Bangko Sentral ng Pilipinas

MANILA

OFFICE OF THE GOVERNOR

29 March 2007

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

Dear Madame President:

I have the honor to submit the ***2006 Annual Report of the Bangko Sentral ng Pilipinas*** *(BSP)* pursuant to the provisions of Sections 39 and 40 of Republic Act No. 7653.

The report contains a review of key economic and financial developments in 2006, the major policies and other key measures adopted by the monetary authorities, and highlights of the BSP's operations and activities.

Very respectfully,

AMANDO M. TETANGCO, JR.
Governor

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The Governor's Foreword

The year 2006 saw a vibrant Philippine economy. Continuing economic reforms coupled with macroeconomic prudence led to broad-based economic growth and lifted market confidence, including investor sentiment. The growing demand for Philippine goods and services in the international markets propelled exports while strong domestic consumption was sustained during the year.

Economic growth was realized in an environment of decelerating inflation. Headline inflation in 2006 averaged 6.2 percent, lower than the 7.6 percent in 2005. During the last two months of the year, inflation dropped to within the target range of 4-5 percent. Core inflation, an indicator of the underlying trend in prices, also declined and averaged 5.5 percent, the lowest since 2003. In addition to past monetary policy actions, lower domestic oil prices, a stronger peso, and improved agricultural production contributed to the continued easing in price pressures. Decelerating inflation allowed the BSP to keep its policy rates unchanged in 2006, after a round of policy-tightening measures in 2005. This development likewise provided the monetary authorities flexibility to restore the tiering scheme on banks' placements with the BSP in November to encourage banks to use their excess funds for lending and spur business activity. The improving inflation outlook and easing market concerns over the sustainability of the government's fiscal position saw the softening of domestic interest rates, including bank lending rates, during the year.

The BSP remained steadfast in its efforts to further strengthen the banking system by undertaking the necessary reforms to enhance its ability to intermediate funds and manage risks as well as make it a more efficient channel of monetary policy. The banking system's total resources have continued to rise on the back of a growing deposit base and higher capitalization. Asset quality continued to improve as shown by the sustained decline in the KBs' NPL ratio due in large part to the implementation of the SPV law. Using the new risk-based framework, the KBs' CAR has remained above the statutory level set by the BSP and the international standard.

On the external front, the positive sentiment brought about by the country's strong economic fundamentals translated into increased foreign investments. This, along with strong exports and the steady inflow of OFW remittances, contributed to a healthy external payment balance. It also afforded the BSP the opportunity to build up its international reserves to record levels. While the surplus in the overall BOP has led to the strengthening of the peso, other regional currencies also appreciated. Therefore, the external price competitiveness of Philippine-made products with respect to competitor countries has been largely maintained.

One important milestone during the year was the BSP's prepayment in full of its outstanding obligations to the IMF. This allowed the BSP to exit early from its PPM arrangement with the Fund. The event signalled to the international community that the pursuit of macroeconomic prudence and the structural reform process in the country have firmly taken root to allow reduced engagement with the IMF. At the same time, the prepayment served as a watershed event in the Philippines' relationship with the IMF, since it marked the conclusion of the country's use of the IMF resources after nearly four and a half decades.

Against this backdrop, the BSP's policy directions will continue to be founded on its responsibility of promoting sound monetary and financial sector policies. In the monetary sector, the BSP will observe vigilant monetary policy by continuing to closely monitor risks to the inflation outlook in order to move in a pre-emptive fashion to ward off threats against price stability which is important for balanced, strong and sustainable economic growth. Looking ahead, while the inflation outlook is generally benign, it remains at risk from energy-related cost pressures, shocks to agricultural output arising from weather-related disturbances, and the rapid liquidity expansion. The BSP will therefore keep a careful eye over these and other potential price pressures and will respond appropriately.

