect a 1 per cent growth in real domestic demand and a 5 per cent growth in real external demand. The projected growth in external demand is predicated on some recovery in the major traditional exports and continued growth in manufactured exports, particularly electronics, and exports of services. Total real private consumption would rise at about the same rate as population, but real government consumption would decline significantly. Real gross investment and the volume of imports of goods and nonfactor services would remain roughly at their 1982 levels.

To improve efficiency in the industrial sector, the Government intends to implement a reform of investment incentives during 1983 as part of an adjustment program to be supported by the proposed Second Structural Adjustment Loan (SAL II) from the IBRD. The reform aims at rationalizing the structure of incentives to correct distortions and improving the administration of the fiscal incentive system. A system of tax credits which is factor-neutral and performance-oriented has been designed for the manufacturing sector. This system, which provides tax credits to a firm for its first five years of economic production based on its

CHART 3

PHILIPPINES

SELECTED MACRO-ECONOMIC VARIABLES, 1979-85[1]



Sources: Data provided by the Philippine authorities; and staff estimates.
[1]Actuals for 1979-81; preliminary estimates for 1982; and projections for 1983-85.
[2]Consumer price index based on national coverage.
[3]National government cash budget.
[4]At end of period.
[5]Excludes loans of one year or less and debt to IMF.
[6]Defined as amortization and interest payments on medium-and long-term external debt *(excluding prepayments) and payments to IMF.*

value-added, will replace a system biased toward capital-intensive investment. Another provision in the revised incentive system will allow exporters a tax credit based on the net local content of export production during the first five years of operations. To facilitate the administration of the system, the registration of eligible enterprises with the Board of Investments and the subsequent applications for use of the tax credits will be simplified. Complementing these reforms, the Government will abolish import restrictions on industrial machinery and equipment to improve competition in the domestic manufacturing sector.

3. Fiscal policies

Fiscal policy for 1983 is aimed at reducing substantially the deficit of the National Government to a level consistent with the short-term economic situation and the medium-term adjustment strategy. The budgetary program outlined to the November staff mission envisaged a reduction in the overall deficit to ₱ 9.4 billion (2.4 per cent of GNP) (Table 2). This was to be achieved through severe expenditure restraint, resulting in a decline in the ratio of expenditure to GNP by 1.9 percentage points to 13.6 per cent and, to a lesser extent, through new revenue measures amounting to ₱ 1,770 million (0.5 per cent of GNP) to prevent a further significant decline in the revenue effort. The reduction in the budget deficit was to be reflected in a sharply reduced recourse to domestic bank financing to ₱ 4.5 billion (1.2 per cent of GNP). External financing was projected at ₱ 3.0 billion, resulting from receipts of ₱ 4.7 billion from SAL II and project loans, less amortization payments of ₱ 1.7 billion.

Budgetary expenditure was programmed at ₱ 52.9 billion, about the same level as in the previous year, implying a substantial reduction in real terms. Measures would be taken to improve budgetary programming and control procedures.1/ The bulk of adjustment would come from a 44 per cent reduction in lending less repayments to public entities, reversing large increases which took place in 1981-82 (Appendix Table VII). Capital expenditure would be maintained at about the same level as in the previous year, with cutbacks in outlays on highways and water supply and no new office buildings. Current expenditures would increase by about 17 per cent, mainly because of an 85 per cent increase in interest payments on government debt due to a rapid rise in the level of debt and a higher average cost of borrowing; all other major categories of current expenditure would grow more slowly than the rate of inflation. Current transfers would be reduced by 43 per cent, reflecting, inter alia, cutbacks in subsidies to public corporations for payment of import duties. The increase in personal services would be limited to 8 per cent through restraint in salary adjustment and a hiring freeze, except for key positions, such as in the health sector and in the revenue-collecting agencies. Maintenance and other operating

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1/ Specifically, comprehensive releases of allotment at the beginning of the year would be limited to personal services and to selected investment projects. The quarterly cash programs would be specified in greater detail at the ministry/fund level to enable better control and early identification of sources of variance between programmed and actual disbursements.

expenditures would be allowed to increase by about 10 per cent, slightly less than the inflation rate, with cutbacks in purchases of motor vehicles and equipment, traveling, and seminars and workshops.

Revenue was forecast to increase by 13.8 per cent to ₱ 43.5 billion. Without discretionary measures, all major revenue categories would increase at a lower rate than the projected growth rate of nominal GNP (14.9 per cent), due to slower growth in the bases as well as weaknesses in tax administration (Appendix Table VIII).1/ The package of new measures was intended to include the following measures to be implemented in January 1983: upward adjustment of a large number of fees and charges (₱ 600 million), most of which have undergone limited revision in past years; increases in specific rates on cigarettes and cigars (₱ 180 million) to compensate for price inflation; and restrictions on the use of the tax credit method for computation of sales tax (₱ 140 million) to reduce the erosion of the tax base under the present system. Further measures were to follow during the first half of 1983 to generate at least ₱ 850 million during the remainder of the year. The principal measure would be a temporary 1 per cent across-the-board import duty surcharge to recoup some of the losses resulting from the rate reductions associated with the tariff reform. Other measures would include upward adjustments of petroleum taxes and realignment of the system of indirect taxation in the context of SAL II.

Effective January 1, 1983, the authorities introduced the import duty surcharge applicable to all imports, with limited exceptions, at a 3 percentage point rate, instead of the previously intended 1 percentage point rate. At the same time, importers were required to make advance deposits of import duty with banks, mainly as a safeguard against defaults or delays in the payment of duty. The staff estimates that with these extra measures the total yield from the package of discretionary revenue measures would rise from ₱ 1,770 million to about ₱ 2,770 million (0.7 per cent of GNP). However, the authorities view the extra measures as providing a safety margin against a shortfall in revenues from the existing revenue system. For the time being, the staff is treating the additional revenue yield as a cushion, although it is probable that the fiscal position will be improved by the enlarged revenue package. Since the authorities have undertaken to adhere to their expenditure program, a lowering of the budget deficit below ₱ 9.4 billion is likely. This would be a desirable development, because it would allow for less recourse to bank credit by the Government than envisaged and, hence, tend to ease pressures on the balance of payments. The authorities and staff plan to

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1/ The authorities have recently introduced several administrative measures providing for stricter implementation of and compliance with tax laws and regulations. These measures, which should strengthen revenue performance over the medium term, include the expanded use of a computerized master file for the processing and feedback of essential data to the district tax offices, systematic programs to canvass all potential taxpayers to expand the tax base, and improvements in audit management, with increased attention focussed on potentially large cases of under-assessment.

review fiscal developments in the first half-year during the mid-term review and, if necessary, to reach new understandings for the second half-year.

The public corporations are to adjust to the sharp reduction in government equity contributions and lending primarily by scaling down investment plans and generating additional funds from internal sources. Accordingly, capital investment of the major public corporations, which amounted to ₱ 17.3 billion in 1982, is to be reduced by about 12 per cent (about 23 per cent in real terms) to ₱ 15.3 billion in 1983. This reduction reflects the postponement of certain projects (the aluminum smelter, the integrated pulp and paper project, and the petrochemical complex), as well as the deceleration in the implementation of others. At the same time, the internal generation of resources by these corporations is projected to increase from ₱ 3.0 billion in 1982 to ₱ 4.0 billion in 1983. The higher level of internal resource generation is attributable mainly to pricing adjustments and measures to reduce costs. Thus, the investment-savings gap of the major public corporations is projected to be reduced from an estimated ₱ 14.3 billion in 1982 (4.2 per cent of GNP) to ₱ 11.3 billion in 1983 (2.9 per cent). About one third of this gap will be covered by government equity contributions and net lending, compared with one half in the previous year.

Illustrative of the adjustments made by the major public corporations, the National Power Corporation will reduce its investment sharply in 1983 by deferring the initiation of certain power generation projects, while accelerating the implementation of tariff increases to generate an estimated ₱ 600 million in additional revenue. Similarly, the Metropolitan Waterworks and Sewerage System will postpone certain investment outlays (estimated savings of about ₱ 300 million in 1983), while implementing a substantial tariff increase and undertaking a project to improve the distribution system and expand the billing coverage for water usage.

Reflecting the adjustment in the National Government budget and in the corporations accounts, the deficit of the nonfinancial public sector is now projected to decline from ₱ 18.7 billion (5.5 per cent of GNP) in 1982 to less than ₱ 12.9 billion (3.3 per cent) in 1983. Also contributing to the reduction in this deficit is an expected increase in the surplus of social security institutions by ₱ 0.8 billion. Local governments are projected to have a surplus of about the same level as in the previous year.

4. Monetary and credit policies

The main objectives of monetary policy during the program period will be to support adjustment in the external accounts and to ensure an adequate share of available credit for productive investments in the private sector. To accomplish these goals, there will be a substantial deceleration in the expansion of bank credit, particularly with respect to the public sector, and in the growth of total liquidity.

Monetary policy for 1983 has been formulated on the assumptions of a 2 per cent real growth target, a 12.6 per cent increase in the GNP deflator, an overall deficit in the balance of payments of $600 million, and maintenance of positive real interest rates. Consistent with this framework, the increase in total liquidity will be limited to 14.6 per cent in 1983, compared to an estimated 15.9 per cent in 1982 (Table 3). With the exception of 1979, this will be the lowest expansion of liquidity in over a decade. In support of the external adjustment targets, the expansion in net domestic assets of the banking system during 1983 will be limited to an amount equivalent to about 20 per cent of the estimated stock of liquidity at end-1982, compared with an expansion of 30 per cent in the preceding year.

The program of fiscal restraint will significantly reduce the size of bank financing of the public sector deficit. Of the projected ₱ 21.8 billion increase in domestic credit, the public sector will absorb no more than one third, compared with the roughly one half it absorbed during 1982. The projected ₱ 4.5 billion of bank financing of the National Government deficit is less than 5 per cent of the estimated end-1982 liquidity stock, compared to a corresponding figure of over 11 per cent in the preceding year. Credit to the private sector is projected to increase by about 15 per cent of the liquidity stock, compared to about 17 per cent in the preceding year. This deceleration partly reflects a projected slowdown in the growth of investment-related credit needs during 1983.

Quarterly ceilings have been established on the level of the banking system's net domestic assets and its net credit to the public sector as indicators of adherence to the monetary and budgetary policies undertaken in the program. These quarterly ceilings are consistent with established seasonal credit needs and with projections of budgetary financing flows (Table 3).

The authorities have taken measures to strengthen the efficiency of resource allocation and improve competitiveness in the financial sector during 1983. On January 1, 1983, the Central Bank abolished the last remaining interest rate ceiling, which was on lending rates with maturity of one year or less. In addition, a short-term prime rate system has been established to enhance bank competitiveness and to provide the public with up-to-date information on market-determined lending rates.1/

At the beginning of 1983, the Central Bank cancelled a scheduled reduction in the required reserve ratio for commercial banks and eliminated a 3 per cent interest paid on bank reserves deposited with the Central Bank; these steps were intended to remove concessions deemed to be unnecessary because of the deregulation of interest rates. In addition, concessional loans to the Government by the Central Bank are being replaced by Treasury

1/ Under the system, all banks are required to post their minimum lending rates daily on their premises, and multipurpose commercial banks are required to publish their short-term prime rates in newspapers on a regular basis. The Central Bank will monitor interest rates to detect large variations in short-term prime rates.

instruments carrying market rates of interest--a step that should further improve the allocation of resources through financial markets.

5. External policies and prospects

To achieve the targeted reduction in the current account deficit of the balance of payments, the authorities will rely mainly on the demand management policies already described in previous sections supplemented by a flexible exchange rate policy. In addition, they anticipate substantial results from certain policies already in place which are designed to improve earnings in the services account. For example, a series of measures has already been implemented to improve correspondent banking facilities and other incentives available to Filipinos working abroad, especially to contract workers who are legally obligated to repatriate 50 to 70 per cent of their basic salary. Also, the Central Bank has offered premium interest rates to commercial banks on deposits made in foreign banknotes. This action, in turn, allows the banks to offer more attractive exchange rates for purchases of foreign banknotes, a measure which is designed to reduce the relative attractiveness of dealing in parallel exchange markets. Finally, an aggressive effort is underway to increase earnings from tourism. These policies, along with the very moderate improvement of about 3 per cent expected in the terms of trade in 1983 and a projected decline in interest rates prevailing in international capital markets, are designed to limit the current account deficit of the balance of payments in 1983 to $2.5 billion, or 6.2 per cent of GNP.

Export unit value is projected to increase by more than 5 per cent in 1983, and volume is projected to grow by nearly 5 per cent. The unit value of primary exports is projected to increase by 9 per cent. However, the volume of these exports is likely to decline, partly because shipments of coconut products will be restricted by the diversion of some of these items for use in the cocodiesel project, and by the ban on copra exports since August 1982.1/ In contrast to primary exports, the unit value of nontraditional manufactured exports is projected to increase by only 2 per cent in 1983. The volume of these exports is expected, however, to increase significantly in response to exchange rate policy and to the resolution of various specific problems, including quota barriers in the European Community that affected the export of garments in 1982.

Imports are projected to increase slightly to $7.9 billion in 1983. The value of non-oil imports is projected to increase by slightly more than 1 per cent in 1983, and their volume is projected to decline by nearly 2 per cent. The value of petroleum imports is projected to increase moderately as the run-off of inventories is not expected to be repeated in 1983.

1/ This ban was instituted to counteract tax and tariff policies in importing countries which in effect subsidize the domestic milling of copra into oil compared to oil produced by Philippine mills.

