EBS/92/153

CONFIDENTIAL

September 16, 1992

To: Members of the Executive Board

From: The Secretary

Subject: Philippines - Staff Report for the 1992 Article IV Consultation and Review Under Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the 1992 Article IV consultation with the Philippines and review under the stand-by arrangement, which is tentatively scheduled for discussion on Wednesday, October 7, 1992. A draft decision appears on pages 27-29.

Mr. B. J. Smith (ext. 37301) or Mr. C. S. Lee (ext. 36252) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

Other Distribution:
Department Heads

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

PHILIPPINES

Staff Report for the 1992 Article IV Consultation and Review Under the Stand-By Arrangement

Prepared by the Southeast Asia and Pacific and Policy Development and Review Departments

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

Approved by Kunio Saito and Thomas Leddy

September 15, 1992

Contents | Page

Text Tables

Contents

I. Introduction

Discussions for the 1992 Article IV consultation and the second program review under the stand-by arrangement were held in Manila during March 9-18, June 22-26, and August 12-21, 1992. 1/ The Philippine representatives included former Finance Secretary Estanislao; current Finance Secretary del Rosario; Central Bank Governor Cuisia; and other senior officials responsible for economic and financial matters, as well as representatives of private industry and banking.

An 18-month stand-by arrangement in the amount of SDR 264.2 million (60 percent of quota) was approved on February 20, 1991. Due to uncertainties about the financing of the program, quarterly reviews of external financing under the program are required; the first financing assurances review was completed by the Executive Board on June 12, 1991. After a prolonged delay, the first program review and associated review of external financing was completed on March 4, 1992 (EBM/92/27, EBS/92/24). At the same time, the period of the stand-by arrangement was extended from August 19, 1992 through the end of December 1992 and the remaining purchases were rephased. In addition, the date of the second program review was rescheduled to be completed by April 30, 1992, and a third program review was added, to be completed by July 31, 1992. To date, the Philippines has made purchases totaling SDR 113.3 million under the arrangement, as well as a purchase of SDR 277.1 million (62.9 percent of quota) under the compensatory component of the CCFF. 2/ Under the arrangement, 25 percent of each purchase is to be set aside for debt reduction operations and currently SDR 37.8 million of such set-asides have been accumulated. Total outstanding repurchase obligations of the Philippines amounted to SDR 735.4 million as of August 31, 1992, equivalent to 167.0 percent of quota (Table 1). Information on the last Article IV consultation and Fund relations with the Philippines are set out in Annex III.

All quantitative performance criteria for end-March and, except for base money, for end-June 1992 were observed (Table 2). The delays in the completion of the second and third program reviews envisaged under the arrangement were occasioned by the need for ongoing discussions, during a period overlapping national elections, regarding setbacks in the monetary area and the implementation of public finances, and policies to facilitate the achievement of the objectives of the program.

In the attached letter and Memorandum on Economic Policies, the authorities describe their policy intentions for the remaining period of the arrangement. The authorities are also requesting a further extension of the stand-by arrangement from December 31, 1992 to the end of March 1993, which

---

1/ The staff teams included Messrs. Smith, Lee, and Lin (all SEA), Mr. Felman and Ms. Prowse (PDR), Mr. Schiff (FAD), and Miss Cullati and Mrs. Eulate (assistants, SEA). They were assisted by Mr. Browne, the Fund's senior resident representative in Manila. Mr. Evans was present during some of the discussions.

2/ There is also attached to the stand-by arrangement an external contingency mechanism (ECM) under the CCFF with maximum access of SDR 88.1 million (20 percent of quota); the ECM expired on June 30, 1992. Developments under the ECM are discussed in Annex V.

Table 1. Philippines: Fund Position during the Remaining Period of the Stand-by Arrangement

	Outstanding August 31, 1992	1992 Sep.-Dec.	1993 Jan.-Mar.
	(In millions of SDRs)		
Purchases 1/		94.3	56.7
Of which: purchases of set-asides for debt reduction		51.9	--
Repurchases		-29.6	-13.2
Tranche policies		-29.6	-13.2
Special facilities		--	--
Net purchases/repurchases		64.7	43.5
Total Fund credit outstanding (end of period)	735.4	800.1	843.6
Tranche policies	458.3	523.0	566.5
Special facilities	277.1	277.1	277.1
	(In percent of quota of SDR 440.4 million)		
Total Fund credit outstanding (end of period)	167.0	181.7	191.5
Tranche policies	104.6	118.8	128.6
Special facilities	62.9	62.9	62.9

Source: Staff calculations.

1/ All purchases would be made from ordinary resources. Under the stand-by arrangement, 25 percent of each purchase is to be set aside for debt reduction operations. As of August 31, 1992, SDR 37.8 million of such set-asides have been accumulated.

Table 2. Philippines: Performance Criteria for 1992

	March 31		June 30		Sept. 30	December 31
	Prog.	Actual	Prog.	Actual	Program	Program
	(In billions of pesos)					
Domestic sector ceilings						
Base money	131.5	131.0	129.5	133.9	128.5	151.2
Public sector borrowing requirement (PSBR) 1/	-3.4	-4.5	-0.9	-1.4 2/	10.0	21.9
OPSF outstanding balances	--	4.9	--	8.0	--	--
	(In millions of U.S. dollars)					
External sector floors/ceilings						
Net international reserves (NIR) of the monetary authority (floors) 3/	1,960	3,293	1,042	1,996	...	...
	(2,050)		(2,075)		(2,100)	(2,422)
Short-term external debt outstanding	4,450	4,434	4,550	4,458	4,700	4,750
Approvals of external borrowing with maturities of 1-12 years 1/	350	111.5	700	253.4	1,100	1,500
Approvals of external borrowing with maturities of 1-5 years 1/	200	1.4	200	5.3	200	200

Source: Data provided by the Philippine authorities.

1/ Cumulative from January 1, 1992. The ceilings will be adjusted to reflect deviations from the program path of actual income support provided by the National Government to the Central bank.

2/ Estimate.

3/ The figures in parentheses refer to the floor before adjustments for deviations in selected projected capital flows.

would facilitate the monitoring of the program and allow for an appropriate rephasing of the remaining purchases.

II. Recent Developments Under the Program

Real GNP was virtually unchanged in 1991, reflecting mainly a 14 percent contraction in investment (Table 3). Although the weakness in activity continued in the first half of 1992, recent indications point to an emerging recovery, and achievement of the targeted real GNP growth of 2-3 percent appears within reach. Imports have recently picked up considerably, bank credit to the manufacturing sector has risen significantly, and despite widespread problems with electricity supplies, manufactured exports of garments and electronic products have grown markedly. Mining also showed an upturn, although agricultural activity has been adversely affected by drought in southern regions.

After peaking at about 20 percent in the first quarter of 1991, inflation declined to 13 percent by the end of the year and fell further to an annual rate of around 9 percent in early 1992 (Table 4). 1/ However, over recent months inflation has rebounded to double-digit levels at an annualized rate. While this development reflects, in part, cost-push factors associated with supply difficulties, faster than programmed monetary growth beginning in May was also a factor.

The National Government budget deficit narrowed sharply to 2.1 percent of GNP in 1991 from 3.4 percent in 1990. The program for 1992 provides for a further decline to 0.6 percent of GNP, with developments to be monitored by means of a monthly indicative program. During the first half of 1992, the deficit remained within the monthly indicative targets (Table 5). However, there was a sizable shortfall in revenue which was offset by a tight rein on cash expenditures. The revenue shortfall (some 6 percent below the envisaged level) reflected lower-than-projected collections of taxes on international trade, a setback in the sales of government assets, and a delay in foreign grant disbursements. Larger collections from improvements in customs administration were more than offset by the elimination in May 1992 of the 5 percent remaining levy on non-oil imports, two months ahead of schedule. In addition, notwithstanding higher imports, the unexpected strength of the peso contributed to lower custom duties. Government expenditures were held to 6 1/2 percent below the projected level, in part by a cutback in spending on foreign-assisted projects as well as delays in the provision of support for government corporations and local governments.

1/ The index of consumer prices in the Philippines has been revised, based on a 1988 survey, which assigns a larger weight to household expenses and has a widened coverage. As measured by the new index, inflation has generally been somewhat higher than under the old index since 1988.

Table 3. Philippines: Macroeconomic Framework, 1989-92

	1989	1990	1991		1992	
			Program	Actual	Rev. Prog.	Proj.
			(In percent of GNP)			
Foreign saving 1/	3.4	6.1	4.5	2.3	2.9	2.1
National saving	18.7	16.3	14.2	17.5	16.9	17.8
Public 2/	-0.4	-0.3	1.9	2.9	3.4	3.0
Private	18.3	16.6	12.3	14.6	13.5	14.8
Gross domestic investment	22.1	22.4	18.7	19.7	19.8	19.9
Public 3/	4.3	5.3	5.4	5.2	5.7	4.7
Private	17.8	17.1	13.3	14.6	14.1	15.2
Capital transfers from the public to the private sector 4/	0.3	0.5	0.2	0.5	0.3	0.3
Consolidated public sector deficit	-4.5	-5.5	-3.7	-2.8	-2.7	-1.9
			(Percent change)			
Memorandum items:						
Gross capital formation (constant prices)	23.6	5.7	3.6	-14.0	6.4	9.2
Public 3/	30.8	28.4	8.8	-2.8	19.8	-3.7
Private	22.0	0.2	0.3	-15.0	1.7	10.6
Consumption expenditure (constant prices)	5.1	5.7	-1.3	1.4	3.0	3.2
Public 5/	5.6	9.3	1.6	0.5	0.4	4.3
Private 6/	5.0	5.4	-1.6	1.6	3.4	3.1
Domestic demand (constant prices)	8.6	5.7	-0.5	-1.9	2.1	4.4
GNP (constant prices)	5.7	3.9	1-2	--	2-3	2-3
Inflation (end-period) 7/	15.5	16.2	9.5	13.1	7.0	7.0
International reserves (US$ bn.)	2.3	2.0	3.0	4.5	4.7	4.7
(In months of imports)	(1.9)	(1.5)	(2.1)	(3.3)	(3.2)	(3.1)
91-day T-bill rate (period average, in percent)	19.3	23.4	25.0	21.4	20.0	16.6

Sources: Revised national income accounts data provided by the Philippine authorities; and staff estimates.

1/ External current account deficit (+).
2/ Total revenues less current expenditures; the public sector excludes nonmonitored corporations.
3/ Public investment excluding CARP land acquisition and credit.
4/ Includes National Government equity and net lending to nonmonitored corporations, net lending of the social security system, and CARP land acquisition and credit.
5/ National Government current expenditure, excluding interest, subsidies, and OPSF transfers.
6/ Derived as a residual, i.e., includes statistical discrepancy.
7/ Refers to a new consumer price index with 1988 as the base year.

Table 4. Philippines: Recent Developments and Program Objectives, 1989-92

	1989	1990	1991		1992		1992
			Program	Actual	Revised Program	Projection	June Actual
GNP and prices (percent change)							
Real GNP	5.7	4.2	1-2	--	2-3	2-3	0.5 2/
CPI (end-period)	15.5	16.2	9.5	13.1	7.0	7.0	9.2
Public sector (in billions of pesos)							
National Government deficit	-19.6	-37.1	-26.6	-26.3	-9.0	-9.0	3.9
(In percent of GNP)	(-2.1)	(-3.4)	(-2.0)	(-2.1)	(-0.6)	(-0.6)	(...)
Revenue and grants	152.4	180.9	230.8	220.8	263.8	246.0	121.7
Expenditure and net lending	172.0	218.0	257.4	247.1	272.8	255.0	117.8
Unidentified measures	...	...	...	...	...	--	--
Monitored public sector borrowing requirement	-21.2	-50.7	-27.4	-15.8	-21.9	-21.9	1.4 2/
(In percent of GNP)	(-2.3)	(-4.7)	(-2.1)	(-1.3)	(-1.6)	(-1.6)	(...)
Consolidated public sector deficit	-41.0	-59.1	-47.7	-29.2	-37.7	-26.8	2.1 2/
(In percent of GNP)	(-4.5)	(-5.5)	(-3.7)	(-2.3)	(-2.7)	(-1.9)	(...)
Of which: OPSF balance	(--)	(-7.4)	(3.3)	(12.3)	(-2.5)	(3.5)	(5.2)
Money (percent; end-period)							
Base money	35.7	26.3	8.6	14.3	13.2 1/	7.5	13.9
Broad money	25.9	18.8	8.0	14.3	11.7 1/	8.0	11.9
External							
Exports (percent change in dollar value)	10.6	4.7	13.1	8.0	9.8	9.2	8.2 3/
Imports (percent change in dollar value)	27.7	17.2	4.8	-1.3	8.5	14.7	12.1 3/
Terms of trade (percent change)	-3.7	-5.4	-0.4	1.1	2.9	3.2	...
Current account balance							
In billions of dollars	-1.5	-2.7	-2.0	-1.0	-1.4	-1.1	-0.6 3/
In percent of GNP	-3.3	-6.1	-4.5	-2.3	-2.9	-2.1	...
Overall balance (in billions of dollars)	0.5	-0.2	1.1	1.4	1.2	0.9	0.1 3/
Gross official reserves							
In billions of dollars	2.3	2.0	3.0	4.5	4.7	4.7	4.2
In months of imports	1.9	1.5	2.1	3.3	3.2	3.1	3.1
Debt service ratio (in percent, after rescheduling)	27.8	24.8	28.1	22.4	19.7	19.2	...
External debt							
In billions of dollars	27.6	28.5	31.0	30.9	31.7	30.0	...
In percent of GNP	66.0	65.0	70.8	67.8	66.7	58.1	...
Real effective exchange rate vis-a-vis competitors (percent change; end-period)	6.6	-16.0	...	14.1	...	...	5.6

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

1/ Calculated on the basis of estimated data for end-December 1991.
2/ Estimates
3/ Actual data for 1992 only available through May.