In the area of banking supervision, the BSP will pursue further the implementation of key financial sector reforms needed to maintain a healthy and stable banking system and develop a deeper and more efficient capital market. The BSP will follow through with its regulatory reforms aimed at aligning the prudential regulation of the banking system with international standards and best practices. In particular, the BSP has been preparing the banking system for compliance with Basle II Capital Adequacy Framework by 2007. Banks had earlier been required to comply with international financial reporting standards. Other key initiatives will be aimed at further strengthening banks' corporate governance, risk management and capital adequacy. The BSP will also continue to support additional reform initiatives to deepen the development of the Philippine capital market, including through close coordination with Congress to pass vital legislations.

The BSP is confident that a more robust, sustainable and balanced economic growth will be achieved in 2007, with macroeconomic reforms already in place and given the Government's commitment to sustain them. The prospect for more enduring growth will be reinforced by sustaining the momentum of structural reforms. Structural reforms are key to enhancing economic efficiency, increasing policy flexibility and strengthening the foundation for a long-lasting and more vibrant economic growth.

AMANDO M. TETANGCO, JR.

29 March 2007

INTRODUCTION

About the BSP

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

Section 20, Article XII, 1987 Philippine Constitution

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

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

The BSP's Legal Mandate

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

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

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

Powers and Functions

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

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

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

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

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

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

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

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

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

Our Mission

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

Our Vision

The BSP aims to be a world-class monetary authority and a catalyst for a globally competitive economy and financial system that delivers a high quality of life for all Filipinos.

Our Core Values

Integrity
Excellence
Patriotism
Solidarity
Dynamism

The Monetary Board

Amando M. Tetangco, Jr.
Chairman and Governor

Romulo L. Neri
Member

Vicente B. Valdepeñas, Jr.
Member

Raul A. Boncan
Member

Juanita D. Amatong
Member

Nelly F. Villafuerte
Member

Alfredo C. Antonio
Member

The Management Team

Executive Management

Amando M. Tetangco, Jr.
Governor

Juan De Zuñiga, Jr.
Assistant Governor and General Counsel

Vicente S. Aquino
Executive Director II

Teresita O. Hatta
Assistant Governor

Ma. Ramona Gertrudes D.T. Santiago
Managing Director

Monetary Stability Sector

Diwa C. Guinigundo
Deputy Governor

Rene N. Carreon
Managing Director

Celia M. Gonzalez
Managing Director

Pedro P. Tordilla, Jr.
Managing Director

Ma. Aurora L. Cruz[1]
Acting Managing Director

Ma. Cyd N. Tuaño-Amador[1]
Acting Managing Director

Supervision and Examination Sector

Nestor A. Espenilla, Jr.
Deputy Governor

Ma. Dolores B. Yuvienco[2]
Managing Director

Ma. Corazon J. Guerrero
Managing Director

Security Plant Complex

Armando L. Suratos
Concurrent Head

Nestor B. Salanio[4]
Officer-in-Charge

Resource Management Sector

Armando L. Suratos
Deputy Governor

Evelyna C. Avila[2]
Managing Director

Wilhelmina A. De Las Alas[3]
Managing Director

Teresita S. Bulseco
Acting Managing Director

[1] Ms. Ma. Aurora L. Cruz and Ms. Ma. Cyd N. Tuaño-Amador were promoted to Managing Director effective 3 January 2007.
[2] Ms. Evelyna C. Avila and Ms. Ma. Dolores B. Yuvienco were promoted to Assistant Governor effective 19 January 2007.
[3] Ms. Wilhelmina A. De Las Alas retired from the BSP effective 3 November 2006.
[4] Mr. Nestor B. Salanio assumed office as Officer-In-Charge effective 5 December 2006 replacing Mr. Nestor D. Garcia, Managing Director, who retired from the BSP effective 30 November 2006.