The trade balance is projected to be in deficit by $2.4 billion in 1983, a substantial improvement from the $2.9 billion deficit estimated for 1982. The deficit on account of services and transfers is projected at $0.06 billion in 1983, compared with a $0.56 billion deficit in 1982. This improvement will take place, despite a widening of the deficit in investment income because of a large projected increase in the surplus in other services in response to the policy measures described above. The net inflow of capital is projected to decline from $2 2 billion in 1982 to less than $1.9 billion in 1983. Of this amount, nearly two thirds is expected on Official Development Assistance terms and in suppliers' credits and credits from nonbank financial institutions. Lending from commercial banks is expected to account for less than one third, representing an increase in the range of 7-8 per cent in commercial bank net medium- and long-term loans outstanding to the Philippines. In contrast to the past three years, no net short-term capital inflow to the nonbank sector is projected in 1983. Direct investment is expected to amount to $0.25 billion, which is about the same magnitude as in the preceding year.

The overall balance of payments deficit is projected at $0.6 billion in 1983 or about one half of the deficit registered in the preceding year. This deficit is expected to be financed by net drawings of about $280 million from the Fund (including a projected SDR 188.5 million CFF drawing) and the remainder by an increase in other reserve liabilities. Taking into account medium- and long-term debt, short-term debt, and reserve liabilities, total commercial bank exposure is expected to increase in 1983 by about 5-6 per cent.

Total international reserve liabilities, including liabilities to the Fund, increased by 13 per cent in 1981 and 23 per cent in 1982; total reserve assets increased during the same periods by 5 per cent and 6 per cent, respectively (Appendix Table IX). Net international reserves at end-1983 are projected to be negative $3.1 billion, while gross official reserves are projected to be $2.5 billion, equivalent to about four months of projected 1983 imports.

All external borrowing in the Philippines, including borrowing by the private sector, is subject to the prior approval of the Central Bank, but disbursements from approved loans do not need approval. In recent years, approvals of medium- and long-term borrowing have been subject to limitations within the context of arrangements with the Fund. In 1982, total approvals were subject to a self-imposed limit of $2.4 billion, with a sub-limit of $1.4 billion on debt from commercial sources of 1-12 year maturity; the corresponding actual approvals were $2.4 billion and $1.0 billion, respectively. In 1983, the authorities have undertaken to limit new approvals of medium- and long-term borrowing of 1-12 year maturity to $1.6 billion, subject to a sub-limit on borrowing of 1-5 year maturity of $100 million. The commercial banks' share of the projected $1.6 billion of borrowing approvals in the 1-12 year maturity range would be about $1 billion, roughly the same as in 1982, including a $300 million syndicated loan for the Central Bank now being finalized. There would be no further Central Bank syndicated borrowings in 1983 and the balance of $700 million of commercial bank loan approvals would be project-related and shared by the public and private sectors in equal amounts.

In addition, the authorities intend to avoid a net increase in short-term debt, excluding O/As and D/As, between end-1982 and end-1983, though for operational purposes there would be fluctuations during the course of the year. These fluctuations, which would be partly of a seasonal nature, cannot be projected because of data limitations. Trade financing through O/As and D/As is projected to be about $150 million in 1983. 1/ The authorities' implementation of the external borrowing policy--including the understanding on short-term debt--is subject to the mid-term review, which is a performance criterion.

As described previously, in January 1983, the Philippine authorities adopted a 3 per cent ad valorem import surcharge and altered the method of payment of all import duties (including the surcharge). Duties are now payable at the time of opening of letters of credit or, in the case of imports financed by means other than letters of credit, at the time of presentation of import documents to agent banks, rather than upon the withdrawal of the goods from customs. The additional cost occasioned by the new payment method is considered to be part of the effective exchange rate. However, since the additional cost is estimated not to exceed 2 per cent, the staff does not consider that a multiple currency practice is involved.

6. Performance criteria

The program has the following quantified performance criteria for calendar 1983:

a. Quarterly ceilings on net domestic assets of the banking system.

b. Quarterly ceilings on net credit of the banking system to the public sector.

c. Ceilings on approvals of external borrowing in the 1-12 year and 1-5 year maturity ranges.

These have been referred to in the preceding sections and are set out in Table 6. In addition, the program has:

d. The usual performance criterion relating to multiple currency practices, restrictions on payments and transfers for current international transactions, bilateral payments agreements with

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1/ Use of O/As and D/As was excluded from the undertaking on short-term debt due to their special character and the difficulty of controlling their use. O/As and D/As are a form of very short-term (approximately 30-day) trade finance which, in the Philippines, can only be used to finance oil imports and the imports of export-oriented firms (often branches of multinational firms). Commercial banks authorize qualified firms to use this kind of finance subject to certain limitations, under general regulations of the Central Bank. The use of this form of finance, except for petroleum imports, is closely related to nontraditional exports, especially of electronics. It is estimated that the stock of O/As and D/As outstanding at end-1982 was $1.1 billion.

Table 6. Philippines: Quantitative Performance Criteria, 1983

	1983			
	Jan. 1- March 31	April 1- June 30	July 1- Sept. 30	Oct. 1 Dec. 31
	(In billions of pesos)			
Ceilings				
Net domestic assets of the banking system (stock) 1/	122.7	127.2	131.1	136.5
Of which: Net credit to the public sector (stock) 2/	26.8	28.6	29.5	31.6
	(In millions of U.S. dollars)			
Approvals of external borrowing during the year with initial maturity:				
More than 1 year up to and including 12 years	1,600	1,600	1,600	1,600
Of which: More than 1 year up to and including 5 years	100	100	100	100

1/ Per stand-by definition, net domestic assets equals total liquidity minus net international reserves.
2/ Net credit to the public sector is defined as net credit to the National Government and the social security institutions and gross credit to the rest of the public sector.

Fund members, and import restrictions for balance of payments reasons; and

e. Provision for a mid-term review, as a performance criterion, to be initiated in June 1983; this review will be comprehensive, focusing on the implementation of the budgetary program, exchange rate policy, interest rate policy, and external borrowing policy, including the commitment described previously on short-term debt.

Purchases under the stand-by arrangement have been phased in such a manner that total purchases would not exceed SDR 100 million until the consultations initiated in connection with the mid-term review have been concluded and, if necessary, any further understandings have been reached.

IV. Medium-Term Outlook

The authorities intend to pursue policies over the medium term conducive to continued external adjustment and the resumption of a satisfactory and sustainable rate of real growth. On the assumption that there will be a continuing moderate improvement in the terms of trade during 1984-85, substantial further improvements are targeted both in the current account and the overall balance of payments. These improvements would help contain the increases in the debt service burden that have occurred in recent years. At the same time, further reductions are envisaged in the overall budget deficit of the National Government. With continued restraint in demand management, and benefiting from the structural reforms underway for several years, gradual improvements in real growth and in inflation are also projected.

1. Macroeconomic projections

The authorities have targeted a steady reduction in the balance of payments current account deficit from 6.2 per cent of GNP in 1983 to 4.0 per cent by 1985, and in the overall balance from a deficit of 3.0 per cent of GNP in 1982 to a surplus of 0.4 per cent in 1985 (Table 7). In light of the outlook for the world economy, Philippine exports are projected to grow only at a moderate pace in the next few years, even given a continuing flexible management of exchange rate policy and some easing of the protectionist measures that affected exports in 1982. Service earnings are expected to grow strongly in response to the policies encouraging greater repatriation of foreign income which are already in place and which will be strengthened. Demand management policies are expected to contain import growth to rates well under those experienced in recent years. However, even though cautious demand management and adjustments in the public investment program should lead to a decline in net external borrowing over the medium term, the debt service burden will remain a heavy one, since amortization payments will increase during the period. The debt service ratio is currently projected to increase to 27.6 per cent in 1984 before declining slightly to 26.7 per cent by 1987 (Annex VI, Table 2).

Table 7. Philippines: Medium-term Projections of Selected Macroeconomic Variables, 1982-85

	Estimates	Projections		
	1982	1983	1984	1985
	(In millions of U.S. dollars) 1/			
Balance of payments summary				
Exports	4,995	5,516	6,205	6,985
Imports	7,800	7,916	8,458	9,240
Current account deficit	3,364	2,460	2,060	1,732
(As per cent of GNP)	(8.5)	(6.2)	(5.0)	(4.0)
Overall balance	-1,189	-598	-269	163
(As per cent of GNP)	(-3.0)	(-1.5)	(-0.6)	(0.4)
External debt				
Outstanding at end-period 2/	11,701	13,219	14,596	15,941
(As per cent of GNP)	(29.5)	(33.3)	(35.1)	(36.4)
Debt service payments 3/	2,125	2,415	2,758	2,849
(As per cent of exports of goods and services)	(27.1)	(27.3)	(27.6)	(25.3)
Amortization	940	1,141	1,422	1,496
Interest	1,185	1,274	1,336	1,353
	(In billions of pesos) 1/			
Public finance 4/				
Budget revenues	38.2	43.5	49.3	56.5
(As per cent of GNP)	(11.3)	(11.2)	(11.2)	(11.4)
Budget expenditures	52.6	52.9	58.1	65.3
(As per cent of GNP)	(15.5)	(13.6)	(13.2)	(13.2)
Budget deficit	14.4	9.4	8.8	8.8
(As per cent of GNP)	(4.2)	(2.4)	(2.0)	(1.8)
Growth and domestic inflation				
Real GNP growth (in per cent)	2.5	2.0	4.0	5.0
CPI, annual average (change in per cent)	10.2	11.0	9.0	7.0
Savings and investment				
Gross domestic savings	74.5	92.9	114.7	138.7
(As per cent of GNP)	(22.0)	(23.9)	(26.0)	(28.0)
Investment	102.8	117.0	136.6	158.4
(As per cent of GNP)	(30.3)	(30.1)	(31.0)	(32.0)
Resource gap	28.3	24.1	21.9	19.7
(As per cent of GNP)	(8.3)	(6.2)	(5.0)	(4.0)

Sources: Data provided by the Philippine authorities and staff estimates.
1/ Unless otherwise stated.
2/ Medium- and long-term external debt, excluding liabilties to IMF.
3/ Debt service on medium- and long-term external debt plus payments to IMF; excludes prepayments.
4/ The budgetary projections for 1983-85 refer to the projections provided by the authorities to the staff mission in November 1982. With the import duty surcharge being introduced in January 1983 at a 3 percentage point rate, instead of a 1 percentage point rate, it is expected that revenues will be higher and the deficit lower than shown by these projections.

The authorities' medium-term budgetary projections envisage further reductions in the overall deficit of the National Government from 2.4 per cent of GNP in 1983 to 1.8 per cent in 1985, through a moderate revenue mobilization effort and continued expenditure restraint. Revenue as a percentage of GNP is projected to increase modestly from 11.2 per cent in 1983 to 11.4 per cent in 1985. These projections assume both a significant increase in the built-in elasticity of the revenue system, resulting from improvements currently underway in tax administration and being planned in the revenue structure, and discretionary measures to generate net additional revenue of ₱ 1.8 billion in 1984 and ₱ 2.5 billion in 1985. Budgetary expenditure as a ratio to GNP is projected at 13.2 per cent in 1984-85, the lowest level since the early 1970s. The composition of expenditure and lending is expected to change as the share of current expenditure will increase to accommodate higher maintenance requirements of completed projects, wage and salary adjustments, increased demand for social services, and scheduled interest payments. Capital expenditure and lending will be directed to the completion of ongoing projects rather than to the execution of new projects.

The above balance of payments and budgetary projections are considered to be consistent with an increase in the rate of real GNP growth from 2 per cent in 1983 to 5 per cent in 1985 and a decline in inflation from 11 per cent in 1983 to 7 per cent in 1985.

2. Public investment

In the new Development Plan for 1983-87, public investment is projected to be 8 per cent of GNP annually, as compared with 7 per cent of GNP achieved during the 1978-82 Plan period. However, with the short-term economic and financial outlook having been revised downward after the Plan was drafted in early 1982, the program for 1983 has been reduced to about 6 per cent of GNP through the deferral of most new projects. Given the rising trend of interest payments and other current expenditure needs, sustaining even this level of public investment in succeeding years will require a substantially improved public sector resource mobilization effort.

The sectoral composition of the program is as follows: energy, 38 per cent; transportation, 22 per cent; irrigation, 10 per cent; water supply, 10 per cent; and other sectors (non-irrigation agriculture, industry, communications, education, health, and housing), 20 per cent. The proposed program is considered by the World Bank staff to be generally appropriate in relation to Philippine development objectives, such as meeting basic needs, providing the necessary basis for employment generation, and reducing disparities between the Manila area and the outlying regions.

The high priority accorded the energy program reflects the importance of the energy sector in the structural adjustment process. The program has already reduced the dependence on imported energy (i.e., imported petroleum, coal) from 95 per cent in 1973 to an estimated 70 per cent in 1982, and was intended to further reduce this dependence to 47 per cent by 1987. The expansion program of the National Power Corporation (NPC), which accounts for about 80 per cent of electricity generation in the Philippines, would account for two thirds of the energy program. The NPC program includes the construction of one nuclear power plant, to be commissioned in 1985, and a number of hydroelectric, geothermal, and coal-fired plants, with existing oil-fired plants being gradually retired. After examination of several alternatives, the program has been found by the World Bank staff to be justified on the basis of "least-cost" principles. However, the Government and NPC have recently decided to phase the program over a longer period of time than envisaged earlier, in order to reduce the burden on the public finances and on NPC's implementation capacity. The other principal elements of the energy program are rural electrification, implemented through the National Electrification Administration, and energy resource exploration and development (petroleum, coal, and geothermal), implemented primarily through the Philippine National Oil Company.