Table 5. Philippines: National Government Cash Budget, 1989-92

	1989	1990	1991 Program	1991 Actual	1992 Rev. Prog.	1992 Proj.	Jan.-June 1992 Program	Jan.-June 1992 Prel.
			(In billions of pesos)					
Revenue and grants	152.4	180.9	230.8	220.8	254.2	246.0	129.2	121.7
Tax revenue	122.5	151.8	204.2	182.0	217.7	214.8	108.1	105.5
Domestic-based taxes	83.6	105.2	118.2	117.1	141.4	141.0	68.2	68.8
International trade taxes	38.9	46.6	86.0	64.9	76.3	73.8	39.9	36.7
Nontax revenue (including ESF)	29.9	29.1	26.6	38.8	36.5	31.2	21.1	16.2
Total expenditure and net lending	172.0	218.0	257.4	247.1	263.2	255.0	126.0	117.8
Current operating expenditure	142.8	178.0	206.4	195.8	224.7	222.3	...	...
Of which:								
Personnel services	(51.4)	(62.2)	(71.6)	(72.8)	(74.2)	(74.2)	(...)	(...)
Maintenance and operations	(26.8)	(30.2)	(35.6)	(36.2)	(37.3)	(37.3)	(...)	(...)
Interest payments	(54.7)	(71.1)	(83.4)	(74.7)	(83.8)	(82.9)	(43.2)	(40.6)
Domestic	(41.0)	(53.3)	(63.3)	(56.3)	(59.9)	(62.0)	(32.1)	(32.3)
External	(13.8)	(17.8)	(20.1)	(18.4)	(23.9)	(20.9)	(11.1)	(8.3)
Subsidies	(6.5)	(5.2)	(4.1)	(6.2)	(6.1)	(4.6)	(2.9)	(1.8)
Of which: Tax expenditure	(0.9)	(2.2)	(--)	(1.9)	(...)	(...)	(0.7)	(1.6)
Transfer to OPSF	(--)	(4.6)	(5.5)	(--)	(--)	(--)	(--)	(--)
Capital expenditure and net lending	29.2	40.0	51.0	51.3	38.5	32.7	...	...
Capital expenditure 1/	22.6	31.7	44.5	41.5	37.4	31.6	...	...
Equity and net lending 2/	6.6	8.3	6.5	9.8	1.1	1.1	-8.2	-8.7
Of which:								
To monitored public corporations	(4.2)	(5.1)	(3.6)	(6.4)	(4.0)	(...)	(0.7)	(1.1)
Assistance to GFIs	(-0.1)	(0.1)	(0.2)	(0.1)	(--)	(...)	(-0.7)	(-0.3)
Unidentified measures	...	...	...	...	...	...	...	...
Deficit (-)	-19.6	-37.1	-26.6	-26.3	-9.0	-9.0	3.2	3.9
			(In percent of GNP)					
Memorandum items:								
Revenue and grants	16.7	16.8	17.7	17.5	18.2	17.6		
Tax revenue	13.4	14.1	15.7	14.5	15.5	15.4		
Total expenditure and net lending	18.9	20.2	19.8	19.6	18.8	18.3		
Of which:								
Personnel services	5.6	5.8	5.5	5.8	5.3	5.3		
Maintenance and operations	2.9	2.8	2.7	2.9	2.7	2.7		
Interest payments	6.0	6.6	6.4	5.9	6.0	5.9		
Capital expenditure 1/	2.5	2.9	3.4	3.3	2.7	2.3		
Deficit (-)	-2.1	-3.4	-2.0	-2.1	-0.6	-0.6		

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

1/ Including capital transfers to local government units (LGUs), but excluding the transfers on land acquisition and credit in connection with the Comprehensive Agricultural Reform Program (CARP), which are part of equity and net lending. Beginning in 1992, all transfers to LGUs are included in current expenditure in line with the provisions of the new Local Government Code.

2/ In 1992 includes receipts of P9.6 billion from privatization of Philippine Airlines as a reduction in equity.

Following a substantial strengthening in 1991, the surplus in the Oil Price Stabilization Fund (OPSF) rose by P 5 billion in the first half of 1992, compared to a drawdown of P 1.3 billion envisaged under the program. Notwithstanding the lowering of domestic petroleum product prices in April and again in May, this more favorable development reflected lower-than-projected world oil prices and the stronger peso. The deficit of the nonfinancial Government Corporations has remained broadly in line with the program projections, due to a considerable extent to delays and cutbacks in their investment outlays. Nevertheless, the finances of several key corporations remain fundamentally weak. During 1992, the National Power Corporation (NPC) has continued to experience difficulties. There has been a shortfall in operating receipts, reflecting a fall in sales because of frequent power outages and the delay in implementing tariff increases in Mindanao where drought has severely affected supply. In other regions, a part of the tariff increase implemented in early 1992 was rolled back in May following a reduction in fuel oil prices. Despite the reduction in fuel prices, total operating costs were higher because the drought induced a shift from hydro-electric to more expensive forms of generation. The overall financial position of NPC, however, was held close to the program level for the first six months by cutbacks in investment and the postponement of interest payments to the National Government.

The public sector borrowing requirement (PSBR), which narrowed sharply to 1.3 percent of GNP in 1991 (Table 6), remained within the program ceiling in March and June 1992, and is expected to remain below the ceiling also in September 1992. In addition, the stronger peso and lower interest rates, combined with stepped up sales of Treasury bills, contributed to smaller-than-expected Central Bank operating losses. The Central Bank also unwound all $966 million in outstanding swaps and associated blocked peso accounts with domestic banks, and extinguished some $600 million of its external bank debt in the buyback completed in May, both of which contributed to interest savings. In all, the overall deficit of the consolidated public sector, which declined abruptly in 1991 to 2.3 percent of GNP, is estimated to have registered a small surplus in the first half of 1992 instead of a deficit as projected.

Following persistent excesses during the final three quarters of 1991, base money was kept consistently below the indicative monthly targets during the first four months of 1992 under difficult circumstances (Table 7 and Chart 1). Large foreign exchange inflows, which had complicated monetary management in 1991, continued during this period, with the Central Bank intervening to purchase exchange equivalent to a further 8 percent of broad money (or 46 percent of currency in circulation). At the same time, sizable maturities of short-term Central Bank bills issued as part of the monetary control efforts in late 1991 had to be absorbed. The liquidity impact of these operations was successfully sterilized through large-scale issues of government securities, including medium-term floating rate notes. Despite the magnitude of these operations, interest rates continued on the declining trend initiated in 1991, reflecting largely the deceleration of inflation.

Table 6. Philippines: Consolidated Public Sector Deficit, 1989-92

	1989	1990	1991 Program	1991 Actual	1992 Revised Program	1992 Projection
			(In billions of pesos)			
Consolidated public sector deficit	-41.0	-59.1	-47.8	-29.2	-37.7	-26.8
Monitored public sector borrowing requirement (PSBR)	-21.2	-50.7	-27.4	-15.8	-21.9	-21.9
National Government deficit	-19.6	-37.1	-26.6	-26.3	-9.0	-9.0
Monitored corporations' deficit	-4.4	-19.1	-13.2	-8.7	-14.4	-17.7
OPSF deficit 1/	--	-7.4	3.3	12.3	-2.5	3.5
Adjustments for intra-PSBR transfers 2/	2.8	12.9	9.1	6.9	4.0	1.3
OPSF deficit 1/	-9.0	...	...	...	...	...
Surplus of government financial institutions (GFIs) 3/	3.3	1.8	3.1	1.1	3.2	3.2
Net income of the Central Bank 4/	-20.8	-21.9	-32.0	-22.7	-28.6	-17.7
Other 5/	4.2	11.6	8.3	8.1	9.5	9.5
Adjustments for other transfers within the public sector 6/	2.5	0.1	0.2	--	0.1	0.1
			(In percent of GNP)			
Consolidated public sector deficit	-4.5	-5.5	-3.7	-2.3	-2.7	-1.9
PSBR	-2.2	-4.7	-2.1	-1.3	-1.6	-1.6
National Government deficit	-2.1	-3.4	-2.0	-2.1	-0.6	-0.6
Monitored corporations' deficit	-0.5	-1.8	-0.9	-0.7	-1.0	-1.3

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

1/ Consolidated with the PSBR beginning in 1990.

2/ Includes adjustments for net lending for debt buybacks, National Government (NG) net lending and equity to monitored corporations, NG transfers to the OPSF, and OPSF settlement of arrears included in Philippines National Oil Company (PNOC) cash generation, and unresolved payments.

3/ Philippine National Bank (PNB), Development Bank of the Philippines (DBP), the Philippine Export and Foreign Loan Guarantee Corporation (Philguarantee), and the Land Bank.

4/ Net of the impact of debt reduction, estimated at P 1.9 billion in 1990, P 2.1 billion in 1991, and P 2.3 billion in 1992

5/ Includes the Local Government Units (LGUs) and the social security institutions.

6/ Includes NG net lending and equity to GFIs and adjustments for OPSF deficits covered by PNOC before 1990.

Table 7. Philippines: Base Money Program and Developments, 1991-92 1/

(In billions of pesos)

	Actual 1991				Actual 1992							Program 1992	
	March	June	Sept.	Dec.	Jan.	Feb.	March	April	May	June	July	Sept.	Dec.
Base money ceiling 2/													
Program	117.4	116.8	114.5	133.6	134.3	131.9	131.5	135.8	134.1	129.5	128.5	128.5	151.2
Actual	117.1	120.7	116.3	135.4	127.5	128.0	131.0	135.6	142.0	133.9	129.7	...	...
Base money (end-period)	118.8	122.1	117.8	140.6	129.1	130.3	133.0	136.5	143.5	139.1	132.3		
(12-month change in percent)	(31.9)	(29.6)	(19.1)	(14.3)	(4.8)	(11.7	(12.0)	(13.6)	(16.7)	(13.9)	(8.8)		
Less: Reserve-eligible securities	4.5	4.5	4.5	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4		
Reserve deficiency	4.0	6.4	--	6.8	2.2	1.6	--	1.3	--	--	4.7		
Reserve money (end-period)	110.3	111.2	113.2	129.4	122.5	124.3	128.6	131.0	139.1	134.7	123.2	121.5	143.7
Net international reserves of the monetary authority	-1.1	18.9	21.6	39.1	45.6	53.6	61.9	52.2	37.9	38.6	39.9	45.0	52.2
Medium- and long-term foreign liabilities 3/	-89.6	-86.9	-85.9	-84.7	-83.6	-82.7	-80.0	-79.0	-68.3	-67.7	-67.8	-74.1	-71.1
Net domestic assets	201.0	179.2	177.5	175.0	160.5	153.4	146.7	157.8	169.5	163.8	151.1	150.6	162.6
Credit to the public sector	-36.6	-58.5	-58.0	-48.7	-59.3	-81.4	-107.2	-102.3	-89.1	-97.5	-106.7	-43.8	-43.4
Of which: National Government (net)	-42.6	-64.5	-63.7	-54.5	-65.0	-87.1	-110.7	-105.7	-92.6	-101.0	-110.2	-51.8	-51.4
Of which: Deposits (-) 4/	-67.7	-75.6	-74.6	-64.7	-75.2	-99.4	-124.8	-121.5	-122.5	-132.6	-143.9	-76.7	-78.8
Assistance to financial institutions	14.8	14.8	14.7	14.5	14.5	14.5	14.6	14.6	14.5	14.5	14.5	14.2	14.2
Regular rediscounting	10.5	10.1	10.0	9.7	8.9	8.0	7.4	7.2	7.6	7.4	7.2	8.3	8.3
Central Bank securities (net)	-6.3	-21.2	-29.8	-56.0	-65.8	-54.9	-39.3	-38.8	-33.3	-30.6	-37.8	-103.4	-102.1
Other items (net)	218.6	234.1	240.6	255.5	262.2	267.2	271.2	277.1	269.8	270.0	273.9	275.3	285.6
Of which: Revaluation	66.3	77.6	80.5	92.0	95.4	99.4	103.3	99.6	99.4	100.5	...	101.7	103.1

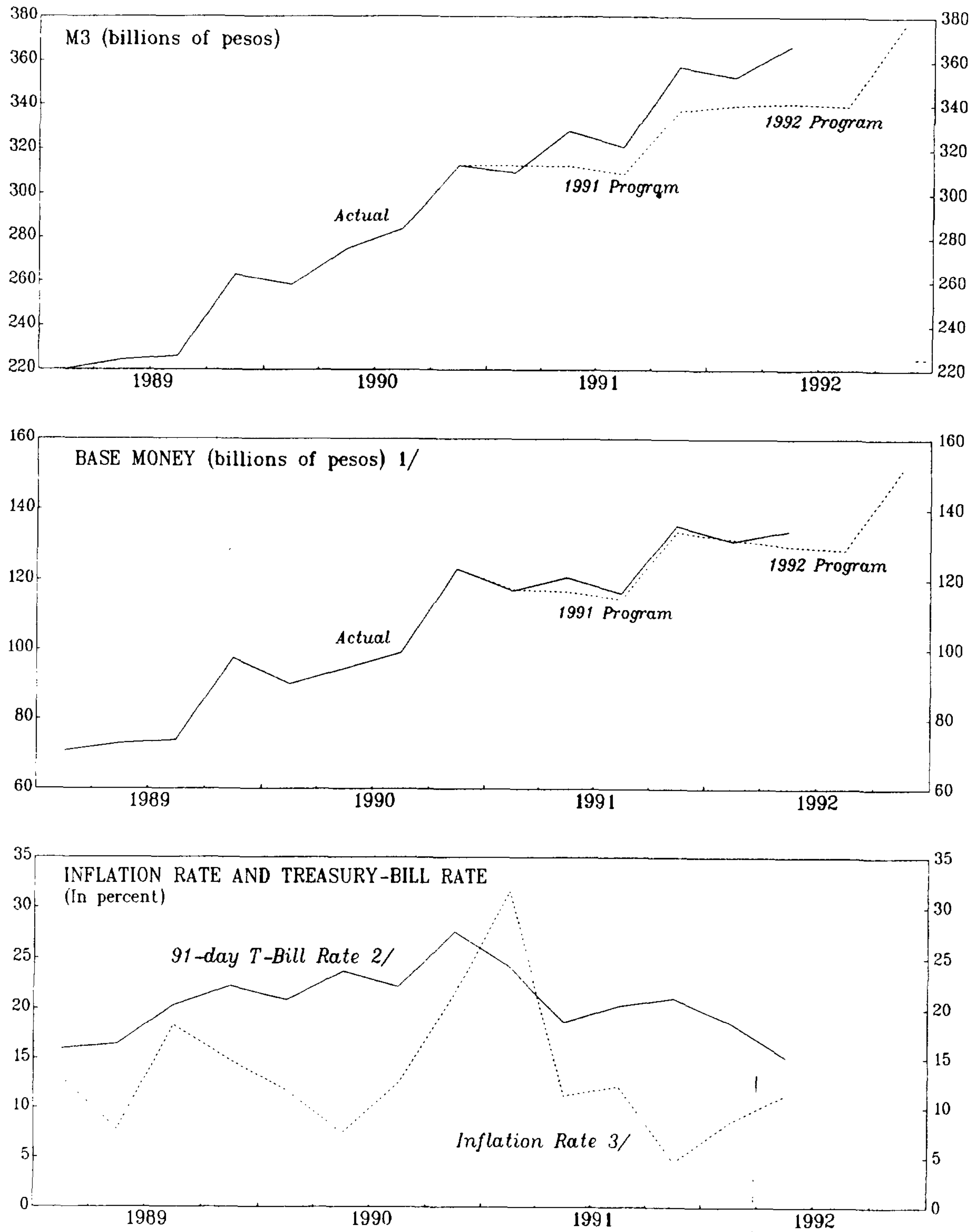
Sources: Data provided by the Philippine authorities; and staff estimates.