In the early years of the Plan period, the transportation program *will consist almost entirely of ongoing highways and ports projects.* The water supply program will concentrate mainly on the large Manila Water II and Manila Sewerage projects, scheduled for completion in 1984, but there will also be significant expenditures on water supply for medium-sized cities, financed through a specialized lending agency. The irrigation program will be entirely committed to ongoing projects during 1983-84; it will contribute to the maintenance of self-sufficiency in rice as well as raising farmers' incomes. The investment programs in these three sectors are almost entirely committed to projects financially assisted by the Consultative Group for the Philippines.

The program of 11 major industrial projects is designed to deepen the industrial structure of the economy through the development of capital goods industries (two projects) and intermediate goods industries (nine projects), with a view to adding value to exports (e.g., copper smelter project) or replacing imports. In the period since the program was originally announced in 1979 following detailed economic and financial analysis, its total estimated cost has been reduced from $6 billion to $3.7 billion through changes in project concepts, and the period of time over which the projects would be initiated has been extended from five years to at least seven years (1980-87). The 5 largest of the 11 projects account for 86 per cent of the total cost of the program. Their status is as follows: (a) The copper smelter and the phosphatic fertilizer plant are under construction in a location where they will utilize relatively cheap geothermal energy; further, the fertilizer plant will utilize the sulphuric acid byproduct of the copper smelter. (b) Construction of the integrated steel project in northern Mindanao is programmed to begin later this year; the project concept has been revised from an entirely new plant to the expansion of an existing steel plant, resulting in a substantial reduction in cost. (c) The aluminum smelter and petrochemical plant have been deferred to 1985 and 1987, respectively, at the earliest.

The World Bank staff has had some concerns about the efficiency of public investment, but these concerns are now being addressed by the authorities: (a) In recent years, the share of GNP devoted to government current expenditures has declined considerably, resulting in inadequate maintenance or ineffective operation of constructed facilities. However, the authorities intend to substantially increase their maintenance efforts in the new Plan period, and the 1983 budget program reflects an improved balance between current and investment expenditure. (b) Too many projects have been undertaken concurrently without sufficient attention to the total financing available. As a result, fiscal constraints have resulted in the unduly protracted implementation of individual projects. However, during the 1983-87 Plan period the authorities intend to develop a medium-term financial planning system covering the public corporations as well as the National Government; this will, among other objectives, improve project implementation and thereby enhance the efficiency of public investment.

V. Staff Appraisal and Proposed Decision

Over many years, with the exception of 1982, the Philippines has had arrangements with the Fund designed, in general, to strengthen its capacity for sustained economic growth and to reduce or avoid external and internal imbalances. Significant achievements during this period included increased public investment, the development of infrastructure and an industrial base, a reduction in dependence on imported energy, and diversification of the export structure, particularly through a rapid growth of nontraditional manufactured exports. However, the overall efficiency of investment has remained relatively low and, in recent years, public sector resource mobilization has not kept pace with investment.

During 1981-82, the Philippines experienced increasing economic difficulties. While a domestic financial crisis was a contributory factor, the difficulties have been associated with adverse external developments--the second round of oil price increases, depressed export markets and sharply falling commodity prices, increasing protectionism, and high international interest rates--for which timely adjustment measures were not taken. The difficulties were reflected most notably in a substantial widening of the deficits in the current account of the balance of payments and in declining real growth rates. Matching the widened current account deficits, net disbursements of medium- and long-term external debt increased sharply between 1980 and 1982, although the bulk of these only offset interest payments on the external debt. The medium- and long-term debt service ratio rose markedly during this period, due to both increasing debt service and weakening exports. In the same period, short-term debt increased at an even more rapid rate than medium- and long-term debt.

The program adopted by the authorities for 1983 is aimed at bringing the current account deficit of the balance of payments back to a sustainable path. While the adjustment will entail sacrifices, it is a necessary step in establishing the basis for future balanced growth. Since the outlook for external demand does not augur well for a rapid export expansion even with the pursuit of appropriate policies, the adjustment of the current account will have to reflect a small deceleration in real growth and associated import restraint. A contraction in the budget deficit relative to GNP by 1.8 percentage points, resulting mainly from expenditure restraint, will play an important role in the external adjustment.

Following the decline in inflation in recent years, the inflation rate is envisaged to increase marginally in 1983 as pricing adjustments take place in connection with the policy program. However, the authorities plan to implement policies that would lead to a progressive decline in inflation over the medium term.

While in 1983 the fiscal adjustment will rely heavily on expenditure reductions in real terms, measures will also be taken to arrest the declining trend in revenue in recent years. Significant discretionary revenue measures have already been adopted and other measures are expected to follow. The largest component of the revenue package is a temporary import duty surcharge which was introduced at a higher rate than envisaged and consequently should result in an improvement in the fiscal outturn beyond that programmed. It should be noted, though, that the import surcharge needs to be replaced as early as possible by domestic-based taxes that will improve the revenue structure. Perseverance in efforts to improve tax administration and collection is also important. Most severely affected by the expenditure cutbacks in the budget are equity contributions and net lending to public corporations. These corporations have been required to adjust to the reductions in budgetary funding by scaling down their investment programs and by increasing their internal generation of funds rather than by increased borrowing. Such adjustments are essential if the reduction in the government budget deficit is to be reflected in the overall deficit of the public sector and if balance of payments pressures are to be eased.

Monetary policy will be significantly tightened in 1983, in support of the external and budgetary adjustments. During the year, the expansion of the banking system's net domestic assets and its net credit to the public sector will be contained by tight quarterly ceilings. At the same time, the composition of credit flows will shift toward the private sector to provide sufficient bank resources for domestic economic activity.

In the area of external policy, the authorities aim to improve the competitiveness of Philippine traded goods through the pursuit of a flexible exchange rate policy during 1983 accompanied by tight demand management. For 1983, the ceilings on approvals of medium- and long-term external borrowings are substantially lower than in the stand-by program of 1981. On the basis of these ceilings, the debt service ratio is projected to rise marginally in the post-program period; however, the authorities intend to keep actual approvals below the ceilings. Given the recent rapid increase in short-term debt, the authorities will also monitor short-term external borrowings closely, with a view to ensuring that there is no net increase in borrowings by nonbanks (excluding certain forms of trade financing) between end-1982 and end-1983. The growth in international reserve liabilities, which has been rapid in recent years, is expected to taper off in the medium term as the overall balance of payments position moves into surplus.

The authorities will continue during the year to implement their programs for structural adjustment. In the financial sector, the abolition at the beginning of 1983 of the interest rate ceiling on loans of one year or less removed the last constraint to the market-determination of interest rates. The phased programs of tariff reform and import liberalization will be continued to improve efficiency in the manufacturing sector. Complementing these measures, the authorities will undertake a reform of fiscal incentives to eliminate their present capital-intensive bias and will realign indirect taxes to remove differentials between imported and domestic goods. In addition, efforts to encourage energy conservation and diversification will be pursued. As a group, these reforms should improve efficiency and resource allocation and contribute to accelerated economic growth in the post-program period. The authorities' investment program, as outlined in the Development Plan for 1983-87 and since modified, will play an important role in the growth strategy. This investment program has been assessed by World Bank staff to be broadly appropriate. However, Bank staff emphasize that a proper balance will need to be maintained between current and investment expenditure and that new projects should only be undertaken with due regard to the available financing.

The staff considers that the program described above and presented in the attached letter from the authorities represents a substantial effort to deal with a difficult situation arising largely from external developments. However, in view of the uncertainties relating to the external outlook, the authorities will be prepared to take any further measures that may be necessary to achieve the objectives of the program. In this context, the provisions for a mid-term review and--more generally--for consultations under the stand-by arrangement, are of considerable importance. The staff recommends that the present request for a stand-by arrangement in support of the program be approved. Accordingly, the following draft decision is proposed for adoption by the Executive Board:

1. The Government of the Philippines has requested a stand-by arrangement for the period from   to February 28, 1984 in an amount equivalent to SDR 315 million.

2. The Fund approves the stand-by arrangement attached to EBS/83/24.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Table I. Philippines: Gross National Product by Expenditure, 1980-83

(In billions of pesos at constant 1972 prices)

	1980	1981	1982 (Est.)	1983 (Proj.)
Consumption	67.7	70.3	72.4	73.5
Private	59.3	61.6	63.5	65.0
Government	8.4	8.7	8.9	8.4
Gross domestic capital formation	26.6	27.2	27.5	27.5
Fixed capital formation	22.8	23.5	24.1	24.2
Construction	11.2	12.0	12.4	12.9
Government	4.9	5.2	5.2	5.0
Private	6.3	6.8	7.2	7.9
Durable equipment	11.6	11.5	11.7	11.3
Change in stocks	3.8	3.7	3.4	3.3
Exports of goods and nonfactor services	18.1	18.2	17.6	18.5
Goods	...	14.2	13.6	14.3
Nonfactor services	...	4.0	4.0	4.2
Imports of goods and nonfactor services	19.5	18.9	18.9	18.7
Goods	...	16.6	16.4	16.0
Nonfactor services	...	2.3	2.5	2.6
Statistical discrepancy	-0.2	-0.6	--	--
Net factor incomes from abroad	-0.1	-0.1	-0.1	-0.1
Real GNP	92.6	96.1	98.5	100.5
Real growth rate (per cent)	4.4	3.8	2.5	2.0
GNP deflator (percentage change)	14.9	11.1	8.1	12.6
Nominal GNP (billions of pesos at current prices)	265.0	305.7	338.6	388.9

Sources: Data provided by the Philippine authorities and staff estimates.

Table II. Philippines: Major Nonfinancial Public Corporations--Summary of Operations, 1981-83 1/

	1981	1982 Latest est.	1983 Program
	(In millions of pesos)		
Investment outlays	12,915	17,296	15,272
Internal cash generation	2,838	2,984	4,014
Investment savings gap 2/	10,077	14,312	11,258
Government equity contributions and net lending	4,925	6,955	3,853
Other net borrowings and use of cash balances	5,152	7,357	7,405
	(In per cent of investment outlays)		
Internal cash generation	22.0	17.3	26.3
Government equity contributions and net lending	38.1	40.2	25.2
Other net borrowings and use of cash balances	39.9	42.5	48.5
	(In per cent of GNP)		
Memorandum item:			
Investment savings gap 2/	3.3	4.2	2.9

Source: Data provided by the Philippine authorities.

1/ Includes the following 12 nonfinancial public corporations: Philippine National Oil Company, National Power Corporation, National Electrification Administration, Philippines Ports Authority, Philippines National Railways, Metro Manila Transit Corporation, Light Rail Transit Authority, National Irrigation Administration, Metropolitan Waterworks and Sewerage System, Local Water Utilities Administration, National Housing Authority, and Export Processing Zone Authority.

2/ Investment outlays less internal cash generation.

Table III. Philippines: Public Sector Fiscal Balances, 1981-83

	1981	1982 Latest est.	1983 Program
	(In billions of pesos)		
Sectoral surplus/deficit (-)			
National Government	-12.2	-14.4	-9.4 1/
Local governments	0.3	0.8	0.9
Social security institutions	2.6	2.2	3.0
Public corporations 2/ 3/	-10.0	-14.3	-11.3
Consolidated public sector 4/	-14.4	-18.7	-12.9 1/
	(In per cent of GNP)		
Sectoral surplus/deficit (-)			
National Government	-4.0	-4.2	-2.4 1/
Local governments	0.1	0.2	0.2
Social security institutions	0.9	0.6	0.8
Public corporations 2/ 3/	-3.2	-4.2	-2.9
Consolidated public sector 4/	-4.7	-5.5	-3.3 1/
	(In billions of pesos)		
Memorandum item:			
National Government lending less repayments to public corporations 2/	4.9	7.0	3.9

Source: Data provided by the Philippine authorities.

1/ The programmed deficit for the National Government refers to the budget outlined to the staff mission in November 1982. With the introduction of a 3 percentage point import duty surcharge, instead of a 1 percentage point rate, it is expected that the National Government budget deficit and the public sector deficit will be lower than the program estimates.

2/ Includes the 12 major public corporations in Appendix Table II.

3/ The sectoral balance is equal to internal cash generation minus investment expenditure.

4/ The consolidated public sector deficit is equal to the sum of the sectoral balances less National Government lending less repayments to public corporations which is treated as an outlay (above the line) in the National Government budget and as a financing item (below the line) in the accounts of the public corporations.

Table IV. Philippines: Increases in External Trade by Category, 1972-83

	Compound Annual Growth Rate	Percentage Change Over Preceding Year					(US$ mn.)	
	1972-82	1979	1980	1981	1982 (Est.)	1983 (Proj.)	1982 (Est.)	1983 (Proj.)
Principal primary exports	7.0	29.0	14.8	-12.7	-22.6	6.1	1,705	1,809
Coconut products	10.4	13.1	-20.3	-7.8	-18.8	-5.9	614	578
Sugar products	7.4	11.1	175.0	-7.6	-26.4	2.7	448	460
Forestry products	3.9	49.4	2.0	-18.2	-17.4	9.8	338	371
Copper concentrates	4.6	76.0	23.9	-21.3	-28.9	31.2	305	400
Nontraditional exports	33.4	41.4	29.0	15.0	0.4	8.8	2,512	2,732
Manufactured	40.9	41.8	31.7	19.9	1.9	8.1	2,320	2,508
Primary 1/	11.1	39.0	13.0	-19.1	-15.0	16.7	192	224
Other 2/	24.2	35.3	52.6	-6.9	-23.5	12.5	778	875
Total exports	16.5	34.3	25.8	-1.1	-12.7	10.4	4,995	5,516
Non-oil imports	18.2	28.9	15.3	-0.1	1.1	1.2	5,549	5,616
Capital goods	16.1	27.4	11.3	-2.9	-2.4	-1.1	1,878	1,857
Raw materials and intermediate goods	20.8	32.1	15.6	0.3	3.8	3.2	2,997	3,093
Consumer goods	15.2	19.2	28.4	6.4	-0.4	-1.2	674	666
Petroleum and petroleum products	30.9	33.1	62.4	10.4	-8.4	2.2	2,251	2,300
Total imports	20.6	29.8	25.8	2.9	-1.8	1.5	7,800	7,916

Source: Data provided by the Central Bank of the Philippines.