1/ Foreign assets and liabilities are converted into pesos at a constant exchange rate of P 18.002 per U.S. dollar.
2/ Refers to the average of the ten-day test period.
3/ Includes liabilities assumed under debt restructuring agreements.
4/ Increase in deposits reflects the sale of treasury securities beyond the National Government's own financing needs. The 1992 program requires an additional build-up of the non-interest bearing deposits of P 16.0 billion by year-end.

CHART 1

PHILIPPINES

MONETARY DEVELOPMENTS AND INTEREST RATES, 1989-92



Sources: Data provided by the Philippine authorities; and staff estimates.
1/ Actual and program figures for 1991 refer to the average of the 10-day test period.
2/ Nominal rate in percent, 3-month period average.
3/ 3-month average CPI, annualized percentage change.

Base money rose to a level above the program path beginning in May 1992 as the national election campaign reached its final stages. The base money targets in May-June were exceeded by 3-6 percent. Moreover, the growth of broad money (M3), which had fallen from near 20 percent in the first half of 1991 to single digit rates by the beginning of the year, rose again to 12 percent in the 12 months to June (Table 8), about twice the rate envisaged under the program. Interest rates continued to decline, reaching a low of 14 1/2 percent in June. Moreover, the growth of bank credit to the private sector rose to 19 percent, about double the rate earlier in the year. However, beginning in July, the authorities initiated action to tighten monetary policy with the aim of bringing base money back to the program path.

The balance of payments strengthened substantially in 1991, with the current account deficit narrowing to about 2 1/2 percent of GNP from 6 percent in 1990 (Table 9). Balance of payments developments have continued to be favorable in 1992. Export growth of 8 percent in 1991 was sustained in the first five months of 1992, while imports rose by 12 percent following a 1 percent decline in 1991. Although agricultural exports have been reduced because of drought, manufactured exports have shown strong growth. Despite the widening of the trade deficit, the current account deficit continued to narrow as a result of lower international interest rates and higher service receipts. With increased foreign investments, and short-term inflows associated with interest rate differentials favoring peso investments, the overall balance of payments has remained in surplus in 1992. Disbursements of multilateral and bilateral assistance so far in 1992 have been as projected. International reserves, which increased by $2.5 billion in 1991, rose by a further $1 billion to $5.4 billion in March 1992. The unwinding of outstanding swaps and the debt buyback in May have since lowered reserves to $4.1 billion in June, equivalent to about 3 months of imports.

The strengthening of the external accounts was associated with sustained upward pressure on the peso in 1991 and 1992. Despite substantial intervention, the peso appreciated by 13.6 percent over the course of 1991 and by a further 5.6 percent in the first half of 1992 in real effective terms (Chart 2).

III. Report on the Policy Discussions

The discussions focused primarily on the developments in implementing policies in 1992 aimed at consolidating the progress made in the first year of the program in stabilizing the economy. The discussions took place against the background of national elections in May and the first peaceful political transition in more than two decades at the end of June. In this environment the options for policy actions have, understandably, been limited. The authorities have, therefore, exerted considerable efforts to ensure that a cautious approach has been sustained so as to avoid undue deviations from the program that would require difficult corrective policy actions. As set forth in the attached letter and Memorandum of Economic

Table 8. Philippines: Monetary Survey, 1988-92 1/

	1988 Dec.	1989 Dec.	1990 Dec.	1991 Dec.	1991 June	1992 June	1992 Prog.	1992 Proj.
	(In billions of pesos, end of period)							
Total liquidity	221.4	275.8	333.7	372.4	340.4	385.3	396.8	402.0
Of which: M3	209.1	263.2	312.6	357.3	328.0	367.0	377.0	386.0
Currency	40.6	52.8	61.9	69.4	53.6	62.3	75.2	75.2
Net foreign assets	-137.4	-130.0	-171.7	-105.9	-128.4	-76.3	-80.0	-46.8
Net international reserves	-21.5	-13.2	-21.0	18.2	8.7	10.5	59.9	38.7
Medium- and long-term foreign liabilities	-109.5	-108.8	-137.2	-118.3	-127.4	-89.0	-130.3	-87.8
Other	-6.4	-8.0	-13.5	-5.8	-9.7	2.3	-9.5	2.3
Net domestic assets	358.8	405.8	505.4	478.3	468.8	461.5	476.8	448.8
Public sector credit (net)	-4.9	-0.9	9.5	-11.9	-9.9	-50.3	-59.3	-72.3
Credit to Government	-27.1	-25.7	-21.0	-41.4	-38.3	-77.4	-91.9	-105.0
Other	22.2	24.8	30.5	29.6	28.3	27.0	32.7	32.7
Private sector credit	185.5	218.4	270.4	284.4	261.7	311.5	311.6	314.8
Other items (net)	178.2	188.3	225.5	205.8	217.1	200.4	224.6	206.3
	(12-month change, in percent)							
M3	23.1	25.9	18.7	14.3	19.3	11.9	11.7 2/	8.0
Net foreign assets	10.6	5.4	-32.1	38.3	6.3	40.6	48.8 2/	55.8
Net domestic assets	7.0	13.1	24.6	-5.4	10.8	-1.6	-6.4 2/	-6.2
Private sector credit	13.6	17.7	23.8	5.2	10.9	19.0	9.6 2/	10.7
	(As percent of GNP)							
M3	26.3	28.8	29.0	28.5	26.1	26.3	27.0	27.6
Currency	5.1	5.8	5.8	5.5	4.3	4.5	5.4	5.4
Net foreign assets	-17.3	-14.2	-15.9	-8.4	-10.2	-5.5	-5.7	-3.4
Net domestic assets	45.1	44.4	46.9	38.1	37.4	33.0	34.1	31.8
Public sector credit (net)	-0.6	-0.1	0.9	-0.9	-0.8	-3.6	-4.2	-5.5
Private sector credit	23.3	23.9	25.1	22.7	20.9	22.3	22.3	22.5
Memorandum items:								
Currency/deposit ratio	0.241	0.251	0.247	0.241	0.195	0.204	0.249	0.242
Base money multiplier	2.913	2.702	2.541	2.541	2.686	2.766	2.493	2.553
91-day T-bill rate (end-period, in percent)	17.3	19.6	30.1	20.5	17.6	15.2	20.0	...
BAP average lending rate (in percent)	16.6	23.8	28.1	23.8	20.8	19.4	...	...

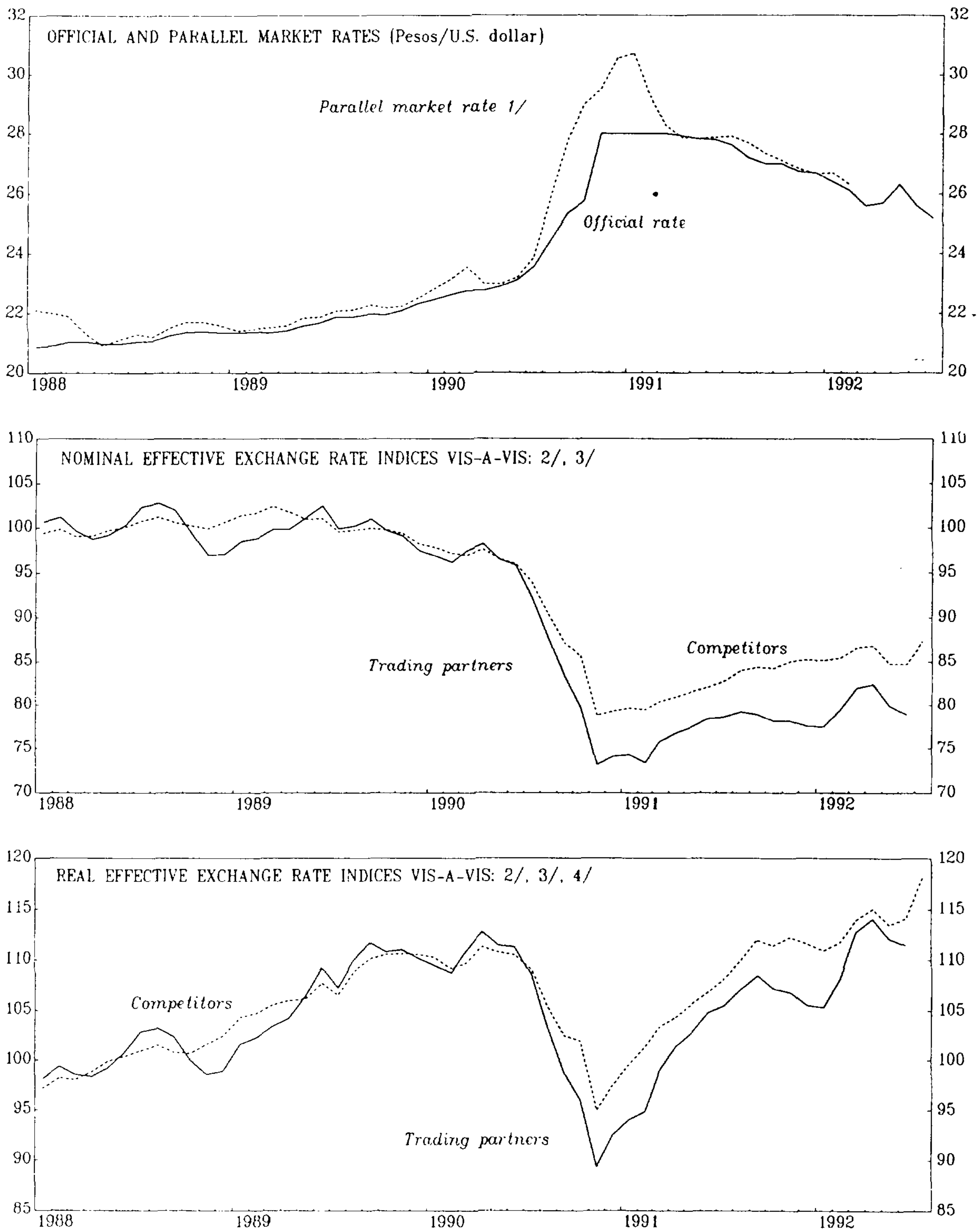
Sources: Data provided by the Philippine authorities; and staff estimates.

1/ Foreign assets and liabilities are converted into pesos at end-period exchange rates.
2/ Based on estimated data for December 1991.

CHART 2

PHILIPPINES

EXCHANGE RATE INDICATORS, 1988-92



Sources: Information Notice System; and staff estimates.

1/ The parallel market was suspended following the exchange market liberalization in early 1992.

2/ Upward movement indicates appreciation of the Peso; 1988=100.

3/ The competitor countries included in the index are Indonesia, Malaysia and Thailand, with weights determined by the average value of each country's non-oil merchandise exports during the period 1983-87.

4/ Relative consumer prices.

Table 9. Philippines: Balance of Payments, 1989-92

(In millions of U.S. dollars)

	1989	1990	1991 Program	1991 Actual	1992 Revised Program	1992 Projection	1991 January - May	1992 January - May
Trade balance	-2,598	-4,020	-3,455	-3,211	-3,477	-4,165	-1,563	-1,889
Exports, f.o.b.	7,821	8,186	9,260	8,840	9,668	9,655	3,439	3,720
Imports, f.o.b.	10,419	12,206	12,715	12,051	13,145	13,820	5,002	5,609
Of which: Oil and oil products	(1,358)	(1,806)	(1,868)	(1,719)	(1,551)	(1,906)	(771)	(814)
Services and transfers (net)	1,142	1,325	1,477	2,178	2,099	3,023	902	1,333
Services (net)	312	611	737	1,351	1,186	2,115	512	961
Receipts	(4,586)	(4,842)	(5,278)	(5,624)	(5,862)	(6,653)	(2,227)	(2,865)
Interest payments	(2,411)	(2,154)	(2,273)	(2,157)	(2,022)	(1,867)	(886)	(841)
Other payments	(1,863)	(2,077)	(2,268)	(2,116)	(2,654)	(2,671)	(829)	(1,063)
Transfers (net)	830	714	740	827	913	908	390	372
Current account	-1,456	-2,695	-1,978	-1,033	-1,378	-1,142	-661	-556
(In percent of GNP)	(-3.5)	(-6.1)	(-4.5)	(-2.3)	(-2.9)	(-2.1)	(...)	(...)
Capital account	550	827	964	825	813	474	895	41
MLT loans	-753	-458	-185	-427	-566	-1,078	-100	-840
Inflows	(1,440)	(2,638)	(2,533)	(2,000)	(2,059)	(2,256)	(933)	(802)
Multilateral	671	987	1,004	686	733	777	...	...
Bilateral	653	773	1,255	962	1,085	1,152	...	...
Commercial banks	--	565	115	110	--	--	...	...
Other	116	313	159	242	241	372	...	...
Outflows	(2,193)	(3,096)	(2,718)	(2,427)	(2,625)	(3,334)	(1,033)	(1,642)
Multilateral	354	378	332	389	373	467	...	...
Bilateral	531	505	699	736	855	972	...	...
Commercial banks 1/	1,119	1,972	1,442	1,129	1,246	1,716	...	...
Other	189	241	245	173	151	179	...	...
Foreign investment (net)	843	480	737	654	870	1,009	333	425
Debt conversion	(306)	(226)	(490)	(273)	(486)	(313)	(138)	(118)
Other	(537)	(254)	(247)	(381)	(384)	(696)	(195)	(307)
Short-term capital (net)	-89	19	172	369	252	427	307	430
Other	549	786	240	229	257	116	355	26
Rescheduling 2/	1,357	1,683	1,202	1,613	1,730	1,695	499	602
Paris Club III	588	610	272	293	--	--	...	...
Paris Club IV	...	...	...	514	1,018	1,007	...	...
Commercial banks	769	1,073	930	806	712	688	...	...
Financing gap	--	--	872	--	--	--	...	...
Net international reserves (- increase)	-451	185	-1,060	-1,405	-1,165	-1,027	-733	-87
Assets (- increase)	-550	106	-1,223	-2,252	-1,098	-595	...	...
Of which: Central Bank	(-265)	(331)	(-1,036)	(-2,477)	(-329)	(-292)	...	...
Liabilities (- reduction)	99	80	163	847	-67	-432	...	...
Of which:								
Fund credit (net)	(126)	(-336)	(307)	(180)	(38)	(54)	...	...
Purchases	303	--	606	474	187	199	...	...
Repurchases	-177	-336	-299	-294	-149	-145	...	...
Memorandum items:								
Gross official reserves	2,324	1,993	3,035	4,470	4,681	4,762	...	...
(In months of imports)	1.9	1.5	2.1	3.3	3.2	3.1	...	...
External debt outstanding	27,616	28,549	30,982	29,956	31,713	30,086	...	...
(In percent of GNP)	66.0	64.4	70.8	65.7	66.7	56.1	...	...
Debt service ratio 3/								
Before rescheduling	38.5	37.7	36.4	33.7	30.9	28.8	...	...
After rescheduling	27.6	24.8	28.1	22.6	19.7	18.4	...	...
Interest due in percent of GNP	5.8	4.9	5.2	4.7	4.3	3.5	...	...