1/ Mainly comprises coffee, rice, and iron ore agglomerates.
2/ Mainly comprises fruits and vegetables, gold, nickel, marine products, unmanufactured tobacco, petroleum products, and abaca fibers.

Table V. Philippines: Short-Term External Debt, 1979-82

(In millions of U.S. dollars; end of period)

	1979	1980	1981	Estimate 1982
Revolving 1/	624.3	1,531.9	2,547.4	3,081.4
Public	488.8	936.4	1,628.5	1,800.7
Oil	250.4	709.7	1,041.8	1,116.0
Non-oil	238.4	226.7	586.7	684.7
Private	135.5	595.5	918.9	1,280.7
Oil	98.6	312.0	334.6	291.2
Non-oil	36.9	283.5	584.3	989.5
Fixed-term	194.9	70.8	112.3	29.3
Public	77.0	10.4	36.0	--
Private	117.9	60.4	76.3	29.3
Total (excluding D/As and O/As) 2/	819.2	1,602.7	2,659.7	3,110.7
Total (including D/As and O/As) 2/	1,813.3	2,547.9	3,566.5	4,162.5

Source: Data provided by the Philippine authorities.

1/ Excluding documents against acceptance (D/As) and open accounts (O/As).
2/ Excludes international reserve liabilities of the banking system.

Table VI. Philippines: Exchange Rate Movements, 1975-82 1/

	Peso/US$ Rate	Peso/SDR Rate	Trade Weighted Index 2/ Nominal	Trade Weighted Index 2/ Real 3/
1975	7.25	8.80	100.0	100.0
1976	7.44	8.59	99.3	97.6
1977	7.40	8.64	96.1	94.6
1978	7.37	9.22	86.7	86.8
1979	7.38	9.53	88.1	96.9
1980	7.51	9.78	86.7	100.8
1981	7.90	9.32	85.6	102.5
1979 I	7.38	9.51	86.1	88.7
II	7.38	9.41	88.5	96.3
III	7.37	9.60	87.8	99.3
IV	7.38	9.61	90.1	103.1
1980 I	7.42	9.67	90.5	104.2
II	7.49	9.72	86.6	99.6
III	7.55	9.97	85.1	99.5
IV	7.58	9.75	84.5	99.9
1981 I	7.68	9.54	84.6	99.8
II	7.86	9.29	86.1	101.1
III	7.96	9.03	87.8	106.6
IV	8.10	9.41	83.9	102.7
1982 I	8.29	9.42	85.1	108.5
II	8.42	9.40	85.0	107.5
July	8.49	9.26	86.7	109.7
August	8.52	9.27	86.8	110.1
September	8.64	9.33	87.0	...
October	8.77	9.39	87.1	...
November	8.88	9.47	83.2	...
December	9.07	9.92	78.5	...

Sources: IMF, International Financial Statistics; and staff calculations.

1/ All data are period averages.
2/ A decrease in the number indicates a depreciation.
3/ Adjusted for changes in relative consumer prices.

Table VII. Philippines: National Government Budgetary Expenditures and Lending Less Repayments, 1980-83

	1980	1981	1982 Latest est.	1983 Program
		(In million of pesos)		
Current expenditure	24,516	26,390	30,772	36,050
Personal services	9,331	10,631	11.075	12,010
Maintenance and other operating expenditure	10,739	11,263	11,753	12,930
Interest payments	2,296	2,429	4,221	7,800
Allotments to local governments	1,528	1,544	2,282	2,495
Transfers to other public sector entities	622	523	1,441	815
Capital expenditure	8,405	12,679	10,328	10,380
Infrastructure investment	7,346	9,973	7,955	7,340
Other capital outlays	1,059	2,706	2,373	3,040
Lending less repayments	5,197	9,010	11,545	6,440
Equity contribution	4,522	8,081	9,346	4,640
Loans less repayments	675	929	2,199	1,800
Total expenditure and lending less repayments	38,118	48,079	52,645	52,870
		(Changes in per cent)		
Current expenditure	19.0	7.6	16.6	17.2
Personal services	13.3	13.9	4.2	8.4
Maintenance and other operating expenditure	21.1	4.9	4.4	10.0
Interest payments	24.7	5.8	73.8	84.8
Allotments to local governments	28.7	1.0	47.8	9.3
Transfers to other public sector entities	30.1	-15.9	175.5	-43.4
Capital expenditure	69.7	50.9	-18.5	0.5
Infrastructure investment	71.9	35.8	-20.2	-7.7
Other capital outlays	56.0	155.5	-12.3	28.1
Lending less repayments	22.3	73.4	28.1	-44.2
Equity contribution	33.1	78.7	15.7	-50.4
Loans less repayments	-20.9	37.6	136.7	-18.1
Total expenditure and lending less repayments	27.9	26.1	9.5	0.4

Source: Data provided by the Philippine authorities.

Table VIII. Philippines: National Government Budgetary Revenue, 1980-83

	1980	1981	1982 Latest est.	1983 Program
	(In millions of pesos)			
Tax revenue	30,530	31,423	33,700	36,850
Domestic based taxes	18,885	20,251	21,650	23,500
Taxes on income and profits	(8,742)	(9,750)	(10,320)	(11,450)
Excise duties	(5,626)	(6,202)	(6,350)	(6,550)
Sales and business tax	(3,714)	(3,673)	(4,000)	(4,400)
Other 1/	(803)	(626)	(980)	(1,100)
Taxes on international trade and transactions	11,645	11,172	12,050	13,350
Import duties	(11,220)	(10,855)	(11,800)	(13,100)
Export duties	(425)	(317)	(250)	(250)
Nontax revenue	4,201	4,510	4,500	4,850
Additional revenue from discretionary measures 1983				1,770 2/3/
Total revenue	34,731	35,933	38,200	43,470 4/
	(Changes in per cent) 5/			
Tax revenue	17.6	2.9	7.2	9.3
Domestic based taxes	11.4	7.2	6.9	8.5
Taxes on income and profits	28.4	11.5	5.8	10.9
Excise duties	2.8	10.2	2.9	3.1
Sales and business tax	6.7	-1.1	8.9	10.0
Other	12.3	-22.0	56.5	12.2
Taxes on international trade and transactions	22.8	-4.1	7.6	10.8
Import duties	28.3	-3.2	8.7	11.0
Export duties	-42.3	-25.4	-21.1	--
Nontax revenue	19.6	7.4	-0.2	7.8
Total revenue	17.9	3.5	6.3	13.8 4/

Source: Data provided by the Philippine authorities.

1/ Includes property tax, documentary and stamp tax, and minor amounts of unclassified tax revenue.

2/ Not included in revenue components above.

3/ With the imposition of a 3 percentage point import duty surcharge, instead of a 1 percentage point rate, the staff project additional revenue from discretionary measures at ₱ 2,770 million.

4/ With the imposition of a 3 percentage point import duty surcharge, total revenue is expected to exceed the program estimate.

5/ For 1983, percentage changes for the components are growth rates based on the existing revenue structure.

Table IX. Philippines: Net International Reserves of the Banking System, 1977-82

(In millions of U.S. dollars)

	December 31					
	1977	1978	1979	1980	1981	1982
Net international reserves	243	153	-426	-778	-1,265	-2,454
Gross reserves	2,263	3,195	3,731	5,059	5,315	5,613
Central Bank	1,525	1,883	2,423	3,155	2,707	2,543
Commercial banks	738	1,312	1,308	1,904	2,608	3,070
Reserve liabilities	2,021	3,042	4,157	5,837	6,580	8,067
Central Bank	602	689	1,179	2,150	2,406	2,949
Commercial banks	1,419	2,353	2,978	3,687	4,174	5,118
Of which: FCDU deposits	(1,160)	(1,878)	(2,402)	(3,077)	(3,049)	(...)

Source: Data provided by the Philippine authorities.

Philippines

Basic Data

Population (1982)	50.7 million
Population growth per annum (1982)	2.5 per cent
Real GNP growth per annum (1977-82)	5.9 per cent
GNP per capita (1982)	US$782

	1978	1979	1980	1981	1982 1/
Selected aggregates as per cent of GNP					
Gross domestic investment	29.0	31.2	30.6	30.5	30.3
Gross domestic savings	22.9	26.8	24.8	24.5	22.0
Agricultural production	26.6	25.1	25.6	25.6	26.0
Manufacturing production	24.9	24.4	25.1	25.0	24.7
National Government revenue	13.5	13.5	13.1	11.7	11.3
National Government expenditure 2/	14.7	13.6	14.4	15.7	15.5
Current budget surplus	2.7	4.1	3.8	3.1	2.2
Overall budget surplus/deficit (-)	-1.3	-0.1	-1.3	-4.0	-4.2
Foreign financing	1.1	1.4	0.8	2.0	0.6
Domestic financing	0.2	-1.3	0.5	2.0	3.6
Of which: Banking system	--	-0.1	0.5	1.7	2.7
Total liquidity 3/ 4/	29.1	26.3	25.6	25.7	28.1
Quasi-money 3/ 4/	19.6	17.4	17.1	18.1	21.2
Narrow money 3/	9.5	8.5	8.5	7.6	6.9
Exports of goods and services	20.0	20.6	22.3	21.4	19.8
Imports of goods and services	26.2	27.1	29.3	28.5	29.3
Current account deficit	4.8	5.3	5.8	6.0	8.5
Total disbursed external debt 3/ 5/	28.3	26.5	27.3	29.1	32.7
External debt service 6/	3.4	3.7	3.6	4.3	5.4
Annual percentage changes in selected economic indicators					
Gross national product (1972 prices)	6.8	6.8	4.4	3.8	2.5
Gross national product (current prices)	22.6	24.0	20.0	15.3	10.8
Consumer price index	7.6	18.8	17.6	12.4	10.2
National Government revenue	20.3	22.9	17.9	3.5	6.3
National Government expenditure	15.0	13.7	27.9	26.1	9.5
Total liquidity	18.0	10.7	18.2	16.0	15.9
Quasi-money 4/	20.3	10.4	17.5	22.0	22.7
Narrow money	13.4	11.2	19.6	3.5	—
Merchandise exports, f.o.b.	8.7	34.3	25.8	-1.1	-12.7
Merchandise imports, f.o.b.	20.9	29.8	25.8	2.8	-1.8
	(In millions of U.S. dollars)				
Balance of payments					
Merchandise exports, f.o.b.	3,425	4,601	5,788	5,722	4,995
Merchandise imports, f.o.b.	-4,732	-6,142	-7,727	-7,946	-7,800
Oil imports	(-1,015)	(-1,371)	(-2,226)	(-2,458)	(-2,251)
Non-oil imports	(-3,717)	(-4,771)	(-5,501)	(-5,488)	(-5,549)
Current account deficit	-1,172	-1,576	-2,051	-2,293	-3,364
Overall balance	-90	-579	-352	-486	-1,189
International reserves 3/					
Gross official reserves	1,883	2,423	3,155	2,707	2,543
(In months of imports)	(4.8)	(4.7)	(4.9)	(4.1)	(3.9)
Net international reserves of the banking system	153	-426	-778	-1,264	-2,453

1/ Actual or latest estimate.
2/ Includes lending minus repayments.
3/ End-of-year.
4/ Includes deposit substitutes.
5/ Excludes loans of maturities of one year or less but includes IMF.
6/ On debts with maturities of over one year and including IMF.

Fund Relations with the Philippines
(As of December 31, 1982)

Date of membership:	December 27, 1945
Quota:	SDR 315 million
Use of Fund Resources:	Total outstanding purchases SDR 755.3 million, including SDR 126.5 million under CFF, SDR 6.9 million under 1975 Oil Facility, SDR 333.0 under SFF, SDR 161.7 million in the credit tranches, and SDR 127.2 million under the Extended Fund Facility.
Fund holdings of pesos:	SDR 1,070.3 million, or 339.8 per cent of quota; of which holdings related to the credit tranches were SDR 161.7 million (51.3 per cent of quota), under the CFF were SDR 126.5 million (40.2 per cent of quota), under the Oil Facility were SDR 6.9 million (2.2 per cent of quota).
Arrangements with the Fund:	With the exception of 1982, programs using Fund resources have been operative in each year since 1962. The last stand-by program covered the two years 1980-81 in the amount of SDR 410 million, of which SDR 333 million was provided under the Supplementary Financing Facility.
SDR position:	Net cumulative allocation amounts to SDR 116.6 million. Holdings amount to SDR 2.5 million or 2.1 per cent of net cumulative allocation.
Gold distribution:	Received 132,654 fine ounces of gold in the four phases. Received profits amounting to US$24.6 million in the three distributions.
Trust Fund:	Received loans totaling SDR 64.2 million in the first period, and disbursements of SDR 87.2 million in the second period.
Exchange rate system:	Formally an independent float since February 1970. The U.S. dollar is used as the intervention currency. From early 1977 through end-1979, the peso/dollar rate remained stable around ₱ 7.4 per U.S. dollar. The exchange rate was ₱ 9.17 per U.S. dollar as of December 31, 1982.

Exchange and trade restrictions:	The Philippines continues to avail itself of the transitional arrangements of Article XIV. At the time of the last Article IV consultation, the Fund granted approval under Article VIII, Section 2(a) of the restrictions on payments and transfers for current international transactions until July 31, 1983, or the completion of the next Article IV consultation, whichever is earlier (Decision No. 7103-82/62).
Last Article IV consultation:	SM/82/55 and Supplement 1 discussed by the Executive Board on April 30, 1982 (Decision No. 7103-(82/62).