Sources: Central Bank; and staff estimates.

1/ Includes cash payments for buyback of $671 million in 1990 and $656 million in 1992.
2/ Excludes rescheduling of maturing monetary liabilities.
3/ Debt service as a percent of exports of goods and services; includes cash value of repayments related to debt conversions, but excludes payments related to 1990 and 1992 buybacks.

Policies, the new administration of President Ramos has publicly affirmed its intention to continue with the economic stabilization program supported by the stand-by arrangement. In this regard, the authorities have pledged to undertake policy measures as needed to achieve the objectives of the program.

The 1992 program was outlined in detail in EBS/92/24 and discussed by Directors on March 4, 1992 in the context of the first program review under the stand-by arrangement. The main objectives of the 1992 program are reducing inflation to 7 percent by year-end, holding the external current account deficit to below 3 percent of GNP, and maintaining gross reserves at the equivalent of 3 months of imports while accommodating a gradual recovery in economic growth. The cornerstone of the program continues to be a strengthening of public finances, which is to be enhanced by further steps in structural reforms. Monetary policy is geared towards reducing inflation and sustaining the improvement in the balance of payments. In light of the uncertain circumstances, the program provides for close monitoring, and in addition to the performance criteria, includes indicative monthly targets for the National Government budget deficit and base money.

1. Public finances

Notwithstanding the uncertainties surrounding the period of political transition, the authorities have made determined efforts to keep overall public finances in line with the program path. This task has been made more difficult by a sizable shortfall in government revenue. Until now, this shortfall has been matched by a sharp cut in spending. The incidence of expenditure cuts has fallen heavily on development spending, including foreign assisted projects, as well as some other categories of spending where restraint may be difficult to sustain in the second half of the year. Although unavoidable in the circumstances, the cutback in capital expenditure has set back efforts to build and maintain infrastructure central to economic growth and development over the medium-term.

Nevertheless, the authorities believe that, with efforts to improve revenue performance and the continuation of a cautious spending policy, the prospects for achieving the program targets for 1992 as a whole are favorable. Indeed, the authorities expect that, with a concerted effort on their part, the shortfall in revenues experienced in the first half of 1992 will not continue in the second semester. With the better-than-envisaged developments in the finances of the OPSF and reduced operating losses of the Central Bank, the PSBR target of 1.6 percent of GNP appears within reach and the consolidated public sector deficit now seems likely to be held to less than 2 percent of GNP in 1992, compared with a target of 2.7 percent under the program.

The authorities have affirmed that fiscal policy will be oriented toward the primary goal of remaining within the PSBR ceiling. In view of the unexpectedly large surplus of the OPSF, there may be room for relaxing somewhat the constraint on budgetary spending in the final months of 1992 and to allow some investment spending, held back thus far, to proceed.

However, it is premature at this stage to allow any such relaxation. While on present projections the OPSF would end the year with an unexpectedly large surplus, the extent of the surplus is uncertain because of unresolved legal claims by oil companies and the possibility of higher-than-expected international oil prices. Moreover, there are significant risks regarding the financial situation of the public corporations for the year as a whole, and present estimates point to a somewhat weaker performance than originally projected.

As set out in the attached Memorandum on Economic Policies, steps to strengthen revenues will include an acceleration of efforts to raise tax collection through the tax administration reform programs, being implemented with technical assistance from the Fiscal Affairs Department. Furthermore, the Ramos administration intends to work with Congress on a legislative agenda aimed at raising revenue on a sustained basis. These measures include those not acted upon before the expiration of the last Congress, but there are also new bills to raise excise taxes, reform the VAT, and increase user fees and charges. The Government intends to work vigorously to have passed into law legislation setting up the large taxpayers unit and removing filing requirements for all single source income earners subject to final withholding; such legislation was acted upon in the final session of the last Congress but did not become law (in the case of the former) or included provisions which nullified the objective of the measure (in the case of the latter). While these tax measures would largely yield benefits for 1993 and the following years, some contribution to 1992 may also be expected. The Government also anticipates that recent improvements in customs administration and valuation will largely reverse the shortfall in trade taxes in the first half of 1992. In addition, the Government is to ensure that further sales of shares in the Philippine National Bank that have been planned, will be effected as soon as possible and that sales of other state-owned assets, which have been held up by administrative delays, are accelerated.

In implementing the budget in the remainder of 1992, the Government is determined to continue keeping a tight rein on monthly cash expenditure authorizations, a mechanism that has succeeded in keeping overall fiscal performance in line with the program path so far this year. The new Local Government Code implemented in 1992 devolves to local government units (LGU) the responsibility for certain programs, matched by an equivalent transfer of revenues. Care will be needed to ensure that the devolution does not lead to higher expenditure or a deterioration in the quality of services provided. In this regard, it is imperative that an adequate system for monitoring the financial operations of LGUs be put in place.

Among the public corporations, the weak position of the National Power Corporation is a continuing concern. Because of delays in approving appropriate tariff increases in recent years, NPC has had difficulties in carrying out adequate maintenance and financing new power plants to meet rising demand. The weakness in NPC's financial situation has been compounded by a drought in the south that has reduced its hydro-generation capacity and by the frequent power outages brought about by equipment failure. Current estimates indicate that NPC's targeted 6 percent return on rate base for

1992 (previously agreed under financial covenants with external creditors, including the World Bank) will not be met. Moreover, an overall cash deficit will only be avoided by cutting back on planned investments.

The Government agrees that action is needed to strengthen the financial position of NPC and thereby help restore reliability in energy supply, which is crucial for sustained recovery. The authorities are working to prepare an Energy Sector Action Plan which includes, as an important element, a review of energy pricing policies covering the deregulation of oil prices and the establishment of an automatic electricity price adjustment mechanism. The Government recognizes the need for increasing electricity tariffs, and the magnitude and timing of an increase designed to set NPC's finances on a firm basis in 1993 are to be established in conjunction with the staffs of the World Bank and the Fund.

Information provided by the authorities indicates that Government subsidies are being gradually phased out and represent less than 2 percent of total Government expenditures. Military outlays are estimated to amount to about 7 percent of total expenditures in 1992 (or 1 1/2 percent of GNP). It is expected that the closure of U.S. military bases and the withdrawal of U.S. forces, that in the past have provided supplies, equipment, and training to the Philippines armed forces, will have budgetary implications. However, the Government is not yet in a position to provide estimates of the possible impact on military outlays.

Poverty remains a formidable problem, particularly in rural areas, and the incidence of poverty has remained high during the last two decades. Recent developments, such as the reduction in inflation and large inflows of worker remittances are believed to have had a positive impact on the incomes of the urban and rural poor, although the closure of U.S. bases and the impact of natural disasters has had a negative impact in some regions. The share of expenditure on social services has remained at around 4 1/2 percent; ongoing policies to alleviate poverty include, inter alia, the Comprehensive Agrarian Reform Program (CARP), infrastructural projects for poor communities, and improvements in education and the delivery of basic health services. The authorities have been aiming to accelerate the implementation of social safety net programs in 1992, concentrating particularly in rural areas, but in view of resource constraints, progress is likely to be limited.

2. Monetary policy

As in 1991, the persistence of large foreign exchange inflows, particularly in the initial months of 1992, posed a difficult challenge for the authorities in the conduct of monetary policy. Nevertheless, during the first four months of the year, the authorities were successful in striking an appropriate balance in policies by keeping monetary growth well within the program path while at the same time avoiding an excessive appreciation of the peso. During this period domestic interest rates also declined. However, in the period surrounding the elections this delicate balance in policies was not sustained; the monetary targets were exceeded even as foreign exchange inflows eased, and interest rates continued their downward trend despite a resurgence of inflation.

Following the rebound in inflation, an upturn in private credit expansion, and a surge in imports the authorities recognized the need for a tightening of policy in order to return monetary aggregates to the program path. Interest rates rose by 1 percentage point in July and by a further 1 1/2 percentage points in the final week of August. Also in late August, the authorities increased the target level of weekly Treasury bill issues at auction from P 8 billion to P 10 billion. These actions led to positive results and base money targets were brought close to the program level.

The authorities are prepared to continue taking actions as needed to ensure that the monetary targets for September and subsequent months are met, including allowing interest rates to rise to the extent needed to absorb excess liquidity. A small measure of flexibility has been agreed to for August because the extent of the adjustment required in the balance sheet of banks may require some time to bring about. Data for August indicate that reserve money was held to the program level. Based on the strength of their actions and the most recent data, the authorities' aim of meeting the performance criterion on base money for end-September would appear to be within reach.

The use of larger than programmed issues of Treasury bills, the unwinding of outstanding swaps, external debt restructuring, the stronger peso, and lower interest rates have all contributed to smaller operating losses for the Central Bank in 1992; Central Bank losses are currently projected to be P 18 billion, compared with P 28.5 billion in the program. The authorities recognized, however, that a sustained effort to eliminate the losses of the Central Bank is needed as part of efforts to strengthen the underlying fiscal position and improve the flexibility of monetary policy. They are currently considering alternative strategies towards restoring financial solvency to the Central Bank with the active assistance of the staffs of the Fund and the World Bank.

3. External policies

Based on performance so far, the balance of payments in 1992 is likely to be considerably stronger than earlier envisaged (Table 9). Revised projections indicate that the current account deficit will narrow to just over 2 percent of GNP, compared with almost 3 percent projected in the program. Despite the use of $1.4 billion for the unwinding of swaps and the buyback of commercial bank debt, gross reserves are expected to be somewhat higher at the end of 1992 than originally envisaged. The reserve position has been boosted by large foreign exchange inflows associated with a return of confidence in the economy following the peaceful political transition, and a favorable response to the liberalization of the exchange and trade system, and the new foreign investment law. Foreign investment flows, particularly of portfolio investment, are projected to be 15 percent higher than the program and about 50 percent larger than in 1991.

Considerable progress has been made in completing financing arrangements with external creditors. The authorities have completed most bilateral agreements with Paris Club creditors under the rescheduling agreed in June 1991 covering eligible debt obligations falling due up to the end of 1992. Also, on July 24, 1992, the Philippines signed a new debt restructuring agreement with commercial banks involving debt and debt service reduction, and covering $4.7 billion of loans. A buyback covering debt with a face value of $1.3 billion was completed at a cost of $656 million on May 14, 1992 (Annex VI).

The authorities are aiming to conclude the commercial bank debt operation following completion of the current review under the stand-by arrangement. In their discussions with the banks, the authorities are seeking to include in the final documentation clarifying language acceptable to the Fund distinguishing voluntary prepayments from Fund repurchases pursuant to expectations or obligations. They have provided an undertaking to the Fund not to proceed with the debt deal unless such language is included. The financing package signed with the banks provides for the inclusion of acceptable clarifying language if parties to a similar transaction with another country agree to insert equivalent language in documentation for that transaction. However, the authorities have expressed an understandable concern regarding the risk that difficulties in the banks' dealings with other debtors might jeopardize the Philippines' debt package.

The Government is continuing its efforts to obtain financial assistance from multilateral and bilateral sources for meeting the cost of enhancements for this debt package. In this connection, the establishment of a track record of performance under the stand-by program would provide a basis for support from the international financial community. Contrary to earlier expectations, it is not planned to pursue a request for augmentation of the present stand-by arrangement. However, the authorities are requesting the purchase of the set-aside amounts already accumulated to assist in the replenishment of reserves in connection with the debt buyback completed in May.

The finalization of the July debt operation would represent a major step forward in the normalization of the Philippines' relationship with commercial creditors and should help foster the Philippines' access to spontaneous capital flows. In this connection, the Government has announced intentions to cautiously re-enter international financial markets, and plans are being developed to issue $100 million of bonds in the market in early 1993.

Upward pressure on the peso has continued in 1992. The peso appreciated by 4 percent against the U.S. dollar in the first half of 1992, although in nominal effective terms the appreciation was limited to 1.7 percent. The authorities are concerned about the possible adverse effects of the appreciation on the export sector; although export performance has remained relatively strong, there are indications that export profitability has weakened. The recent appreciation has been market driven, and is associated with relatively high domestic interest rates and the rebound in confidence. In time, the successful implementation of policies would lower inflation, which would be expected to allow the downward trend in interest rates to resume, and thus, reverse one of the factors behind the recent strengthening of the peso. More fundamentally, the re-establishment of reasonable price stability would lead to a narrowing of the inflation differentials with trading partners that have been the root cause of pressures on competitiveness.

The authorities have undertaken major actions to liberalize the exchange system. In January 1992 foreign exchange surrender requirements were reduced, the use of service receipts markedly liberalized, restrictions on service payments eased, and capital transactions liberalized. Off-floor foreign exchange trading by commercial banks was introduced in April, and all trading moved off-floor in August. In September, the authorities moved decisively further by eliminating all restrictions on current account transactions and removing all surrender requirements. Most restrictions on capital transactions have also been eliminated. The liberalization of the exchange system is expected to help reduce transaction costs and give impetus to foreign investment flows. Despite the removal of restrictions on current transactions, the Philippines continues to avail itself of the transitional arrangements of Article XIV. The authorities have indicated the possibility of moving to Article VIII status at a later date.

4. Other structural policies

The authorities have made important progress in implementing other structural measures to reduce distortions and improve efficiency in the economy. A five-point program to improve tax administration is being implemented with technical assistance from the Fund; the program includes measures to provide a unique taxpayer identification system, rationalize collection procedures, eliminate filing requirements for single source incomes subject to final withholding, and establish a special unit to monitor compliance of large taxpayers. Parallel to these measures, an eleven-point program to improve customs administration is being put in place to modernize customs procedures, reduce evasion, and improve valuation methods. New foreign investment legislation was approved in 1991 and clarification of implementing rules and regulations which liberalized entry barriers and registration procedures were issued in April 1992. Consistent with a program agreed with the World Bank, complementary measures, which have been taken in the trade area, include steps to reduce import tariffs and simplify the structure to just four rates (with a few exceptions) so as to reduce average tariff protection to 20 percent by 1995; a schedule to eliminate most remaining quantitative restrictions has also been set.

5. Medium-term balance of payments outlook

The medium-term balance of payments outlook has improved considerably since early 1991, and current projections suggest that external viability could be restored during the current decade (Table 10). For this to materialize, however, it will be essential that the fundamental problems that have hampered development and undermined the balance of payments be

Table 10. Philippines: Medium-Term Balance of Payments Projections, 1992-2000

(In millions of U.S. dollars)

	1992	1993	1994	1995	1996	1997	1998	1999	2000
Trade balance	-4,165	-4,635	-5,410	-5,224	-4,997	-4,739	-4,375	-3,862	-2,890
Exports	9,655	10,789	12,184	13,995	16,147	18,544	21,269	24,383	28,219
Imports 1/	13,820	15,423	17,594	19,219	21,144	23,284	25,643	28,245	31,109
Services and transfers (net)	3,023	3,277	3,217	3,257	3,262	3,256	3,200	3,191	3,172
Service receipts	6,653	7,309	7,865	8,364	8,764	9,211	9,663	10,183	10,746
Service payments	4,538	4,998	5,670	6,185	6,640	7,163	7,751	8,375	9,069
Interest	1,867	1,894	2,132	2,248	2,257	2,274	2,283	2,246	2,174
Other	2,671	3,104	3,538	3,937	4,383	4,889	5,468	6,129	6,895
Transfers	908	966	1,022	1,078	1,138	1,208	1,288	1,383	1,495
Current account	-1,142	-1,357	-2,193	-1,966	-1,736	-1,483	-1,174	-671	282
(In percent of GNP)	-2.1	-2.4	-3.6	-3.0	-2.5	-2.0	-1.4	-0.8	0.3
Capital account	474	1,051	1,509	2,232	2,410	2,213	1,957	1,535	1,612
Direct investments	1,009	1,201	1,152	1,170	1,301	1,444	1,600	1,771	1,957
Debt conversion	313	286	102	--	--	--	--	--	--
Other	696	915	1,050	1,170	1,301	1,444	1,600	1,771	1,957
MLT loans	-1,078	-477	-7	670	683	307	-146	-783	-941
Inflows	2,256	2,252	2,713	2,873	2,945	2,826	2,462	2,070	2,146
Outflows	3,334	2,729	2,720	2,203	2,262	2,519	2,608	2,853	3,087
Short-term capital	427	248	282	308	339	373	411	452	498
Other	116	79	82	84	87	89	92	95	98
Rescheduling	1,695	607	478	--	--	--	--	--	--
Paris Club	1,007	--	--	--	--	--	--	--	--
Commercial banks	688	607	478	--	--	--	--	--	--
NIR (increase-)	-1,027	-1,296	-579	-1,020	-983	-730	-783	-864	-1,894
CB gross reserves (increase-)	-292	-1,099	49	-497	-669	-745	-705	-832	-1,920
Fund credit (net)	54	14	-249	-316	-240	-161	-61	-44	--
Other	-789	-211	-379	-207	-74	176	-17	12	26
Financing gap	--	995	785	754	309	--	--	--	--
Memorandum Items:									
CB gross reserves	4,762	5,861	5,812	6,309	6,978	7,723	8,428	9,260	11,180
(months of imports)	3.1	3.4	3.0	3.0	3.0	3.0	3.0	3.0	3.3
External debt outstanding	30,086	31,410	32,636	34,190	35,525	36,936	37,691	37,915	38,510
(in percent of GNP)	56.1	55.2	53.8	52.7	51.0	49.1	46.4	43.2	40.6
Debt service ratio									
Before rescheduling	28.8	25.9	25.4	21.3	19.1	17.8	16.0	14.9	13.5
After rescheduling	18.4	22.5	23.1	21.3	19.1	17.8	16.0	14.9	13.5
Interest due (in percent of GNP)	3.5	3.3	3.5	3.5	3.2	3.0	2.8	2.6	2.3

Sources: Central Bank; and staff estimates.

1/ For 1994-97, acquisition of new aircraft (26) to replace existing equipment of recently privatized Philippines Airlines is estimated to total US$ 2.4 billion and would represent, on average, one-third of the current account deficit on an annual basis over this period. Financing for these purchases are expected to be available from the supplier.

addressed. In this, it is important that monetary and fiscal policies be maintained on a steady and prudent path so as to build confidence and enhance savings, capital inflows, and investment. Equally, actions must be continued to transform the structure of the economy away from import substitution and towards export-oriented growth.

Such actions would build on the progress that has been made during the current stand-by arrangement. Financial policies have been tightened considerably and, compared with the past, implemented with increasing consistency. Moreover, foreign exchange controls have been eliminated, the trade system rationalized, and a new more liberal framework for foreign investment introduced. Together with the boost to confidence following the smooth political transition, these measures have resulted in a surge of remittances and foreign investment flows and a sharp improvement in the overall external balance.

Based on a continuation of this thrust of policies, projections indicate that the balance of payments position could achieve viability by the second half of the present decade. The projections are based on an average growth to 4.5 percent per annum and inflation of 5 percent over this period; other assumptions are broadly in line with the most recent World Economic Outlook exercise for non-oil import volume growth in partner countries, world oil prices, international interest rates, and partner country non-oil export unit values. The projections indicate an initial widening in the current account deficit in 1993-96 to about 2 1/2 percent of GNP, as recovery spurs a revival of imports. With the expiration of the consolidation period for the Paris Club rescheduling agreement at the end of 1992 and the existing commercial bank accord in late 1994, financing gaps averaging about $0.7 billion a year are projected during 1993-96. Assuming that the international reserves position remains at around three months of imports, these gaps could be closed through a combination of further rescheduling and financial support obtained under the aegis of the Consultative Group for the Philippines.

From 1996 onwards, export growth of some 14 percent per annum--reflecting the impact of foreign investments and the effects of the liberalization of the exchange and trade system on output of manufactures, including garments and electronics--is projected to outpace that of imports, while service receipts and foreign investment flows are projected to rise steadily. On this basis, the external current account deficit is envisaged to shift to a small surplus by the end of the decade. Medium- and long-term loan inflows (excluding sizable financing needed for planned aircraft purchases) would remain about $2 billion per year. By the year 2000, external debt would have declined to 41 percent of GNP and the debt service ratio to 13 1/2 percent of exports of goods and services.

In these circumstances, the Philippines would be well-placed to meet its obligations to the Fund. Total repurchases and charges are expected to peak in 1995 at SDR 276 million, equivalent to 63 percent of quota, but representing only 6 percent of gross official reserves and less than

2 percent of exports of goods and services; by 1998, Fund obligations would have fallen to minimal levels (Annex III).

In the event that the remaining elements of the commercial bank debt restructuring operation are completed as planned in 1992, the improvement in the external balances would be even greater. Taking into account the cash flow savings, and the likely positive effect on foreign investment, the financing gaps over the period 1993-96 would be smaller by about $160 million per annum, while during 1997-2000 foreign exchange resources would rise by over $145 million per annum. Moreover, the Philippines would become much less sensitive to interest rate fluctuations because a considerable portion of the bank debt would have been extinguished while the interest rates on a significant portion of the remaining debt would be fixed.

The medium-term balance of payments projections are sensitive to changes in the external environment and underlying assumptions. For example, during 1993-96, were partner countries' import volume growth to be 1 percentage point lower than the 8 percent assumed, exports would be about $245 million lower per year. Similarly, should the world price of oil be $1 higher than the assumed average price of $19.10 per barrel, the current account deficit would be about $120 million larger, on average, during 1993-96. However, even in a more difficult external environment, medium-term external viability would likely remain within reach.

IV. Performance Criteria and Extension of the Stand-by Arrangement

In view of the considerable delay in completing the current review under the stand-by arrangement, the previously agreed schedule of reviews and purchases no longer remains feasible. In these circumstances, it is proposed that the second and third program reviews be combined in the present review, the arrangement be extended again to allow monitoring of performance for 1992 as a whole, the final three purchases be rephased into two purchases, and the set-aside amounts already accumulated be made available following completion of the current review.

To give effect to this, in the attached letter the authorities have requested that the period of the arrangement be extended from December 31, 1992 to March 31, 1993, and that the indicative targets for end-December, set out in their letter of February 10, 1992, be converted into performance criteria. 1/ The authorities have also requested that the three remaining purchases of SDR 37.75 million each, including set asides, that were to take place after April 30, 1992, July 31, 1992, and October 31, 1992, would be combined and rephased into two equal purchases. The first amount (SDR 42.45 million, excluding set-asides) would be made available on comple-

1/ The end-September 1992 ceiling for the PSBR, which had not been set at the time of the first review of the stand-by arrangement on March 4, 1992, was established in the letter of the authorities dated September 4, 1992 and approved by the Executive Board on a lapse-of-time basis in September 1992.

tion of this review (Table 1). The authorities have also requested the release of the previously accumulated set-asides (SDR 37.75 million) and the amount that would otherwise be set aside from the purchase to be made available upon completion of the present review (SDR 14.15 million).

The final purchase under the arrangement (SDR 56.7 million), would take place after February 14, 1993, upon observance of performance criteria for end-December 1992. For this purchase, it is proposed that the designation of set-aside amounts for debt reduction operations be discontinued.

V. Waiver of Applicability of Performance Criteria

The authorities are seeking the earliest possible consideration by Executive Directors of the current review so they can move to complete the commercial bank debt deal. Accordingly, Executive Board discussion is tentatively envisaged to take place on October 7, 1992 although, by this date, data concerning the end-September performance criteria will not be available. Most recent available data, together with the recent measures to tighten monetary policy, support the authorities' belief that the end-September performance criteria will be observed. The staff will confirm that this remains the case at the time of the Board meeting.

VI. Staff Appraisal

The progress in restoring financial stability which began in 1991 has been maintained during the current year. Despite the underlying difficulties the authorities have had in agreeing on and sustaining strong policies, they have achieved a good measure of success. The external position has continued to be strong and reserves have been built to a healthy level, inflationary pressures have been contained, and more recently, economic activity has begun to recover. These achievements are all the more notable in light of national elections held in May 1992. The smooth transition of power, following the election of President Ramos, bodes well for strengthening confidence and sustaining progress in the period ahead.

Central to the success of the program so far has been control of public finances under difficult circumstances. It was recognized at the outset that cautious implementation of the national government budget would be needed in 1992, and to assist in this an indicative monthly budgetary plan was drawn up consistent with the target of limiting the PSBR to 1.6 percent of GNP. During the first half of the year, budgetary revenues fell substantially short of the program. This was largely due to unexpected developments, including the weakness in activity and the stronger-than-expected value of the peso, which acted to reduce customs receipts. In addition, there was slippage in the authorities' revenue raising plans; some tax administration legislation and asset sales were delayed, while the Government eliminated the remaining 5 percent import levy ahead of schedule, without offsetting measures. Nevertheless, the authorities were able to adhere to the program targets for the budget balance during the first half of the year by exercising very tight control over expenditure. Unfortunately, and despite their intentions in the program, development expenditures bore the brunt of the cutbacks.

The authorities are determined to carry forward their pragmatic program to control public finances and, in this connection, have reaffirmed their intention to live within the original targets for the PSBR in 1992. To this end, the staff encourages the authorities in their efforts to arrest the shortfall in revenues evident in the first half of the year. Additional revenues are essential both to limiting the extent of the cutback in spending that will be needed in the second half of 1992, and to easing constraints on public finances and development activities over the medium term.

Current estimates indicate that while resources in the OPSF are likely to be larger than expected, this will be balanced by a shortfall in the financial position of the public corporations. The staff would emphasize that in these circumstances the national government budget should continue to be implemented in line with the agreed monthly program, at least until later in the year. Only in the event it becomes clear that the constraint on budgetary spending can be eased, while meeting the PSBR target, will it be feasible to aim for a somewhat larger national government deficit. If budgetary policy continues to be implemented cautiously, the consolidated public sector deficit would be held to about 2 percent of GNP in 1992, representing a considerable overperformance relative to the target, and a substantial improvement from the deficit of over 5 percent of GNP ruling at the start of the program.

During the early months of 1992, monetary developments were maintained in line with the program, and inflation stabilized at around 7 percent at an annualized rate. However, beginning in May 1992, base money growth picked up and the program ceiling for June was also exceeded. The initial surge in base money was associated with the national elections, and efforts to restore monetary control have been complicated, as they were during much of 1991, by foreign exchange inflows. Inflation has also returned to double-digit levels, and while the elections and supply side difficulties were undoubtedly important, excessive monetary growth has probably also been a contributory factor.

In the staff's view, returning base money to the program path in the remainder of 1992 will be critical to achieving the program's objective of reducing inflation in a sustained manner. In the present environment, maintaining the necessary degree of monetary tightness may involve upward pressure on the value of the peso in the exchange market, from levels which already--were they to be sustained for long enough--would cause difficulties for exporters. However, the staff believes that such pressures are unlikely to endure and that, in any case, the most lasting contribution that policies can make to encouraging exports is in restoring and sustaining reasonable price stability.