Financial Relations of the World Bank Group with the Philippines

IBRD/IDA lending operations: 1/	Disbursed		Undisbursed
	IBRD	IDA	
	(In millions of U.S. dollars)		
Structural adjustment lending:	196.97	--	3.03
Agricultural and rural development	552.65	18.09	410.54
Education	53.53	12.70	141.22
Power and utilities	304.89	14.08	190.30
Transportation	198.92	--	142.11
Industry	375.42	--	172.30
Population	19.13	1.62	44.25
Urban development	54.33	--	107.60
Total	1,755.84	46.49	1,211.35

Repayments: 1/ — $275.16 million

Debt outstanding: 1/ 2/ — $3,223.85 million

Commitments, November 1981-October 1982: — $538.33 million

Disbursements, November 1981-October 1982: — $249.58 million

IFC investments: 1/ — $84.18 million (investments held for the Corporation including undisbursed balances).

Structural adjustment loan: — A first SAL of $200 million was approved by the Bank Board in September 1980; it was disbursed (except for an ongoing technical assistance component) in 1981. The loan supports the first phase of the Government's industrial policy reform program. The objectives of the reform program are to sustain a high growth of manufactured exports, improve the efficiency of domestic industry, and increase employment generation by the industrial sector. The first phase reform measures include strengthening export incentives, tariff reform, and liberalization of import licensing. A policy program for a

1/ As of October 31, 1982.

2/ Includes disbursed amounts, undisbursed amounts, loans approved but not signed, and loans signed but not effective.

Structural adjustment loan (continued):

second SAL, centered around reform of fiscal incentives for investment as a second phase of industrial policy reform, and energy policy, is at an advanced stage of preparation.

Technical assistance:

The IBRD has provided technical assistance to the Philippines through its standard lending operations for projects. In addition, the IBRD acts as executing agency for the UNDP-financed Regional Planning Assistance Project.

Recent economic and sector reports:

Economic report, "The Philippines: Selected Issues for the 1983-87 Plan Period," June 1, 1982, No. 3861-PH. "Industrial Development Strategy and Policies," October 29, 1979, No. 2513-PH. Joint IMF/World Bank report "The Philippines-Aspects of the Financial Sector," October 1, 1979, No. 2546-PH. Structural Adjustment Loan, Presidents Report, August 21, 1980, No. P-2874-PH. Poverty report "Aspects of Poverty in the Philippines: A Review and Assessment," December 1, 1980, No. 2984-PH. Energy report "The Philippines: Energy Sector Survey," February 12, 1982, No. 3199a-PH.

Aid Consultative Group:

The last meeting was held under the Chairmanship of the IBRD in June 1982 in Tokyo. The following documents were distributed and discussed: (a) the Government's "Five-Year Philippine Development Plan," 1983-87; (b) the Government's "Philippine Energy Development Program," 1982-87; (c) a World Bank economic report "Selected Issues for the 1983-87 Plan Period;" and (d) the joint World Bank/ADB "Energy Sector Survey."

The next meeting is tentatively scheduled for early July 1983 in Paris.

The 1980-81 Stand-by Arrangement

The broad objective of economic policy during 1980-81 was to strengthen the capacity of the economy for sustained growth with improved external and internal balance. To accomplish these objectives, the authorities proposed cautious monetary and fiscal policies and flexible exchange rate management, complemented by a series of structural reforms in the financial and external sectors. This program was supported by a two-year stand-by arrangement in an amount equivalent to SDR 410 million (130 per cent of quota). The arrangement expired on December 31, 1981, with the full amount of the stand-by resources having been drawn (Table 1).

The implementation of the economic program during 1980-81 was made more difficult by a series of adverse external and domestic developments. The sharp deterioration in the terms of trade from the oil price hikes of 1979-80 was aggravated by a sharp decline in the prices of the major commodity exports due largely to recessionary trends in the world economy. Compounding the effects of the depressed terms of trade, a financial crisis in early 1981 disrupted private sector activity and generated severe liquidity problems for a number of enterprises. Demand management policies were adjusted to cope with the difficulties confronting the economy, while the authorities persevered in implementing policies of structural reform on schedule. The structural reforms included the liberalization of interest rates, the development of multipurpose banking, tariff reform, relaxation of import restrictions, and adjustments in public enterprise pricing policies, particularly for energy products.

The stand-by program was successful in achieving a substantial deceleration of inflation and in containing the current account deficit of the balance of payments within program targets (Table 2). However, real growth fell short of program expectations as a result of the weak external demand conditions and the effects of the deterioration in the terms of trade on profits and private investment. A detailed review of economic developments under the stand-by program is provided below.

1. The balance of payments

The current account deficit in 1980 increased by about \$500 million to reach \$2,051 million (5.8 per cent of GNP) which was in line with the program target. The main factors contributing to the higher deficit were a 21 per cent deterioration in the terms of trade and a substantial increase in interest payments due to the combined effect of higher interest rates and the growth of external debt. Although the increase in the deficit was substantial, it was only about one half of what was attributable to higher oil prices alone, implying significant external adjustment. The adjustment was achieved mainly by a 26 per cent increase in the value of exports, which entailed a 21 per cent increase in export volume partly attributable to the sale of large stocks of sugar. Capital inflows, particularly short-term inflows, were greater than programmed, with the result that the overall deficit was somewhat lower than targeted.

The current account deficit in 1981 increased to \$2,293 million (6.0 per cent of GNP), which was considerably lower than envisaged in

Table 1. Philippines: Quantitative Performance Criteria Under the Financial Program for 1980-81

	1980				1981			
	March	June	Sept.	Dec.	March	June	Sept.	Dec.
	(In millions of pesos)							
Net domestic assets of the banking system								
Program ceiling 1/	69,675	71,885	74,475	79,905	80,610	84,677	86,339	92,277
Actual	66,974	67,315	70,742	78,339	80,480	83,964	86,183	93,415
Net credit to the public sector								
Program ceiling 2/	9,200	10,000	10,900	11,600				
Actual	8,731	9,383	9,875	10,573				
	(In millions of U.S. dollars)							
Net international reserves of the banking system 3/								
Program limit	-567	-627	-687	-797				
Actual	-401	-629 4/	-632	-778				
Approvals of external borrowing during the year:								
More than 1 year up to and including 5 years:								
Program limit				100	120	120	120	120
Actual				84	3	5	8	14
More than 1 year up to and including 12 years:								
Program limit				1,200	2,050	2,050	2,050	2,050
Actual				1,200	396	744	1,160	1,481
1-12 year maturity excluding approvals for the nuclear power project:								
Program limit					1,700	1,700	1,700	1,700
Actual					396	744	1,117	1,438

Source: Data supplied by the Philippine authorities.

1/ The ceilings for the June-December 1981 period are reported as modified in EBS/81/160.

2/ As modified, EBS/81/160.

3/ The targets for net international reserves for the banking system apply to the end-quarter dates.

4/ The Fund agreed to a waiver of this performance criterion (EBS/80/194).

Table 2. Philippines: Economic Performance Under 1980-81 Stand-by Program

	1980			1981		
	Original program	Revised program	Actual	Original program	Revised program	Actual
			(Changes in per cent)			
Real GNP	6.0	5.0	4.4	5.5	4.0	3.8
Consumer prices 1/ (Annual average)	15.0	17.0	17.6	12.0	12.0	12.4
Exports, f.o.b.	22.2	...	25.8	19.0	12.6	-1.1
Imports, f.o.b.	16.9	...	25.8	19.0	14.0	2.8
Total liquidity	19.0	19.0	18.2	14.5	15.7	16.0
Net domestic assets 2/	26.8	26.8	24.1	13.2	20.5	22.2
Net credit to public sector 2/	5.2	5.2	3.4	...	8.7	8.2
			(In per cent of GNP)			
National Government revenue	13.0	12.8	13.1	13.3	13.5	11.7
National Government expenditure 3/	14.3	14.1	14.4	14.6	16.4	15.7
Current budget surplus	4.0	3.7	3.9	3.2	2.9	3.1
Overall budget deficit (-)	-1.3	-1.3	-1.3	-1.3	-2.9	-4.0
Foreign financing	0.5	0.7	0.8	0.7	1.3	2.0
Domestic financing	0.8	0.6	0.5	0.6	1.6	2.0
Of which: Banking system	0.5	0.5	0.5	0.4	1.3	1.8
			(In millions of U.S. dollars)			
Current account	-1,990	-2,090	-2,051	-2,640	-2,490	-2,293
(As per cent of GNP)	(5.9)	(-5.9)	(-5.8)	(-6.3)	(-6.4)	(-6.0)
Overall balance of payments	-380	-371	-352	-375	-375	-486
Gross official reserves	...	...	3,155	...	...	2,707
Debt service, including IMF	...	...	1,259	...	...	1,665
(As per cent of exports of goods and services)	(...)	(...)	(16.0)	(...)	(...)	(20.1)
Disbursed medium- and long-term external debt outstanding	...	...	8,554	...	...	10,028
(As per cent of GNP)	(...)	(...)	(24.1)	(...)	(...)	(25.9)

Sources: Data supplied by the Philippine authorities and staff estimates.

1/ National coverage.

2/ As per cent of the stock of liquidity at beginning of period.

3/ Includings lending minus repayments.

the program. The lower-than-expected deficit was mainly attributable to strong current earnings from services, particularly through remittances of Filipinos working abroad. Both exports and imports were markedly lower than projected. Merchandise exports fell by 1 per cent, compared to an increase of 19 per cent envisioned in the program. The poor export performance was partly the reflection of weaker external demand, growing protectionism, and depressed export prices. Unit value of exports declined by 0.6 per cent and volume by 0.5 per cent. The decline in export prices was largely due to lower prices for coconut products, forestry products, and copper concentrates--three of the Philippines' most important primary product exports. Merchandise imports rose by only 2.9 per cent in 1981, compared to the program projection of 19 per cent. The volume of imports fell by 5.5 per cent, due in large part to sharp declines in capital goods imports stemming from depressed investment activity. Despite the lower-than-projected current account deficit, the overall balance of payments deficit at $486 million was about $100 million greater than targeted because of unexpected short-term capital outflows.

2. Growth and inflation

The growth of real GNP during 1980-81 was significantly below program targets, increasing at an annual compound growth rate of about 4 per cent compared to a program target between 5.5 and 6.0 per cent. The discrepancy is largely due to the depressing effects of the deterioration in the terms of trade on profits and investment, weaker-than-expected external demand in 1981, and the repercussions of the financial crisis in 1981 on economic activity. Real gross capital formation grew at an annual compound rate of only about 1.6 per cent during the period, reflecting stagnant construction activity in 1980 followed by a decline in the demand for durable equipment in 1981. Reflecting the weak demand conditions, most sectors of the economy experienced depressed growth rates during 1980-81. The growth in manufacturing output, which registered over 5 per cent in real terms in 1979, decelerated in the following two years. Growth in mining and quarrying was also sluggish partly due to depressed mineral prices during the period. Real value-added in commerce rose by less than 2 per cent in 1981, reflecting the disruptive effects of the financial crisis and a substantial slowdown in retail and wholesale trade. In addition, agricultural output in 1981 was affected by unfavorable weather, including a severe typhoon in the latter part of the year.

The rate of increase in consumer prices abated broadly in line with the program targets during 1980-81. Aggravated by further large increases in oil prices in early 1980 and by subsequent hikes in utility rates as the Government passed on increases in oil costs to consumers, the 12-month rate of inflation peaked at 25 per cent in the first quarter of 1980. Throughout the remainder of the year, the rate of inflation declined steadily. For the year as a whole, the average rate of inflation was 17.6 per cent, but the rate had fallen to 15 per cent in the year ending in December 1980. Inflation continued to decelerate in 1981 to about 12 per cent on an average basis, which was the program target. This rate included further upward adjustments in the prices of utilities and other price-controlled items; fuel, light, and water prices increased by 15 per cent.

3. Domestic financial policies

Monetary policy during 1980 was implemented cautiously and remained well within the program parameters. Net domestic assets of the banking system--a performance criterion--was maintained substantially below the program ceilings. Similarly, the expansion of net credit to the public sector during 1980 was equivalent to only 3.4 per cent of the liquidity stock at end-1979, compared to a program ceiling of 5.2 per cent. The National Government's recourse to the banking system in financing its overall deficit was less than envisioned in the program.

The original credit program for 1981 was formulated on the assumptions of a 5.5 per cent growth in real GNP, a 12 per cent rate of inflation, and an overall deficit in the balance of payments of $375. Given this basis, the expansion in net domestic assets of the banking system during 1981 was projected to be equivalent to about 13 per cent of the stock of liquidity at end-1980, with a corresponding figure of 18 per cent for domestic credit. Consistent with these projections, total liquidity was expected to increase by 14.5 per cent during the year. This program was revised during the mid-term review to take account of the effects of a major financial crisis that erupted in early 1981 and to allow for a weaker-than-expected external environment.1/ The target for real growth was reduced to 4 per cent, while the ceiling on net domestic assets and projections for total liquidity were raised to accommodate the financial rescue plan and a substitution of banking system credit for credit previously provided by nonbank financial institutions.

Monetary developments in 1981 were broadly as anticipated during the mid-term review. However, the level of net domestic assets exceeded the modified credit ceiling in December by about 1.2 per cent, largely as a result of additional Central Bank financing operations taken to stem continuing repercussions from the financial crisis. Offsetting measures of credit restraint were not used because of possible adverse effects on the sluggish economy and on financially troubled firms. Reflecting weak credit demands by the private sector and countercyclical expansion of investment by the public sector, the expansion of net credit to the public sector was equivalent to 52 per cent of the expansion in total liquidity in 1981, compared with an average of 14 per cent in 1979-80. Total liquidity expanded by 16 per cent, which was in line with the revised monetary program.