The staff is encouraged that the authorities have acted with increased firmness recently in implementing policy. Monetary conditions were tightened sharply at the end of July and reserve money brought swiftly back to the program path. However, in view of the extent of the adjustment required, and the difficulty of banks in reordering their balance sheets quickly, sizable reserve deficiencies emerged so that the base money target for July was exceeded again by a small margin. The authorities have taken additional measures to reassert monetary control: interest rates on Treasury bills rose by 1 1/2 percentage points in the week ending August 28, and the target on weekly issues of Treasury bills has increased. Even though the problem of reserve deficiencies is expected to take some time to resolve, the staff is impressed by the strength of these new measures and the willingness of the authorities to raise interest rates further if needed. If policies are sustained, the authorities should be successful in achieving the desired reduction in monetary growth.

Energy pricing policies have been an area of persistent difficulty. Although the partial rollback in electricity tariffs in advance of the elections was matched by fuel cost savings and did not, in itself, damage the financial position of the NPC, other factors have led to a weakening of NPC's finances from original projections for 1992. The staff therefore, welcomes the authorities' intention to prepare an Energy Sector Action Plan which will outline far-reaching reforms in energy pricing policies. A further sizable increase in electricity tariffs will be needed to establish the finances of NPC on a fully satisfactory basis in 1993, and the staff will collaborate with the authorities and the World Bank regarding the magnitude and timing of the increase.

The staff welcomes the steps the authorities have taken to liberalize the exchange system during 1992, which are of historic proportions. The most recent measures remove all restrictions on current transactions and most capital items, and effectively bring to an end four decades of exchange controls. Significant parallel progress has been made in developing the exchange market, and in liberalizing the trade and investment regimes. Moreover, in May, the authorities completed a large debt buyback operation with the commercial banks and, on completion of this review, intend to conclude the remaining elements of a major commercial bank debt restructuring. With these actions, the authorities will have moved a long way toward creating a truly open exchange system and restoring regularized relations with commercial credit markets.

The delay in completing the review has prevented the Fund from providing immediate support for the commercial bank debt operation which the authorities now plan to complete, using their own resources; the request to purchase the accumulated set-aside amounts would, however, provide retrospective assistance for the May debt buyback. Fund support through the release of the set-asides to support the debt reduction operations would be consistent with the Fund's guidelines regarding such support. The staff believes that the objectives of the program can be achieved and supports the Philippines' request to discontinue the designation of set-asides for debt reduction with respect to the final purchase under the arrangement.

In light of the most recent available data, and the significant tightening of monetary policy, the staff supports the authorities' request to waive the applicability of the end-September performance criteria. In addition, the proposed extension of the period of the arrangement and rephasing of purchases will be helpful in allowing necessary monitoring.

Despite many difficulties, the authorities have succeeded in holding the program to a path that has been, on balance, close to that envisaged at the beginning of the year. This success was supported by a continuing close dialogue with the Fund. While completion of the present review under the program has been much delayed, the staff believe the policies now put forward are sufficiently strong to sustain the program during the remainder of 1992. The staff welcomes the assurances provided by the new Government regarding their commitment to the aims of the program, and believes that the policies merit the Fund's support.

The staff also looks forward to early discussions with the authorities concerning their desire for a successor program, built upon sustained financial stability but with further structural reforms oriented toward creating an environment for faster growth and conceived in a medium-term context.

The Philippines has been placed on the standard 12-month consultation cycle; accordingly the next Article IV consultation with the Philippines will be completed within 12-months following the present consultation.

VII. Proposed Decision

The following decision is proposed for adoption by the Executive Board:

A. Stand-By Arrangement

1. The Philippines has consulted with the Fund in accordance with paragraphs 4 (b) and (c) of the stand-by arrangement for the Philippines (EBS/91/17, Sup. 3, 2/26/91) and the fourth paragraph of the letter of the Governor of the Central Bank of the Philippines and the Secretary of Finance, dated February 10, 1992 (EBS/92/24, 2/11/92).

2. The letter of the Governor of the Central Bank of the Philippines and the Secretary of Finance, dated September 15, 1992, with annexed supplementary memorandum, shall be attached to the stand-by arrangement and their letters dated February 5, 1991, February 10, 1992, and September 4, 1992, with annexed memoranda, shall be read as supplemented and modified by the letter dated September 15, 1992, with annexed supplementary memorandum.

3. Accordingly,

a. Paragraph 1 of the arrangement shall be modified by replacing "December 31, 1992" with "March 31, 1993."

b. Paragraph 2 (a) of the arrangement shall be modified by replacing "the equivalent of SDR 226.5 million until November 1, 1992" with "the equivalent of SDR 207.6 million until February 15, 1993."

c. The performance criteria as specified in paragraph 4 (a) of the arrangement for December 31, 1992 shall be as set forth in Table 1 attached to the letter dated September 15, 1992.

4. The Fund decides that the second and third program reviews and the associated financing reviews contemplated in paragraphs 4 (b) and 4 (c) of the arrangement are completed and that, notwithstanding that data for the performance criteria for September 30, 1992 are not available, the Philippines may proceed to purchase up to the equivalent of SDR 42.45 million.

5. a. The Philippines has requested that the Fund make available, in accordance with paragraph 2 (c) of the arrangement, the equivalent of SDR 51.9 million representing the set-aside amounts which, pursuant to paragraph 2 (c) of the arrangement, (i) were made in the purchases already made under the arrangement (SDR 37.75 million), and (ii) are to be made in the purchase to be made available upon completion of the present review (SDR 14.15 million).

b. The Philippines has also requested that the Fund, with respect to the purchase to become available after February 15, 1993, discontinue the designation of amounts for debt reduction in accordance with paragraph 2 (e) of the arrangement.

c. In light of the requests referred to in paragraph 5 (a) and the representation of the Philippines, the Fund has reviewed the financing of the Philippines' program supported by the arrangement, and determines that the debt reduction involved is consistent with the objectives of the program and that the purchase of the amounts referred to in paragraph 5 (a) is needed for the replenishment of the Philippines' reserves in connection with the Philippines' debt reduction operation.

d. Accordingly, the Fund decides that (i) the amounts referred to in paragraph 5 (a) above shall be available to the Philippines under the arrangement; and (ii) with respect to the purchase which is to become available after February 15, 1993, there shall be no designation of amounts for debt reduction.

Basic Data

Area:	300,000 sq km
Population (1991):	63.0 million
Annual rate of population growth (1978-91)	2.4 percent
Gross national product (1991):	$45.6 billion
GNP per capita (1991):	$724

	1988	1989	1990	1991	1992 Proj.
			(Changes in percent)		
GNP and prices					
Real GNP	7.2	5.7	4.2	--	2-3
Of which: Agriculture	3.2	3.0	0.4	0.7	1.5
Manufacturing	8.5	6.4	2.0	0.9	2.5
Nominal GNP	18.1	14.9	17.8	16.5	10.7
Implicit GNP deflator	10.2	8.7	11.4	17.8	8.0
Consumer price index (end-period)	9.1	15.5	16.1	13.1	7.0
Nominal GNP (in billions of pesos)	795.2	913.8	1,076.5	1,253.9	1,397.1
National Government					
Total revenue	9.4	35.0	18.7	22.1	11.4
Total expenditure and net lending	13.5	26.4	26.7	13.3	3.2
Money and credit 1/					
Net domestic assets	7.0	13.1	24.6	-5.4	-6.2
Domestic credit	7.4	20.4	28.7	-2.6	-11.0
Of which: Private sector credit	13.6	17.7	23.8	5.2	10.7
Total liquidity	21.9	24.6	12.1	11.6	7.9
M3	23.1	25.9	18.8	14.3	8.0
Base money	15.1	35.7	26.3	14.3	7.5
Interest rate (short-term deposit rates; weighted average)	13.4	17.0	18.5	19.1	...
External sector					
Exports, f.o.b. (in U.S. dollar terms)	23.7	10.6	4.7	8.0	9.2
Imports, f.o.b. (in U.S. dollar terms)	21.1	27.7	17.2	-1.3	14.7
Terms of trade	6.9	-3.6	-5.4	1.1	...
Exchange rate (period average)					
Nominal effective	-7.8	-0.2	-10.6	-13.5	...
Real effective	-2.8	5.7	-3.9	-2.1	...
Peso/U.S. dollar (level)	21.1	21.7	24.3	27.5	...
			(In millions of U.S. dollars)		
Balance of payments					
Exports, f.o.b.	7,074	7,821	8,186	8,840	9,655
Imports, f.o.b.	-8,159	-10,419	-12,206	-12,051	-13,820
Services and transfers, net	662	1,142	1,325	2,178	3,023
Current account balance	-423	-1,456	-2,695	-1,033	-1,142
Overall balance 2/	650	451	-185	1,405	1,027
External debt (end-period)					
Total	27,915	27,616	28,549	29,956	30,086
Medium- and long-term	22,983	22,405	23,176	23,288	...
Short-term	3,761	3,950	4,376	5,494	...
IMF	1,171	1,261	997	1,174	1,080
Debt service (as a ratio to exports of goods and services) 3/	35.2	27.6	24.8	22.6	18.4
Gross official reserves (end-period)					
(In months of imports of following year's imports of goods and services)	2.1	1.9	1.5	3.3	3.1
			(In percent of GNP)		
Gross domestic investment	18.5	22.1	22.4	19.7	19.9
Gross national saving	17.4	18.7	16.3	17.5	17.8
National government revenue	13.7	16.7	16.8	17.5	17.6
National government expenditure and net lending	16.5	18.9	20.2	19.6	18.3
National government deficit	-2.8	-2.1	-3.4	-2.1	-0.6
M3 (end-period) 1/	25.4	28.8	29.0	28.5	27.6
Exports	18.1	18.6	18.5	19.4	18.0
Imports	20.9	24.8	29.5	26.4	25.8
Current account balance (deficit -)	-1.1	-3.5	-6.1	-2.3	-2.1
External debt	74.1	66.0	65.0	67.8	56.1

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

1/ End-period and at end-period exchange rates.

2/ After rescheduling, concerted lending and changes in nonmonetary arrears; equivalent to the change in net international reserves of the banking system.

3/ Debt service includes cash value of payments related to debt conversions, but excludes payments related to 1990 buyback.

Philippines: Social and Demographic Indicators

Area	Population	Density
300 thousand sq. km.	63.0 million (1991) Annual rate of growth: 2.4 percent	210 people per sq. km. 600 people per sq. km. of arable land

Population characteristics		Health	
Life expectancy at birth		Population per physician	6,700
Male 64 years		Population per hospital bed	600
Female 66 years			
Infant mortality rate (per 1,000 live births)	43		

Income distribution		Education	
Percent of national income		Primary school enrollment rate 1/	106
Highest 20 percent	48	Secondary school enrollment rate 1/	66
Lowest 20 percent	6		

Access to safe water	
Percent of population	
Urban	49
Rural	54

Nutrition	
Per capita calorie intake (calories per day)	2,255
Per capita protein intake (grams per day)	52

Sources: Data provided by the Philippine authorities; and the World Bank.

1/ As percentage of age group.

Philippines--Fund Relations
(As of August 31, 1992)

I. Membership Status: Joined 12/27/45; Article XIV

II. General Resources Account: 1/

	SDR Million	% Quota
Quota:	440.40	100.0
(Proposed Ninth Review)	(633.3)	
Fund holdings of currency	1,136.99	258.2
Reserve portion in Fund	38.83	8.8

III. SDR Department:

	SDR Million	% Allocation
Net cumulative allocation	116.60	100.0
Holdings	1.28	1.1

IV. Outstanding Purchases and Loans:

	SDR Million	% Quota
Stand-by arrangements	222.35	50.5
Extended arrangements	235.92	53.6
CCFF	277.10	62.9

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-by	02/20/91	12/31/92	264.20	113.25
Extended	5/23/89	2/19/91	660.60	235.92
Stand-by	10/24/86	8/23/88	198.00	198.00

IV. Projected Obligations to Fund (SDR Million; Based on Existing Use of Resources Only):

	Forthcoming				
	1992	1993	1994	1995	1996
Principal	32.6	46.0	188.7	239.1	112.9
Charges/Interest	27.0	58.3	52.4	36.5	20.5
Total	59.6	104.3	241.1	275.6	133.4

1/ The Philippines has consented to the proposed increase in its quota under the Ninth General Review and has notified its acceptance of the proposed Third Amendment of the Fund's Articles of Agreement.

VII. Exchange rate arrangement

Since October 15, 1984, the exchange rate for the Philippine peso has been determined freely by market forces. During the period 1984-1990, the peso depreciated broadly against the U.S. dollar from P 20.0 = US$1 to P 28.0 = US$1. Since early 1991, however, the rate has generally appreciated against the U.S. dollar reaching P 24.9 = US$1 in July 1992.

VIII. Article IV Consultation

The Philippines is on the standard 12-month cycle. The last Article IV consultation report (EBS/91/17) was discussed by the Executive Board on February 20, 1991. The Board approved the proposed stand-by arrangement in an amount of SDR 264.2 million, the associated external contingency financing up to a maximum amount of SDR 88.1 million, and compensatory financing of SDR 277.1 million.

The current Article IV consultation report has been delayed mainly because of the slippage in completion of the reviews under the stand-by arrangement. The second and third reviews were originally scheduled to have been completed by end-April and end-July 1992, respectively.

IX. Technical assistance

Date	Department	Purpose
01/90	FAD	Tax administration
02/90	FAD	Tax administration
05/91	FAD	Tax administration
09/91	FAD	Customs administration
01/92	FAD	Tax and customs administration
02/92	FAD	Short-term expert on customs administration
06/92	FAD	Tax customs administration
09/92-09/93	FAD	Long-term expert on customs administration
11/92	LEG	Review of new Central Bank legislation
1993	FAD	Review of VAT
	FAD	Tax and customs administration
	FAD	Possible long-term expert on tax administration
	MAE	Monetary instruments, financial restructuring and reorganization of the Central Bank

X . Resident Representative

A Resident Representative has been stationed in Manila since January 1984. Mr. Christopher Browne assumed the post in September 1991.