As a result of higher nominal interest rates and a reduction in the rate of inflation, the real rate of interest rose from negative 3 to 4 per cent in 1980 to positive 3 to 4 per cent in 1981. The average Central Bank rediscount rate on outstanding loans was raised to 7.8 per cent in

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1/ Catalyzed by the disappearance of a heavily indebted industrialist in January 1981, the crisis began with large withdrawals of funds from nonbank financial institutions. Severe liquidity problems resulted for these institutions and for certain industrial enterprises, which made it necessary for the Central Bank and the Government to undertake a financial rescue operation. For details on the financial crisis and the rescue operation, see EBS/81/160, July 1981.

1981, compared to 5.6 per cent at the end of 1980. The weighted average interest rate on money market instruments rose by 2.5 percentage points to an annual average of 15.8 per cent in 1981, primarily reflecting higher interbank rates and yields on CBCIs. To provide greater scope for the market determination of interest rates, the Central Bank removed the ceiling on interest rates on savings and time deposits with a maturity of less than two years during 1981. The subsequent impact on the interest rate structure, however, was partially limited by the decision to maintain a ceiling on lending rates of one year or less. Other structural reforms of the financial sector in 1981 included a reform of the securities market and further expansion of multipurpose banking.

Fiscal developments were broadly in line with the program targets in 1980, but fell substantially short of program targets in 1981. The overall deficit of the National Government in 1980 was ₱ 3.4 billion (1.3 per cent of GNP), or just below the target deficit of ₱ 3.6 billion. Both revenues and expenditures fell short of program projections, but by similar margins. Total revenue increased by about 18 per cent in 1980, compared to the original projection of a 20 per cent increase. This revenue effort incorporated the effects of several discretionary measures taken during 1980 to increase the yield from domestic-based taxes. The revenue impact of these measures, however, was partially offset by the introduction of fiscal incentives to financial institutuions to promote long-term lending. Expenditures increased by 28 per cent in 1980, which was 3 percentage points below expectations. The lower level of expenditure was attributable to less current expenditure than had been programmed. Capital expenditures exceeded the program target by about 5 per cent.

Fiscal policy became more stimulative in 1981 as capital expenditures were adjusted to respond to the sluggishness of the economy and to the financial disruption. At the same time, revenues fell substantially short of program projections, and as a consequence, the overall budget deficit increased sharply to ₱ 12.2 billion (4 per cent of GNP), compared to the original program target of ₱ 4.2 billion (1.3 per cent of GNP). Total revenues were only slightly higher than in the preceding year, as tax revenue rose by only 3 per cent. The program had targeted a 20 per cent increase in total revenues based entirely on higher tax receipts. The poor revenue performance was attributable to the depressed economic conditions and to a sharp decline in the income elasticity of tax revenue, reflecting problems in tax administration. With respect to expenditures, the Government stepped up sharply its equity contribution and lending to financially distressed enterprises in the wake of the banking crisis. In addition, the Government accelerated the implementation of the infrastructure program in an effort to compensate for depressed private investment. As a result, capital expenditure and net lending was about ₱ 7 billion larger than projected in the original program. Partially offsetting these measures, however, drastic economy measures were imposed on current expenditures in order to contain the widening budget deficit. Reflecting these developments, total expenditures increased by about 26 per cent, compared to the original target of 20 per cent. In light of the unexpectedly sharp increase in the budget deficit, the National Government relied on bank credit and foreign borrowing to a much greater extent than envisaged in the program.

4. External policies

From early 1977 to late 1979, the peso remained virtually pegged to the U.S. dollar. In line with commitments in the stand-by program to adopt a flexible exchange rate to ensure export competitiveness, the peso was allowed to depreciate gradually by about 2.5 per cent vis-a-vis the dollar during 1980. When adjusted for relative prices and movements in cross exchange rates, the effective exchange rate depreciated by about 1.7 per cent during the year. Although the depreciation of the peso against the dollar accelerated to 8 per cent during 1981, the relative strength of the dollar vis-a-vis trading partner countries limited the depreciation of the peso in nominal effective terms to less than 1 per cent on a year-end basis. When adjusted for movements in relative prices, this movement implied an appreciation of the real effective exchange rate by 4 per cent during 1981.

Approvals of new external borrowing in the 1 to 12 year maturity range were within the program ceilings during 1980-81. In 1980, approvals for new debt of 1 to 12 year maturity totalled $1.2 billion, which was the program ceiling. Of that amount, $84 million was in the 1 to 5 year maturity range, compared to the subceiling of $100 million. In addition, approvals of new loans with initial maturity greater than 12 years, ODA commitments, and loans for refinancing or restructuring of amortization due in future years amounted to $2,180 million; these loan approvals were not subject to program limits. During 1980, net disbursements of new debt amounted to $2.6 billion, with medium- and long-term debt accounting for about $1.4 billion. The debt service ratio, defined as interest and amortization on loans of more than one year including repurchases and charges on IMF credit divided by exports of goods and services, stood at 16 per cent in 1980 compared to 18 per cent in 1979.

Under the stand-by program in 1981, the basic limit on new external debt approvals of 1 to 12 year maturity was raised to $1.7 billion and an additional $350 million of approvals was separately allowed for the nuclear power project. Actual approvals remained well within these limits as total approvals subject to program ceilings amounted to only $1.5 billion; less than $50 million was approved for the nuclear power plant due to delays in project implementation. Debt approvals with maturity exceeding 12 years amounted to $1.2 billion, substantially lower than in the preceding year. However, actual disbursements of new debt during 1981 amounted to $2.4 billion, with about $1.3 billion in medium- and long-term debt. The debt service ratio increased substantially in 1981, rising to just over 20 per cent as a result of higher international interest rates and the increased stock of external debt.

5. Structural reform

During 1980-81, important measures were taken to encourage a more efficient use of resources and to strengthen the economic base. A major five-year tariff reform and a three-year plan for the removal of import restrictions were adopted in late 1980 and implemented on schedule during the stand-by program, despite a period of increasing protectionism abroad. The target of the tariff reform is to reduce average effective production for the manufacturing sector from 44 per cent to 29 per cent. The list of restricted imports was reduced by about 20 per cent during 1981, as the first stage of a three-year plan. Considerable progress was also made toward developing indigenous energy resources, and encouraging energy conservation and efficiency. Increases in imported fuel costs were generally passed on to domestic consumers. Energy conservation-related investments and the utilization of coal and nonconventional resources were promoted through fiscal incentives. Reflecting these efforts, there was a significant slowdown in energy consumption during the stand-by program accompanied by a reduction in the share of oil imports in the supply of energy. In the financial sector, the development of multipurpose banking and the abolition of interest rate ceilings on deposits with maturities over two years were important steps taken to improve the efficiency of financial intermediation.

Philippines: Summary of the Financial Program, 1983

I. Targets

1. GNP is expected to grow by 2 per cent in 1983. The source of this growth is expected to be moderate increases in export demand and agricultural output.

2. The inflation rate is expected to remain virtually unchanged from 1982. The annual average CPI is projected to increase by 11 per cent, compared with a 10.2 per cent increase in 1982. However, it is expected that relative prices will change as a result of pricing adjustments intended to direct resources into the tradable sector.

3. The balance of payments is programmed to show an overall deficit of $0.6 billion, while the current account deficit is programmed to decline to $2.5 billion, or 6.2 per cent of GNP, compared with an estimated current account deficit of $3.4 billion in 1982, equivalent to 8.5 per cent of GNP.

II. Major Assumptions

1. The annual rate of inflation in Philippine industrial trading partners is expected to be 4.9 per cent in 1983, in accordance with World Economic Outlook projections. The terms of trade are projected to improve by 3.2 per cent in 1983, reflecting a 5.4 per cent increase in export prices and a 2.1 per cent increase in import prices, expressed in U.S. dollars. The U.S. dollar price of petroleum is expected to be stable during 1983, while the volume of oil imports is to rise by 2.2 per cent. Total import volume is projected to decline by 0.6 per cent in 1983, while export volume is expected to grow by 4.8 per cent.

2. The London Interbank Offer Rate (LIBOR) on six-month U.S. dollar deposits is projected to fall from an estimated 13.5 per cent per annum in 1982 to 10 per cent in 1983 and to decline steadily to 7 per cent in 1986-87. The spread above LIBOR has been assumed to be 1 percentage point throughout the period.

3. The velocity of average total liquidity with respect to nominal GNP is projected to remain virtually unchanged in 1983.

III. Principal Elements of the Program

1. Budgetary policies 1/

a. The overall deficit of the National Government will be limited to ₱ 9.4 billion (2.4 per cent of GNP) in 1983. Domestic and foreign

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1/ With the introduction of a 3 percentage point import duty surcharge, instead of a 1 percentage point rate, it is expected that total revenue will be higher than the program estimate, and that the overall deficit and domestic bank financing will be lower than envisaged in the program.

financing of the deficit are programmed at ₱ 6.4 billion and ₱ 3.0 billion, respectively.

b. Revenue is programmed to increase by 13.8 per cent, with half of the increase being generated by the following revenue measures: upward adjustments in fees and charges, increases in specific rates on cigarettes and cigars, restrictions on use of tax credit method for sales tax computation (all preconditions); temporary import surcharge and upward adjustments in petroleum taxes.

c. Budgetary expenditure is programmed to remain at the 1982 level. Lending less repayments will be reduced by 44 per cent, while capital expenditures will be maintained at the 1982 level. Current expenditures will increase by about 17 per cent, mainly on the basis of a sharp increase in interest payments on government debt; all other major categories of current expense will grow slower than the rate of inflation.

d. Complementing the adjustment in the National Government budget, the investment savings gap of the major public corporations is to be reduced from ₱ 14.3 billion (4.2 per cent of GNP) in 1982 to ₱ 11.3 billion (2.9 per cent) in 1983. Public corporations will scale down investment by 12 per cent in 1983, by postponing certain projects and decelerating the implementation of others. No major new projects will be implemented. Internal generation of resources is expected to increase by ₱ 1.0 billion through pricing adjustments and cost-saving measures.

2. Money and credit

a. The net domestic assets of the banking system are to be subject to quarterly ceilings as a performance criterion. For 1983, as a whole, the increase in net domestic assets will be limited to an amount equivalent to about 20 per cent of the estimated stock of liquidity at end-1982, down sharply from the 30 per cent expansion of the preceding year. This projection is consistent with a 14.6 per cent increase in the demand for total liquidity.

b. A subceiling on bank credit to the public sector has been established. The subceiling allows for bank financing of the National Government deficit in an amount of ₱ 4.5 billion or 5 per cent of the end-1982 liquidity stock.

c. Domestic credit to the private sector in 1983 is projected to increase by an amount equivalent to about 15 per cent of the end-1982 liquidity stock, compared to 16 per cent in 1982. This deceleration is consistent with a projected slowdown in the growth of investment-related credit requirements.

d. On January 1, 1983, the Central Bank completed the process of interest rate deregulation by removing the limit on lending rates with maturity of one year or less. During the program period, real interest rates for domestic financial instruments are projected to be maintained at positive levels (about 2 to 4 per cent).

3. Wage policy

The authorities intend to limit minimum wage adjustments in 1983 to gains in productivity. The private sector, in conjunction with the trade unions, will similarly be encouraged to observe wage restraint.

4. External sector

a. Exchange rate policy will be managed flexibly, to improve the competitiveness of the Philippine economy.

b. New approvals of external borrowing for all debt of 1-12 year maturity will be limited to an overall ceiling of $1.6 billion, with debt of 1-5 year maturity subject to a subceiling of $100 million. There will be no increase in short-term debt outstanding, excluding trade financing through Open Accounts and Documents Against Acceptance and any debt classified as an international reserve liability of the banking system.

c. Stage three of a five-year program to reduce effective tariff rates for the manufacturing sector from 44 per cent to 29 per cent will be enacted. In addition, the final stage of a three-year program of reducing import restrictions will be adopted.

External Projections Through 1987

To aid in assessing the Philippine external debt situation in the medium-term, the staff has constructed a set of balance of payments projections through 1987 (Table 1) complemented by a presentation of medium- and long-term external debt operations over the same period (Table 2).1/

The projections are based on a targeted continuing reduction of the current account deficit of the balance of payments from 8.5 per cent of GNP in 1982 to 3.0 per cent by 1987. The projected improvement in the current account performance will allow a reduced reliance on net capital inflows, while the overall balance of payments is projected to move into surplus by 1985. Growth in real GNP is targeted to increase gradually to a sustained annual rate of 5 per cent by 1985, while domestic inflation is targeted to decline to an annual average of 5 per cent by 1987.

Assumptions regarding external demand and prices were consistent with the most recent set of medium-term global projections. Interest rates in international capital markets were assumed to decline through the projection period. Income elasticity of demand for imports in the Philippines was estimated econometrically to be about unity. A recovery in exports is projected in response to an expected moderate strengthening of real economic growth in world markets, in addition to continuing flexible management of Philippine exchange rate policy. Receipts from services are expected to continue to increase in response to the policy measures which will have been enacted in 1982-83, and are described in the text. Import growth is projected to accelerate gradually over the years, in line with the targeted growth rates in real GNP and projected increases in import prices. At the same time, service payments will increase at a reduced rate compared to recent years, mainly due to the projected continuing decline in interest rates.

However, even given the projected improvements in the balance of payments performance and the projected decline in interest rates, the external debt situation will continue to require careful management through the projection period, as the debt service ratio is expected to increase from 27.1 per cent in 1982 to 27.6 per cent in 1984, declining only to 26.7 per cent by 1987 (Table 2). Total interest payments are projected to increase, despite the decline in rates, due to the increased debt outstanding, and amortization payments will increase sharply after 1985. This increase in amortization is attributable in part to refinancing efforts undertaken in 1978-79 which reduced amortization payments falling due, especially in 1979-80.

1/ These data have been extensively revised from a similar exercise presented in Appendix I of the most recent Staff Report (SM/82/55).

Table 1. Philippines: Summary Balance of Payments, 1980-87

(In millions of U.S. dollars)

	1980	1981	Staff Estimate 1982	Staff Projections 1983	1984	1985	1986	1987
Goods, services, and transfers	-2,051	-2,293	-3,364	-2,460	-2,060	-1,732	-1,592	-1,437
Trade balance	-1,939	-2,224	-2,805	-2,400	-2,253	-2,255	-2,530	-2,536
Exports, f.o.b.	(5,788)	(5,722)	(4,995)	(5,516)	(6,205)	(6,985)	(7,855)	(9,033)
Imports, f.o.b.	(-7,727)	(-7,946)	(-7,800)	(-7,916)	(-8,458)	(-9,240)	(-10,305)	(-11,569)
Services and transfers (net)	-112	-69	-559	-60	193	523	858	1,099
Investment income (net)	(-732)	(-1,130)	(-1 768)	(-1,826)	(-1,869)	(-1,883)	(-1,947)	(-2,041)
Other services (net)	(186)	(589)	(766)	(1,246)	(1,052)	(1,776)	(2,112)	(2,378)
Transfers (net)	(434)	(472)	(443)	(520)	(560)	(630)	(693)	(762)
Capital movements	1,699	1,807	2,175	1,862	1,791	1,895	1,613	1,487
Long-term capital (net)	1,098	1,739	1,732	1,762	1,691	1,795	1,413	1,237
Direct investment (net)	(45)	(407)	(259)	(244)	(314)	(450)	(490)	(541)
Borrowing (net)	(1,053)	(1,332)	(1,473)	(1,518)	(1,377)	(1,345)	(923)	(696)
Short-term capital (net)	765	188	423	--	--	--	100	150
Errors and omissions	-350	-621	-204	--	--	--	--	--
Monetization of gold	128	400	278	100	100	100	100	100
Allocation of SDRs	29	27	--	--	--	--	--	--
Valuation adjustment	29	74	-54	--	--	--	--	--
Changes in net international reserves of the banking system	-352	-486	-1,189	-598	-269	163	21	50
			(In millions of U.S. dollars; end-of-period)					
Memorandum items:								
Net international reserves of the banking system	-778	-1,264	-2,453	-3,051	-3,320	-3,157	-3,136	-3,086
Gross official reserves	3,155	2,707	2,543	2,543	...	...	...	...
Medium- and long-term external debt 1/	8,554	10,028	11,701	13,219	14,596	15,941	16,864	17,560
Public external debt 2/	6,583	7,767	9,106	10,259	...	...	...	...
			(In per cent of GNP)					
Current account deficit	5.8	6.0	8.5	6.2	5.0	4.0	3.5	3.0
Merchandise exports	16.4	14.8	12.6	13.9	14.9	15.9	17.1	18.7
Merchandise imports	21.9	20.5	19.7	19.9	20.3	21.1	22.4	23.9
Debt service 3/	3.6	4.3	5.4	6.1	6.6	6.5	7.3	7.9
Interest	(1.9)	(2.3)	(3.0)	(3.2)	(3.2)	(3.1)	(3.0)	(3.0)
Amortization	(1.7)	(2.0)	(2.4)	(2.9)	(3.4)	(3.4)	(4.3)	(4.9)

Sources: Data provided by the Philippine authorities and Fund staff estimates.

1/ Excludes IMF.
2/ Includes publicly guaranteed debt of the private sector.
3/ Includes IMF.

Table 2. Philippines: External Debt Operations, 1980-87

(In millions of U.S. dollars)

	1980	1981	Est. 1982	Staff Projections 1983	1984	1985	1986	1987
Outstanding Debt at End of Period 1/	8,554	10,028	11,701	13,219	14,596	15,941	16,864	17,560
Outstanding debt at beginning of period	7,137	8,554	10,028	11,701	13,219	14,596	15,941	16,864
Net drawings	1,053	1,332	1,473	1,518	1,377	1,345	923	696
Drawings 2/	(1,600)	(2,072)	(2,348)	(2,600)	(2,582)	(2,675)	(2,733)	(2,927)
Amortization (-)	(547)	(740)	(875)	(1,082)	(1,205)	(1,330)	(1,810)	(2,231)
Adjustment 3/	364	143	200	--	--	--	--	--
Debt service burden	1,065	1,541	1,977	2,194	2,457	2,599	3,095	3,572
Interest	609	825	1,111	1,195	1,252	1,269	1,285	1,341
Amortization	456	716	866	999	1,205	1,330	1,810	2,231
Prepayments	92	24	--	83	--	--	--	--
Outstanding Use of Fund Credit at End of Period	1,085	1,232	1,158	1,246	1,114	948	787	607
Outstanding at beginning of period	783	1,085	1,232	1,158	1,246	1,114	948	787
Net drawings	302	182	-74	88	-132	-166	-161	-180
Purchases	(447)	(236)	(--)	(230)	(85)	(--)	(--)	(--)
Repurchases (-)	(145)	(54)	(74)	(142)	(217)	(166)	(161)	(180)
Adjustments	--	-35	--	--	--	--	--	--
Debt Service to Fund	195	124	148	221	301	250	245	264
Repurchases	145	54	74	142	217	166	161	180
Charges	50	70	74	79	84	84	84	84
Total Debt Service Burden 4/ (including Fund)	1,260	1,665	2,125	2,415	2,758	2,849	3,340	3,836
Exports of Goods and Services	7,863	8,277	7,837	8,852	9,998	11,243	12,638	14,379
(Per cent change over preceding year)	(27.3)	(5.3)	(-5.3)	(13.0)	(12.9)	(12.5)	(12.4)	(13.8)
Debt service ratio 5/ (excluding IMF)	13.5	18.6	25.2	24.8	24.6	23.1	24.5	24.8
Debt service ratio 5/ (including IMF)	16.0	20.1	27.1	27.3	27.6	25.3	26.4	26.7
Memorandum items:								
Current account deficit	-2,051	-2,297	-3,347	-2,460	-2,060	-1,732	-1,592	-1,437
(As per cent of GNP)	(5.8)	(6.0)	(8.5)	(6.2)	(5.0)	(4.0)	(3.5)	(3.0)
LIBOR/SIBOR (annual average 6-month rate)	14.0	16.6	13.5	10.0	9.0	8.0	7.0	7.0

Sources: Data provided by the Philippine authorities and Fund staff estimates.

1/ Excludes loans of maturity of one year or less and debt to IMF.
2/ Assumes 40 per cent of debt committed after 1981 will be floating rate.
3/ Consists of credit adjustments and adjustments due to exchange rate changes.
4/ On medium- and long-term debt.
5/ Defined as amortization and interest payments on medium- and long-term external debt (excluding prepayments) as a per cent of exports of goods and services.

Philippines--Stand-by Arrangement

Attached hereto is a letter dated December 31, 1982 from the Prime Minister and Minister of Finance and the Governor of the Central Bank of the Philippines requesting a stand-by arrangement and setting forth the objectives and policies which the Government of the Republic of the Philippines intends to pursue for the period of the stand-by arrangement. To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period from ...., 1983 to February 28, 1984, the Philippines will have the right to make purchases from the Fund in an amount equivalent to SDR 315 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. a. Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 50 million until May 1, 1983, the equivalent of SDR 100 million until August 15, 1983, the equivalent of SDR 165 million until November 1, 1983, and the equivalent of SDR 230 million until February 1, 1984.

b. None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of the Philippines' currency in the credit tranches beyond 25 per cent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 per cent of quota.

3. Purchases under this stand-by arrangement shall be made from ordinary resources until purchases under this arrangement reach the equivalent of SDR 164,717,648; thereafter, each purchase shall be made with borrowed resources; provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. The Philippines will not make purchases under this stand-by arrangement that would increase the Fund's holdings of the Philippines' currency in the credit tranches beyond 25 per cent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 per cent of quota:

a. During any period in which the data at the end of the related period indicate that:

(i) the limit on net domestic assets of the banking system, or the limit on net credit from the banking system to the public sector, referred to in paragraph 12 of the annexed letter of ...., 1982, and specified in the Table appended to it, is not observed, or

(ii) the limits on approvals of external borrowings in the maturity ranges of 1 to 12 years and 1 to 5 years, respectively, described in paragraph 16 of the attached letter, are not observed; or

b. During any period after August 14, 1983 in which the consultations with the Fund to be initiated in June 1983, as contemplated in paragraph 18 of the attached letter, have not been concluded, or in which any performance criteria established during those consultations are not observed.

c. During the entire period of this stand-by arrangement, if the Philippines:

(i) imposes or intensifies restrictions on payments and transfers for current international transactions, or

(ii) introduces or modifies multiple currency practices, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When the Philippines is prevented from purchasing under this arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and the Philippines and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. The Philippines' right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of the Philippines. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and the Philippines and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of the Philippines, the Fund agrees to provide them at the time of the purchase.

7. The value date of a purchase under this stand-by arrangement involving borrowed resources will be normally either the 15th day or the last day of the month, or the next business day if the selected day is not a business day. The Philippines will consult the Fund on the timing of purchases involving borrowed resources.

8. The Philippines shall pay a charge for this arrangement in accordance with the decisions of the Fund.

9. a. The Philippines shall repurchase the outstanding amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as the Philippines' balance of payments and reserve position improves.

b. Any reductions in the Philippines' currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

c. The value date of a repurchase in respect of a purchase financed with borrowed resources under this stand-by arrangement will be normally either the 6th day or the 22nd day of the month or the next business day if the selected day is not a business day, provided that repurchase will be completed not later than seven years from the date of purchase.

10. During the period of the arrangement, the Philippines shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to the Philippines or of representatives of the Philippines to the Fund. The Philippines shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of the Philippines in achieving the objectives and policies set forth in the attached letter.

11. In accordance with paragraph 18 of the attached letter, the Philippines will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 4 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while the Philippines has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning the Philippines' balance of payments policies.

Central Bank of the Philippines

Manila, December 31, 1982

Dear Mr. de Larosiere:

1. Our last stand-by arrangement with the Fund, which covered the years 1980-81, supported programs aimed at making progress toward domestic and external balance while maintaining the growth momentum of the economy. Our implementation of the programs was made exceptionally difficult by adverse exogeneous as well as domestic developments. The external factors included the sharp increases in oil prices in late 1979 and early 1980, the subsequent progressive weakening of external demand conditions and the decline in the prices of primary commodities, the increasing trade restrictions on our exports, and an unprecedented rise in international interest rates. On the domestic side, the financial crisis of early 1981 hampered adjustment efforts. Nevertheless, we were broadly successful in implementing the programs. Between 1979 and 1981, inflation was reduced from 17 per cent to 12 per cent, the extent of deterioration of the balance of payments current account deficit was limited to 0.7 per cent of GNP, and the overall payments deficit was reduced moderately. These adjustments were achieved, however, at the cost of a decline in real economic growth from nearly 7 per cent in 1979 to under 4 per cent in 1981. A consequence of the external and domestic recessions was a marked expansion in the government budget deficit. While in 1980 the budget deficit amounted to 1.3 per cent of GNP, smaller than originally programmed because of delays in project implementation resulting from contract renegotiations triggered by the oil price increases, in 1981 the deficit rose to 4.0 per cent of GNP. This reflected partly a shortfall in revenue resulting from the external and domestic recessions, partly an acceleration of project implementation to compensate for past delays, and partly the adoption of a deliberate countercyclical policy of expanding capital expenditures.

2. In 1982, the increasing severity of the international recession has confronted the economy with difficult problems of adjustment. With continued deterioration in the terms of trade in 1982 by an estimated 9 per cent, a major contraction in export markets, and an intensification of protectionism, the trade deficit is estimated to have widened substantially. Export earnings declined by 11 per cent mainly as a result of lower prices, while import payments and volume remained virtually unchanged from the preceding year. The current account deficit of the balance of payments is estimated to have increased to 8.4 per cent of GNP and the overall deficit to 2.7 per cent of GNP. Real economic growth is estimated to have declined to about 2.5 per cent from the previous year's relatively low level of 3.8 per cent, which until then had been the lowest growth rate in a decade. Reflecting the impact on government revenue of the decline in economic activity, the sluggishness of imports, and the lowering of import tariffs, the budget deficit is estimated to have been about 4.2 per cent of GNP--slightly higher than in the previous year. The only major favorable element in the economic picture was a further moderate decline in inflation to 10 per cent.

3. Despite the economic difficulties, we have persevered in implementing on schedule our policies of structural reform. The trade and payments system has been liberalized to induce improvements in the efficiency of domestic resource use. The financial system has been strengthened and complemented with a progressive deregulation of domestic interest rates to improve resource allocation and encourage savings mobilization. Measures have been taken to encourage the growth of non-traditional exports and to increase the flow of foreign exchange income from overseas employment and construction services. The program for developing domestic energy resources has already resulted in a decline in the volume of oil imports from peak levels and a reduction in the dependence on external energy sources from 95 per cent in 1973 to 69 per cent in 1982. While these policies to strengthen the country's economic base were being followed, monetary policy was designed to moderate the impact of the worsening terms of trade on the external accounts and ensure a continued decline in inflation.