Table 1. Philippines: Projected Payments to the Fund as of July 31, 1992

(In millions of SDRs)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total
Obligations from existing drawings											
Principal											
Repurchases	32.5	45.9	188.6	239.0	112.8	46.3	39.3	33.4	--	--	738.3
ESAF/SAF repayments	--	--	--	--	--	--	--	--	--	--	--
Trust Fund obligations	--	--	--	--	--	--	--	--	--	--	--
Charges and interest 1/	27.0	58.2	52.4	36.4	20.5	14.8	11.9	9.2	7.3	7.2	245.2
Total obligations	59.5	104.2	241.0	275.5	133.4	61.2	51.2	42.6	7.3	7.2	983.5
(Percent of quota)	13.5	23.6	54.7	62.5	30.2	13.9	11.6	9.6	1.6	1.6	223.3
Obligations from prospective drawings											
Principal											
Repurchases	--	--	--	--	68.4	75.4	7.0	--	--	--	150.9
ESAF/SAF repayments	--	--	--	--	--	--	--	--	--	--	--
Trust Fund obligations	--	--	--	--	--	--	--	--	--	--	--
Charges and interest 1/	0.3	9.7	10.9	10.7	8.6	3.6	0.1	--	--	--	44.1
Total obligations	0.3	9.7	10.9	10.7	77.0	79.1	7.2	--	--	--	195.0
(Percent of quota)	--	2.2	2.4	2.4	17.5	17.9	1.6	--	--	--	44.2
Cumulative (existing and prospective)											
Principal											
Repurchases	32.5	45.9	188.6	239.0	181.2	14.8	46.3	33.4	--	--	889.3
ESAF/SAF repayments	--	--	--	--	--	--	--	--	--	--	--
Trust Fund obligations	--	--	--	--	--	--	--	--	--	--	--
Charges and interest 1/	27.3	67.9	63.3	47.1	29.1	18.4	12.0	9.2	7.3	7.2	289.3
Total obligations	59.8	113.9	251.9	286.5	210.4	140.3	58.4	42.6	7.3	7.2	1,178.6
(Percent of quota)	13.5	25.8	57.2	65.0	47.7	31.8	13.2	9.6	1.6	1.6	267.6

Source: Staff calculations.

1/ Projections are based on current rates of charge, including burden-sharing charges where applicable, for purchases in the GRA, and on current interest rates or SAF, ESAF, and Trust Fund. The current SDR interest rate is assumed for net use of SDRs.

World Bank Activity in the Philippines 1/

1. World Bank lending in 1988-92

Between January 1, 1988 and July 31, 1992, the Bank approved 26 loans to the Philippines, totaling $3.2 billion in new commitments of IBRD funds and SDR 76.4 million ($102 million) in IDA resources (Table 1). Loans approved in 1988 include a Public Corporation Reform Project, which supports a program of divestiture and other reforms for nonfinancial government corporations; a loan for irrigation operations support which helps define a realistic program for rehabilitation and maintenance of the irrigation system; a housing sector loan which supports reforms of various housing finance entities and provides support for mortgage lending; and a power sector development project, which finances the expansion of geothermal-based power. Loans approved in 1989 include a fourth small and medium industry development project, a financial sector adjustment loan, a Manila Power Distribution project, a health development project, a water supply project, an industrial investment credit project, a municipal development project, and a debt management loan. In 1990, loans for the energy sector, coconut farms development, water supply, sewerage, sanitation, second elementary education, communal irrigation, and earthquake reconstruction were approved. In 1991, loans for industrial restructuring, cottage enterprise development, environment and national resources adjustment, rural finance, and highway development were approved. IDA resources were allocated for the Environmental loan to complement the IBRD loan. In 1992, three loans have already been approved; one for $85 million for engineering and science education, one for $91.3 million for rural electrification, and one for $68.0 million for a third municipal development project and an IDA credit of $36.0 million was approved for a second vocational training project (Table 1).

As of July 31, 1992, there were 33 Bank-assisted projects being implemented in the Philippines. Disbursements totaled $259 million in 1988, $463 million in 1989, $506 million in 1990, and $377 million in 1991 (Table 2).

The Bank has a number of projects under development for possible approval in 1991/92. These include a Telecommunications Loan, and loans for Vocational Training, and Export Development.

The Bank is engaged in a number of economic and sector studies that will help to define development issues and future lending strategies in key sectors. Recent reports have focused on important issues such as poverty/unemployment, transportation, the financial sector, energy/power, and public sector resource management. A report on population and family planning has recently been prepared. A Country Economic Memorandum was issued in October 1990, which served as background documentation for the meeting of the Consultative Group (CG) held in Hong Kong on February 25-26,

---

1/ Prepared by the World Bank staff.

1991. A report on Public Sector Resource Mobilization and Expenditure Management was circulated for the second CG meeting, held in Hong Kong during March 12-13, 1992.

Table 1. Loan Approvals Between January 1988 and July 1992

(In millions of U.S. dollars)

		Amount		Date
		IBRD	IDA	
1.	Irrigation Operations Support	23.5		06/02/88
2.	Program for Government Corporations	200.0		06/15/88
3.	Bacon-Manito Geothermal Power	100.0		06/23/88
4.	Housing Sector	160.0		06/24/88
5.	Fourth Small/Medium Industry Development	60.0		04/25/89
6.	Financial Sector Adjustment	300.0		05/04/89
7.	Manila Power Distribution	65.5		06/08/89
8.	Health Development	70.1		06/22/89
9.	Angat Water Supply	40.0		10/05/89
10.	Industrial Investment Credit	65.0		10/05/89
11.	Municipal Development II Project	40.0		12/14/89
12.	Debt Management Loan	200.0		12/21/89
13.	Energy Sector Loan	390.0		02/01/90
14.	Coconut Farms Development	121.8		
15.	Water Supply, Sewerage, and Sanitation	85.0		06/28/90
16.	Second Elementary Education Loan	200.0		07/03/90
17.	Second Communal Irrigation Development	46.2		10/04/90
18.	Earthquake Reconstruction Project	125.0		10/04/90
19.	Industrial Restructuring	175.0		01/08/91
20.	Cottage Enterprise	15.0		03/19/91
21.	Rural Finance	150.0		06/21/91
22.	Environmental & National Resources	158.0	66.0	06/25/91
23.	Highway Management	150.0		12/20/91
24.	Engineering and Science Education	85.0		01/28/92
25.	Rural Electrification	91.3		02/25/92
26.	Municipal Development III	68.0		03/31/92
27.	Second Vocational Training		36.0	06/18/92
	Total	3,184.4	102.0	

Disbursements on World Bank loans outstanding as of December 31, 1991 are summarized in Table 2.

Table 2. IBRD/IDA Disbursements, 1988-92

(In millions of U.S. dollars)

	1988	1989	1990	1991	1992 1/
Disbursements on projects, pipeline 10/83	59.3	41.2	34.4	14.4	4.9
Disbursements on new loans made after 10/83	199.2	422.1	472.0	362.6	298.8
Total	258.5	463.4	506.4	377.0	303.7

1/ Disbursement from January 1992-July 1992.

2. Financial relations

(a) IBRD/IDA lending operations as of July 31, 1992

Table 3. IBRD/IDA Lending Operations

(In millions of U.S. dollars)

	IBRD	IDA
Ninety-seven loans and six credits disbursed 1/	4,090.4	105.2
Disbursement (29 loans and 2 credits)	3,142.8	102.0
Total commitments	7,233.2	207.2
Total undisbursed	2,001.3	73.3
Repayments	1,903.8	5.9

1/ Net of cancellations.

(b) IFC investments (as of July 31, 1991)

Total gross commitments	988.4
Less: repaid, sold, or canceled	606.3
Total commitments held by IFC	382.1

3. Recent economic and sector reports

Philippines: Rural Electrification Sector Study: An Integrated Program to Revitalize the Sector, No. 8016-PH

Philippines: Toward Sustaining the Economic Recovery, January 30, 1989, No. 7438-PH.

The Philippines: The Challenge of Poverty, October 17, 1988, No. 7144-PH.

Philippines: Transport Sector Review, March 31, 1988, No. 7098-PH.

Philippines: Selected Issues in Public Sector Resource Management, April 15, 1988, No. 6887-PH.

Philippines: Financial Sector Study, August 23, 1988, Report No. 7177-PH.

Philippines: Energy Sector Review, September 1988 No. 7269-PHL.

The Philippines: Education Sector Study, December 1988, No. 7473-PH.

The Philippines: Vocational Training for Operations and Craftsmen, January 1990, No. 8259-PHL.

Environment and Natural Resource Management Study, World Bank Country Study, 1989.

The Philippines: Country Economic Memorandum--Issues in Adjustment and Competitiveness, October 31, 1990, No. 8933-PH.

New Directions in the Philippines Family Planning Program, October 1, 1991, Report No. 9579-PH.

Public Sector Resource Mobilization and Expenditure Management, February 20, 1992, Report No. 10056-PH.

4. Technical assistance

The World Bank has provided technical assistance to the Philippines through its standard lending operations in such sectors as agriculture, transportation, public utilities, and debt management. In addition, the Japan Grant Facility (JGF) has helped in preparation of several projects in the lending operations.

External Contingency Mechanism

The Philippines stand-by arrangement included an external contingency mechanism (ECM) for a maximum of SDR 88.1 million covering the 18-month period January 1991-June 1992. As indicated in the previous staff report (EBS/92/24, Annex V), the symmetry provision of the ECM was triggered in the second quarter of 1991, largely as a result of unanticipated sharp falls in international petroleum prices and interest rates. As of December 1991, the cumulative net sum of deviations had reached SDR 252 million, suggesting an upwards adjustment of SDR 73 million to the net international reserve (NIR) target. Actual reserve performance was even stronger and even if the floor for December had been adjusted upwards by this amount, NIR would have exceeded the target by $1.9 billion.

In the context of the first program review, performance criteria were set for NIR for the first three quarters of 1992 that took into account the 1991 reserve performance and a revised, more favorable, set of assumptions about the external environment. These new floors were considerably higher than the original program targets, with the difference far exceeding the maximum upward adjustment of SDR 88.1 million specified under the ECM. For this reason, the staff indicated that it would not recommend any further adjustment in the NIR target in the event of continued favorable deviations under the ECM.

Data for the first half of 1992 confirm that, as expected, the deviations relative to the original baseline continue to be positive. The net sum of deviations during the first semester of 1992 amounted to SDR 219 million, essentially reflecting SDR 77 million in higher receipts from coconut oil exports and savings of SDR 96 million in oil import costs and SDR 45 million in net interest costs. Under the symmetry provisions, these deviations would have suggested an upward adjustment to the NIR target for June 1992 of the remaining SDR 15.1 million which could have been made under the symmetry provisions of the ECM. 1/ However, since the revised NIR target already incorporated an adjustment of an even larger magnitude, no further modifications to the NIR targets needed to be made. The ECM expired on June 30, 1992.

1/ This figure would include an adjustment of SDR 112 million stemming from the excess of the net deviation in the first half of 1992 (see attached Table).

Philippines: Contingency Mechanism, Developments during 1991-92

(In millions of U.S. dollars; unless otherwise specified)

	Baseline Scenario 1/ 2/				Actual				Difference (Actual-Projected)			
	1991 S1	1991 S2	1992 Q1	1992 Q2	1991 S1	1991 S2	1992 Q1	1992 Q2	1991 S1	1992 S2	1992 Q1	1992 Q2
1. Coconut oil exports												
Volume (in '000 m.t.) 3/	517	473	264	210	482	358	142	154	-35	-115	-122	-56
Under forward contract	80				80							
Spot transactions	437				402							
Price (f.o.b., in US$/m.t.)	348	361	490	460	308	460	715	664	-40	99	225	204
Under forward contract	300				300							
Spot transactions	357				126							
Deviation 4/									-20.65	40.05	63.10	43.19
2. Copper concentrate exports												
Volume (in '000 m.t.)	212	230	104	119								
Price (in US$/m.t.) 5/	527	500	479	461	530	520	477	532	3	2	-2	71
Deviation 4/									2.16	-1.63	-0.17	1.14
3. Copper metal exports												
Volume (in '000 m.t.)	62	67	42	29								
Price (in US$/m.t.)	2,385	2,282	2,205	2,138	2,389	2,287	2,198	2,243	4	5	-7	105
Deviation 4/									1.99	-1.87	-0.24	1.00
4. Petroleum imports												
a. Crude petroleum												
Volume (in million barrels)	33.69	40.73	18.19	19.38								
Price (in US$ per barrel)	23.25	20.68	20.27	20.12	17.90	18.70	16.53	18.92	-5.35	-1.98	-3.74	-1.20
Deviation 6/									156.71	88.06	67.91	48.26
b. Other petroleum products												
Volume (in million barrels)	4.47	5.27	2.89	2.13								
Price (in US$ per barrel)	25.27	22.29	21.90	21.74	19.31	20.17	17.23	20.40	-5.96	-2.11	-4.07	-1.34
Deviation 6/									21.47	11.71	11.71	5.80
5. Net interest cost on floating rate debt 7/									-6.00	51.00	31.00	52.00
a. Gross interest cost	569	568	278	287	499	428	173	170	-70	-140	-103	-117
Debt stock at the beginning of period	14,141	14,256	13,967	14,416	14,141	14,256	13,967	14,416				
Average interest rate 8/	4.00	3.98	1.99	1.99	3.52	3.00	1.24	1.24				
Deviation 9/									1.00	83.00	64.00	64.0
b. Investment income of banking system	183	195	110	111	161	145	64	65	-22	-50	-46	-46
Claims at the beginning of period	4,663	4,835	5,646	5,691	4,663	4,385	5,646	5,691				
Average interest rate 10/	3.88	3.88	1.94	1.94	3.40	2.87	1.13	1.13				
Deviation 11/									-7.00	-32.00	-33	-33
Net sum of deviations [(favorable(+)/unfavorable(-)]									155.68	187.28	173.35	130.39
SDR equivalent of deviations 12/									114.27	138.13	124.87	93.80

Philippines: Contingency Mechanism, Developments during 1991-92 (concluded)

	1991		1992		
	S1	S2	Q1	Q2	Cumulative
Cumulative deviation (In SDR mn.)	114.27	252.40	377.27	471.07	
Minimum threshold (In SDR mn.)	66.06				

Compensable deviation (In SDR mn.)	48.21	138.13	124.87	93.80	
Financing/reserve adjustment	28.93	44.31	74.92	37.52	185.68
Compensable deviation (In US$ mn.)	64.50	187.32	173.35	130.39	
Financing/reserve adjustment (In US$ mn.)	38.70	59.77	104.00	52.16	254.63

1/ Baseline period starts on January 1, 1991 and ends on June 30, 1992.

2/ Changes in copper prices (concentrates and metal) affect the balance of payments (BOP) with a two-month lag; changes in the price of petroleum imports with a one-month lag; and changes in the reference interest rates affect the investment income in the BOP 3 months after the change takes place and the gross interest cost 5 months after; coconut oil prices have no lagged effect on the BOP.