4. Given the marked expansion of the balance of payments current account deficit that occured in 1982 largely because of the exceptionally adverse external conditions, we plan to focus our policy efforts in 1983 on effecting a substantial improvement in the external accounts. This will not be an easy task since the long-awaited recovery in the industrial countries is now expected to be further delayed and to be quite moderate. Because of the time lags involved, we do not foresee a significant recovery in the demand for our exports until the latter half of 1983. Nevertheless, we expect to be able to reduce the current account deficit as a proportion of GNP by one fourth in 1983. External demand conditions are expected to improve only slightly further in 1984-85, but we plan to make further progress in external adjustment in those years and to reach our goal of a 3 per cent investment savings gap by 1986-87. With such an adjustment path in mind, we are instituting major changes in the areas of budgetary, monetary, and external sector policy. Our fiscal and monetary policies will be directed toward a further tightening of demand management, which will help contain inflation despite increases envisioned in the retail prices due to various cost adjustments. Meanwhile, we will continue to press ahead with the implementation of structural reforms with a view to improving domestic productivity, even though these reforms include tariff reductions and import liberalization, which in the short-term impede external adjustment. We recognize that continuation of a low rate of real growth in 1983 will be a consequence of the overriding emphasis given to policies conducive to external adjustment; this is a cost to be borne in the interest of strengthening the economic structure and preparing the base for a renewed acceleration of growth in future years. In support of our adjustment program, which has the objectives and characteristics outlined above, we are requesting a one-year stand-by arrangement from the International Monetary Fund in an amount equivalent to SDR 315 million.

Growth and supply policies

5. While real GNP is expected to grow in 1983 at a rate slightly lower than in the preceding year, the supply policies followed should pave the

way for higher growth--in the 4 to 5 per cent per annum range--during 1984-85. Industrial policies for 1983 will emphasize promotion of export-oriented industries and rationalization of investment incentives. With a view to promoting private investment, the Government is in the process of reforming investment incentives and associated activities of the Board of Investment. As a first step, the reform will involve changes in the structure of fiscal incentives to improve efficiency and stimulate new economic activity. To ensure attainment of the investment priority program, incentives will be extended on the basis of production and export performance. With a view to increasing investment efficiency, the Government will also ensure that large projects meet the criteria of economic viability. The maintenance of a flexible exchange rate policy, together with efforts to have barriers to Philippine exports reduced in partner countries, is estimated to improve growth in the manufacturing sector, particularly for nontraditional exports and import-substitution industries. The agricultural sector, which has performed relatively well in recent years in spite of the sharp downward trend in the world market prices for key agricultural commodities, is projected to grow in 1983 at a satisfactory rate, aided by intensified use of fertilizer and expanded extension services.

Budgetary policy

6. Our programmed adjustment in the external account deficit for 1983 implies a reduction in the overall investment-savings gap by an amount equivalent to 2.2 per cent of GNP. The main burden of adjustment will have to fall on the public sctor and, in particular, on the National Government whose budget deficit has risen sharply since 1980. Budgetary policy in 1983 will aim at reducing this deficit to ₱ 9.4 billion (2.4 per cent of GNP) from the ₱ 14.4 billion (4.2 per cent of GNP) level of the previous year. The reduction in the budget deficit will be reflected in the amount of financing from the domestic banking system, which is projected to decline sharply from about ₱ 9.1 billion in 1982 to ₱ 4.5 billion in 1983.

7. Revenue will be affected by the low growth rate for real GNP, and will increase only by 9 per cent compared with 1982 if the existing revenue structure were to remain unchanged. However, the Government will take discretionary measures, effective in January 1983 at the latest, to yield an additional ₱ 920 million during 1983. These measures consist of upward adjustments in fees and charges (₱ 600 million), increases in specific rates on cigarettes and cigars (₱ 180 million), and restrictions on the availment of the tax credit method for the computation of sales tax (₱ 140 million). The Government intends to take additional revenue measures, including adjustment of petroleum taxes, during the first half of 1983 with a view to further improving the revenue structure and generating at least ₱ 850 million of additional revenue during the remainder of 1983. As a result, revenue in 1983 will amount to ₱ 43.5 billion or 14 per cent higher than in 1982.

8. Total expenditures on a cash basis are programmed at ₱ 52.9 billion, which implies a reduction in real terms of about 11 per cent from the

previous year. In determining which areas of expenditure will be maintained and which will be reduced, we will be guided by mandatory obligations, and by priorities set out in our new Development Plan for 1983-87. In keeping with these principles, adequate funding will be provided for: (a) maintenance of the existing infrastructure base, (b) debt service, (c) salaries of occupied permanent positions, and (d) high-priority ongoing projects. Some new capital projects will be deferred, while equity contributions to government corporations will be drastically reduced. In accordance with well-established practice, the allocated equity contributions represent ceilings and the release of funds will depend on the cash positions of the corporations.

9. Current operating expenditures, excluding interest payments, are programmed to increase by about 6 per cent in nominal terms. The increase in expenditure on personal services will be limited to about 8 per cent, through deferment of new organizational proposals, control in the filling-up of new positions, and restraint in salary adjustments. Maintenance and other operating expenditures will be allowed to increase at about the same rate as inflation, with cutbacks consistent with economy measures provided for in Letters of Instructions. Current transfers to government corporations will be reduced by 43 per cent. Interest payments, however, are projected to increase by about 85 per cent, reflecting the increase in government debt and a higher average cost of borrowing. Capital expenditures, including net lending, will be reduced by 23 per cent. Infrastructure expenditures will be reduced by 8 per cent, largely by cutting back outlays on highways, water supply, and irrigation and telecommunication facilities. Corporate equity contributions will be reduced by about 50 per cent, reflecting the elimination of contributions to some corporations and cutbacks for most others. Net lending (including on-lending of disbursements under SAL II) will be reduced by 18 per cent.

10. The reduction in government equity contributions to government corporations will affect the financial plans of the individual corporations. We are issuing guidelines to government corporations requiring them either to increase the internal generation of funds, through improvements in operational efficiency and, wherever possible, through pricing adjustments, or to effect appropriate reductions in their investment programs, rather than increasing their borrowing from the banking system or from external sources. Some of the major government corporations will be improving their savings-investment balances in the following ways:

a. The National Power Corporation is already implementing a series of seven quarterly increases (each of 0.75 centavos per KWH) in the electricity tariff, beginning in mid-1982 and ending at end-1983. In view of the more difficult fiscal situation in our country, the increase in electricity tariffs will be accelerated. Certain power generation projects originally contemplated for initiation in 1983 have been deferred. While this will slow down the rate of growth of domestic energy production, it is also the case that our economic adjustment policies will slow down the rate of growth of energy demand below what was contemplated earlier.

b. Certain major industrial projects of government corporations, originally contemplated for initiation in 1983, have been deferred. These include the aluminum smelter (National Development Company), the integrated pulp and paper project (National Development Company), and the petrochemical complex (Philippine National Oil Company).

c. The Manila Waterworks and Sewerage System (MWSS) will implement a tariff increase in early 1983, and will undertake an ADB-financed project to improve the distribution system and expand the billing coverage for water usage during 1983.

d. The National Irrigation Administration, which has a large ongoing investment program, will not undertake any major new projects in 1983.

Monetary and credit policies

11. Since the financial crisis in 1981, we have taken many steps to strengthen financial institutions and improve financial intermediation. Particular mention may be made of the expansion of the universal banking system designed to promote greater maturity transformation of financial assets, the establishment by the Central Bank of a rediscount window for medium- and long-term loans and equity investments made by authorized banks, measures to prevent the overissuance of commercial paper by controlling the volume and quality of such instruments, and the issuance of Treasury notes of varying maturities carrying market rates of interest. Furthermore, our program for the phased deregulation of interest rates is nearing completion. The deregulation so far has contributed to the maintenance of high nominal interest rates, which together with declining inflation, has resulted in positive real interest rates. With the removal in mid-1981 of the interest rate ceiling on deposits of maturity of two years or less, the only remaining ceiling is that on loans of one year or less. We are at present laying the groundwork for the completion of the interest rate reform by instituting a prime rate system and we intend to remove the last interest rate ceiling very shortly.

12. The main objectives of monetary policy during the program period will be to support adjustment in the external accounts, contain inflation, and ensure an adequate share of the available credit for productive investments in the private sector, particularly those which are export oriented. To achieve these objectives, quarterly credit ceilings will be implemented. Given the projected increase in real GNP of 2 per cent and in the GNP deflator of 12.6 per cent, the demand induced growth in total liquidity in 1983 is projected to be 14.6 per cent. Much of this expansion is expected to be in the form of deposits in interest-bearing accounts in response to the high real interest rates. In support of efforts to limit the deficit in the overall balance of payments to the targeted level of $598 million, the expansion in the net domestic assets of the banking system during 1983 will be limited to 16.4 per cent. Accordingly, taking into account the latest available data on net domestic assets of the banking system and projecting appropriate growth rates thereafter, and taking into account relevant seasonal patterns of credit demand, quarterly ceilings have been set on the outstanding level of net domestic assets of the banking system, as shown in the attached table. In addition, reflecting the limit on the government budget deficit in 1983 and taking into

account the credit requirements of the rest of the public sector as well as relevant seasonal patterns, quarterly ceilings have also been established on outstanding net credit to the public sector, as presented in the same table. All these ceilings have been set on the assumption that there will be no financing of the budget deficit of the National Government from external commercial sources; if the National Government borrows from external commercial sources, the quarterly ceilings on net domestic assets of the banking system and on net credit to the public sector will be adjusted downward by a corresponding amount.

External sector policies

13. We recognize that, in addition to fiscal and monetary policies, exchange rate policy can play an important role in external adjustment. The rapid growth of our nontraditional exports during much of the 1970s attested to the general appropriateness of our exchange rate policies during most of that time. During 1983, we intend to continue the trend of increasing flexibility in the use of the exchange rate instrument that has characterized our external policies during recent months with the aim of further improving the competitiveness of Philippine goods. We also plan to improve the institutional framework for exporters by expanding extension services to small exporters, streamlining export regulations and further simplifying export processing procedures. Thus, although most exports, with the notable exception of electronic goods, suffered declines in 1982 because of depressed demand, we are confident that our nontraditional exports, in particular, will benefit from increased price competitiveness and renew their previous rapid growth as external market conditions improve and as protective barriers are reduced.

14. In the promotion of exports, exchange rate policies and institutional improvements are being supplemented by the ongoing structural reforms designed to improve the competitiveness of domestic industries. An important element in these reforms is a five-year program to reduce effective tariff rates for the manufacturing sector from their previous average level of 44 per cent to 29 per cent. In the first two stages, which were implemented in January 1981 and January 1982, nominal rates in excess of 50 per cent were lowered. During 1983, we will make further downward adjustments of high tariff rates. In addition, we intend to adjust low tariff rates upward, with a 10 per cent minimum nominal tariff as a guideline, thus complementing the movement toward greater uniformity in the structure of protection through reductions in high tariff rates.

15. In August 1980, we adopted a three-year program to substantially reduce import restrictions. Out of 1,304 restricted items, we liberalized 263 items in 1981 and a further 610 items in 1982, despite the increasing protectionism in several major industrial countries. We have already identified a further 83 items for liberalization in 1983. Moreover, we are giving consideration to the liberalization of additional items, although many of the presently restricted items would have to remain restricted for national security, health, or social reasons.

16. Since the early 1970s, we have been monitoring both the public and private external debt of the country and maintaining a self-imposed

Philippines: Limits on Net Domestic Assets of the Banking System and on Net Credit to the Public Sector During 1983

(In billions of pesos)

	Up To			
	March 31	June 30	Sept. 30	Dec. 31
Net domestic assets of the banking system (stock) 1/	122.7	127.2	131.1	136.5
Net credit to public sector (stock) 1/ 2/	26.8	28.6	29.5	31.6
Memorandum item:				
External commercial financing of government budget deficit (cumulative flow since January 1, 1983)	--	--	--	--

1/ As of October 1982, net domestic assets of the banking system and net credit to the public sector amounted to ₱ 110.6 billion and ₱ 21.5 billion, respectively.

2/ Net credit to the public sector is defined as net credit to the National Government and the social security institutions and gross credit to the rest of the public sector.

statutory limit of 20 per cent on the ratio of debt service to foreign exchange receipts of the immediately preceding year. While borrowing on ODA terms will remain an important source of finance for our development program, we intend to continue our policy of regulating our medium- and long-term borrowing in order to maintain future debt service payments within manageable levels. Accordingly, we will limit approvals of external borrowing by the public and private sectors in the maturity range of more than 1 year up to and including 12 years to $1,600 million during 1983. Within this aggregate, we will limit approvals in the maturity range of more than one year up to and including five years to $100 million. We also intend to monitor the incurrence of short-term debt, namely debt of maturity of one year or less, with a view to avoiding any net increase in the total of such debt of the public and private sectors between the beginning and end of 1983.

17. The Government of the Philippines does not intend to introduce any multiple currency practices or introduce new or intensify existing restrictions on payments and transfers for current international transactions, or enter into any bilateral payments agreements with Fund members; furthermore, the Government does not intend to introduce new restrictions or intensify existing restrictions on imports for balance of payments reasons.

Mid-term review

18. The Government believes that the policies set forth in this letter are adequate to achieve the objectives of the program, but will take any further measures that may become appropriate for this purpose and will consult with the Fund on the adoption of such measures. Because of substantial uncertainties concerning future developments, the Philippine authorities will initiate consultations with the Fund during June 1983 to review the progress made in implementing the program and the Government's macroeconomic policies, including budgetary, external sector, and interest rate policies, and to reach such further policy undertakings with the Fund as may become necessary to achieve the objectives of the program.

Sincerely yours,

/s/
Cesar E. A. Virata
Prime Minister and Minister of Finance
For the Government of the Republic of the Philippines

/s/
Jaime C. Laya
Governor, Central Bank of the Philippines
For the Government of the Republic of the Philippines

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