3/ If the actual volume in the quarter in which the price deviation occurs differs by more than 10 percent from the projected volume, the applicable actual price to be used for calculating the deviation will be raised/lowered by 1/3 of the percentage change by which the volume was lower (higher) than projected in the baseline scenario.

4/ Volume in the baseline projection multiplied by price change in U.S. dollars from the baseline projection. The deviation in price is:

a. For coconut oil, the difference in U.S. dollars between the prices in the baseline projections and the actual export prices as reported by the National Statistical Office (NSO). Actual prices for the first quarter of 1991 were adjusted upward by 1/3 of the 16.41 percent shortfall in the volume of spot transactions compared with the baseline projection. Actual prices for the third quarter of 1991 were adjusted upward by 1/3 of 33.78 percent shortfall in the volume compared with the baseline projection for the same quarter.

b. For copper metal, the difference in U.S. dollar terms between the prices in the baseline projections and the spot prices for copper as monitored by the Fund's Research Department; (price in US$/lb. multiplied by 2,204.6 = price in US$/m.t.).

c. For copper concentrates, the difference in U.S. dollar terms between the prices in the baseline projections and the adjusted spot prices our copper metal based on the formula used to derive copper concentrate prices in the baseline projection.

5/ Computed based on the spot price of copper metal (as monitored by the Fund's Research Department) using the formula:

Price of copper concentrates in US$/m.t. = (Price of copper metal in US$/lb. minus $0.21)(0.275)(2,204.6)

where: 1 m.t. = 2,204.6 lbs.

$0.21 = tolling fee per lb. of copper metal (refining and smelting charges)

0.275 = average assay value of copper metal content per unit of copper concentrates

6/ a. Volume in the baseline projection multiplied by the difference in U.S. dollar terms between the projected price and average actual crude oil spot prices as monitored by the IMF.

b. The actual price for petroleum products is derived by multiplying the actual spot price of crude petroleum by 7.864 percent, which is the difference between the prices per NSO of crude petroleum and petroleum products for 1989.

c. For both variables, positive change in price from the baseline projection means unfavorable deviation in the cost of imports and vice versa.

7/ The difference between deviations in gross interest payments and deviations in investment income of the banking system.

8/ Weighted average of the 6-month LIBORs for euro-dollar, euro-yen, euro-French franc, euro-deutsche mark, euro-Swiss franc, euro-pound sterling, ECU deposits and Fund charges; weights are determined by the currency distribution of floating rate external debt at end-March 1990 and liabilities to the Fund.

9/ The difference (in percentage points) between the projected and actual average international reference interest rate applied to the amount of variable interest rate debt outstanding at the beginning of each quarter as projected under the program. Positive difference (in percentage points) in average interest rates means unfavorable deviation and vice versa.

10/ Weighted average of the 6-month LIBORs for euro-dollar, euro-yen, euro-French franc, euro-deutsche mark, euro-Swiss franc, euro-pound sterling; weights are determined by the currency distribution of claims at end-March 1990.

11/ The difference (in percentage points) between the projected and actual average international interest rate applied to the amount of gross foreign assets of the banking system outstanding at the beginning of each quarter. Positive difference (in percentage points) in average interest rates means favorable deviation and vice versa.

12/ Exchange rates:

1991 Q1: SDR 1 = $1.415	1991 Q3: SDR 1 = $1.337	1992 Q1: SDR1 = $1.388
1991 Q2: SDR 1 = $1.338	1991 Q4: SDR 1 = $1.385	1992 Q2: SDR1 = $1.390

Philippines: Debt and Debt Service Reduction Operation with External Commercial Banks

A new agreement between the Philippines and commercial banks on a financing package involving total eligible debt of $4.7 billion was signed in London on July 24, 1992. The term sheet on the package was issued on February 28, 1992 and includes a debt buyback option, debt service reduction bonds, and a new money component. As with the debt financing package the Philippines completed with commercial bank creditors in 1989, the current operation would represent an important market-based reduction of debt and debt service obligations on a voluntary basis.

The following is a summary of the main elements of the package:

a. Debt buy-back option: Banks were provided with an option to exchange existing debt for cash at 52 percent of face value, except for debt related to the nuclear power plant, for which a price of 43 percent of face value was set.

b. Temporary interest rate reduction bonds (TIRR bonds): Banks could exchange existing debt for TIRR bearer bonds, which would carry a 15-year maturity with a 7-year grace period. The interest rates would be fixed at 4 percent in the first two years, 5 percent in years 3-5, and 6 percent in year 6. Thereafter, the interest rate would be LIBOR plus 13/16. Additionally, an amount equivalent to 12 months of interest payments, calculated at an interest rate of 6 percent, would be set aside in escrow for 6 years.

c. Principal collateralized interest reduction bonds (PCIR bonds): Banks could opt for registered PCIR bonds with a bullet repayment after 25 years and interest rates of 4.25 percent in the first year, 5.25 percent in the second year, 5.75 percent in the third year, 6.25 percent in the fourth and fifth years, and 6.5 percent thereafter. An amount equivalent to 14 months of interest payments calculated at a rate of 6.5 percent would be set aside in escrow over the life of this bond. The principal repayment of the bonds would be fully secured by zero coupon U.S. Treasury securities.

d. New money conversion bond: Banks have an option to provide new money in the form of bearer bonds with a maturity of 17 years, with a 5-year grace period, and an interest rate of LIBOR plus 13/16. For every dollar of new money provided, a bank would have the right to convert $4 of existing debt into bonds, with terms identical to the new money bonds.

Analysis by the staff indicates that the reduction in debt service obligations implied by these operations is broadly in line with secondary market prices for Philippines' bank debt. Tenders for the buyback were submitted by March 23, 1992; and the operation was completed on May 14, 1992, when $1.263 billion was purchased at a cost of $656 million financed entirely from the authorities' own reserves. As for the remainder of the financing package, no closing date has yet been established. The authorities have until the end of 1992 to finalize the deal, pending agreement with banks on the inclusion of language satisfactory to the Fund in the final documents, clarifying that repurchase expectations to the Fund would not be regarded as voluntary prepayments, and progress in obtaining financial support from bilateral and multilateral creditors. The authorities hope to complete the deal by end-October.

As of August 31, 1992, a total of $4.546 billion had been tendered for all elements of the package, equivalent to about 97 percent of total eligible debt. The table below details the options selected by commercial banks and the authorities' estimate of the amount of resources needed for funding each of the options.

(In US$ billion)

	Face Value of Options Chosen	Estimated Cost
Buyback	1.263	0.652
PCIR bonds	1.884	0.413
TIRR bonds	0.864	0.052
New money bonds	0.535	--
Total	4.546	1.117

The authorities expect that new money provided in the package (about $134 million) and a drawdown of the country's international reserves could go a considerable way towards meeting the cost of $1.1 billion needed to finalize the package. Additional funds from donors and creditors would still be required, however, and the authorities have been consulting with bilateral donors, the World Bank, and the Fund to seek financial support. The authorities are requesting from the Fund the release of accumulated set-aside purchases, under the current stand-by arrangement, to support the buyback operation that has already taken place.

Assuming that the debt package is completed during the second half of 1992, the staff has estimated its medium-term impact on the balance of payments. The net annual reduction in interest costs resulting from this operation are estimated to average about $58 million a year in 1992-96 before falling off sharply thereafter. The restructuring of amortization obligations falling due would yield cash flow relief averaging around $140-160 million a year through the year 2000. Moreover, completion of this debt operation would be expected to facilitate a return to normal access to international financial markets and would improve the environment for inflows of private investment.

With this proposed financing package, virtually all of the medium- and long-term public sector debt to commercial bank creditors would be completely restructured. Such debt with banks would decline from $7.4 billion to $6.2 billion, of which about one-third would carry fixed interest rates, and about 14 percent would have temporarily reduced interest rates until 1999. The authorities have also stated that the current debt/equity conversion arrangements would continue, under which conversion rights of up to $75 million are sold at quarterly auctions.

September 15, 1992

Dear Mr. Camdessus:

The attached Memorandum on Economic Policies outlines additional policies and measures the Government is adopting in the context of the economic stabilization plan supported by the stand-by arrangement approved on February 20, 1991. The memorandum is provided as a supplement to the letters dated February 5, 1991, February 10, 1992, and September 4, 1992, and the attachments thereto.

The stand-by arrangement is currently due to expire on December 31, 1992. The Government now requests a further extension of the period of the stand-by arrangement to March 31, 1993. In light of the delays in concluding the present review, such an extension would facilitate the monitoring of the program in the second half of 1992 and allow an appropriate phasing of purchases.

With the extension of the stand-by arrangement, we would request that the remaining purchases be rephased, with the three final purchases under the arrangement being combined and made available in two equal purchases. The first purchase of SDR 42.45 million would be made available after completion of the present review, and the final purchase would be made available after February 14, 1993, subject to observance of quantified performance criteria for end-December and other relevant performance criteria.

The performance criteria referred to in paragraph 4 of the arrangement and identified in our letters to you dated February 5, 1991 and February 10, 1992 would also apply during the period of the extension. The quantitative performance criteria proposed for December 31, 1992 are set out in the attached Table 1; these are unchanged from the indicative targets established previously.

We believe that the policies and measures described in the attached Memorandum on Economic Policies are sufficient to achieve the objectives of the program but will take any additional measures that may become necessary for this purpose. In this regard, we do not expect that the end-September data for the quantitative performance criteria will be available when the present review is completed by the Executive Board. We therefore request that the Fund grant a waiver of the applicability of the end-September performance criteria specified in Paragraph 4 (a) of the stand-by arrangement and that the Philippines, upon completion of the present review, may proceed to purchase the equivalent of SDR 42.45 million.

We also request that an amount equivalent to SDR 51.9 million be made available for purchase pursuant to paragraph 2 (c) of the stand-by arrangement, representing the set asides related to previous purchases and to the purchase which will be made available upon completion of the present review. With respect to the purchase to be made available after February 14, 1993, we request that the setting aside of amounts under paragraph 2 (c) of the stand-by arrangement be discontinued and that the amount that would otherwise be set aside be made available for purchase in accordance with the phasing provisions of paragraph 2 (a) of the stand-by arrangement.

The Philippines represents that it has a need to make the purchases of SDR 51.9 million mentioned in the previous paragraph because of the use of its reserves for the discharge of liabilities under debt reduction operations. In this regard, the Philippines, on May 14, 1992, purchased $1.263 billion in commercial bank debt at a cost of $656 million, financed entirely from the resources of the central bank, in the context of planned comprehensive debt and debt service reduction operations.

Sincerely yours,

Jose L. Cuisia
Governor
Central Bank of the Philippines

Ramon del Rosario
Secretary of Finance

Attachment

Mr. Michel Camdessus
Managing Director
International Monetary Fund
Washington, D.C. 20431

Table 1. Philippines: Proposed Quantified Performance Criteria for December 31, 1992

		Dec. 1992
In billions of pesos		
1.	Base money	151.2
2.	PSBR 1/	21.9
3.	OPSF: outstanding balance	--
In millions of U.S. dollars		
4.	Net international reserves (NIR) of the monetary authority 2/	2,422
5.	Short-term external debt outstanding	4,750
6.	Approval of external borrowing with maturities of 1-12 years 3/	1,500
7.	Approval of external borrowing with maturities of 1-5 years 3/	200

1/ Cumulative from January 1, 1992.

2/ The floors will be adjusted upwards (downwards) for any upward (downward) deviations in the cumulative total of new money disbursements, or the equivalent from foreign commercial banks and disbursements from certain specified loans from official sources or from other program loans, or the equivalent, not included in the 1992 balance of payments projections exceeding (falling short of) $658 million. The floors may also be adjusted downwards, in consultation with the Fund, for the net effect on net international reserves of operations involving debt and debt service reduction, or in relation to the unwinding of foreign currency swaps previously entered into by the Central Bank with the commercial banks, or other similar operations. The total downward adjustment to the floors would not exceed US$1 billion.

3/ Cumulative from January 1, 1992. The limits on approvals may be adjusted upwards, in consultation with the Fund, to reflect financing obtained in relation to operations involving debt and debt service reduction.

Fund distinguishing voluntary prepayments from Fund repurchases pursuant to expectations and obligations is included in the final documents. With these operations, the Philippines' relations with its commercial creditors will be reestablished on a firm basis and the option to reenter commercial loan markets will likely reemerge. The Government plans to cautiously reestablish its presence in these markets, initially through the planned issue of $100 million of bonds in the international market in early 1993.

The authorities have continued to follow a flexible exchange rate policy in 1992. With the strength of the external position, the central bank intervened in the exchange market to purchase a net $1.4 billion during the first seven months of the year. While the peso also appreciated by about 4 percent against the U.S. dollar in the first half of 1992, the appreciation in nominal effective terms was limited to 1.7 percent. In this favorable external situation, the authorities have moved decisively to liberalize the exchange system. In January, foreign exchange surrender requirements were reduced, restrictions on service payments and the use of service receipts were eased, and capital transactions liberalized. Also, as part of efforts to develop the foreign exchange market, off-floor foreign exchange trading by commercial banks began in April.

Building upon the success of these steps, the authorities have recently announced a further substantial foreign exchange liberalization, which virtually eliminates the controls that have existed for the last forty years. From September 1992, all restrictions on current account transactions have been eliminated and all surrender requirements removed. In addition, most remaining restrictions on capital transactions will be eliminated. Prohibitions on foreign deposits by Filipinos have been abolished, and foreign currency purchases of up to $1 million from banks for investment abroad no longer require approval. In parallel with these changes, foreign exchange market transactions among banks have been moved totally off floor as from August 1992.

There has also been progress in implementing structural measures in other areas in 1992. Clarifications of the implementing rules and regulations applying to the Foreign Investment Act enacted in 1991 were issued in April 1992. To encourage private sector participation in infrastructure investment, the Government simplified procedures for build-operate-transfer operations and has enhanced private sector access to ODA resources. The Government has taken action to remove 279 items from quantitative import restrictions. Following this, and pending completion of industrial rationalization programs, no more than 135 items remain subject to quantitative restrictions, a large number of which are for health and security reasons.

At the same time, the program to reduce import tariff dispersion is on track. With some exceptions, by mid-1995 tariffs would be regrouped in just four rates, the maximum rate lowered to 30 percent and average effective tariffs reduced to 20 percent from an estimated 26 percent at present. Finally, the Government is preparing legislation to strengthen the Central Bank, including provisions for its financial restructuring.