LIST OF ACRONYMS, ABBREVIATIONS AND SYMBOLS

ABF	Asian Bond Funds
ABMI	Asian Bond Market Initiative
ACBF	ASEAN Central Bank Forum
ACC	Asian Consultative Council
ADB	Asian Development Bank
AFDM	ASEAN Finance and Central Bank Deputies Meeting
AFAS	ASEAN Framework Agreement on Services
AFF	Agriculture, Fishery and Forestry
AFMM	ASEAN Finance Ministers' Meeting
AFS	Audited Financial Statements
AMCs	Asset Management Companies
APEC	Asia Pacific Economic Cooperation
APG	Asia Pacific Group
ASEAN	Association of Southeast Asian Nations
BBCP	BSP Business Continuity Plan
BEST	BSP Educational Scholarship and Training
BIR	Bureau of Internal Revenue
BIS	Bank for International Settlements
BLES	Bureau of Labor and Employment Statistics
BMBEs	Barangay Micro-Business Enterprises
BMCPF	Basic Model of Communication Process Flow
BoC	Bureau of Customs
BOP	Balance of Payments
BPM5	Fifth Edition of the BOP Manual
BPO	Business Process Outsourcing
BPR	Bank Performance Report
BSA	Bilateral Swap Arrangement
BSP	Bangko Sentral ng Pilipinas
BSP-EPRP-AIP	BSP Emergency Preparedness and Response Plan on Avian Influenza Pandemic
BTr	Bureau of the Treasury
BTRCP	Bureau of Trade Regulation and Consumer Protection
CAR	Capital Adequacy Ratio
CAS	Central Accounting System
CCRs	Credit Card Receivable
CEMLA	Center for Monetary Studies in Latin America
cFAS	Core Financial Accounting System
CIPI	Certification International Philippines, Inc.
CLMV	Cambodia, Laos, Myanmar and Vietnam
CMFP	Center for Monetary and Financial Policy
CMI	Chiang Mai Initiative
CNP	Clean Note Policy
CPI	Consumer Price Index
CRIS	Credit Information System
CSD	Critical-Support Departments
CTRM	Committee on Tariff and Related Matters
DA	Department of Agriculture

DBCC	Development Budget Coordination Committee
DCS	Depository Corporations Survey
DDA	Demand Deposit Account
DepEd	Department of Education
DER	Department of Economic Research
DES	Department of Economic Statistics
DILG	Department of Interior and Local Government
DIR	Daiwa Institute of Research
DLC	Department of Loans and Credit
DMFAS	Debt Management and Financial Analysis System
DOF	Department of Finance
DOH	Department of Health
DOJ	Department of Justice
DORT	Directors of Research and Training
DMFAS	Debt Management and Financial Analysis System
DSGE	Dynamic Stochastic General Equilibrium
DTI	Department of Trade and Industry
DvP	Delivery versus Payment
DWP	Data Warehousing Project
ECWS	Electronic Cash Withdrawal System
eRediscounting	Electronic Rediscounting
EDYRF	Exporters Dollar and Yen Rediscount Facility
EFS	Executive Forum Series
EFTIS	Electronic Funds Transfer Instruction System
EMEAP	Executives’ Meeting of East Asia Pacific Central Banks
EMP	Exchange Market Pressure
EOH&SMS	Environmental and Occupational Health and Safety Management System
EPP	Edukasyong Pangkabuhayan at Pantahanan
EPIRA	Electric Power Industry Reform Act
EPRA	Economic Policy Reform and Advocacy
ESE	Environmental Scanning Exercise
ERB	Energy Regulatory Board
ETWG	Technical Working Group on Economic and Financial Monitoring
EXCO	Executive Committee
EWS	Early Warning System
FAR	Financial Audit Report
FBT	Food, Beverage and Tobacco
FCDU	Foreign Currency Deposit Unit
FDEIS	Foreign Direct Equity Investment System
FIs	Financial Institutions
FIE	Fixed Income Exchange
FIREBS	Financial Institutions, Real Estate and Business Services Sector
FLP	Financial Literacy Program
FLW	Fuel, Light and Water
FMM	Finance Ministers’ Meeting
FMP	Finance Ministers’ Process
FOF	Flow of Funds
FRP	Financial Reporting Package
FTA	Free Trade Agreement

FXPIMS	Foreign Exchange Portfolio Investment Management System
FXTB	Fixed Rate Treasury Bonds
FXTN	Fixed Rate Treasury Notes
GA	General Assembly
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
GIR	Gross International Reserves
GNP	Gross National Product
GOE	Group of Experts
GS	Government Securities
HEKASI	Heograpia, Kultura at Sibika
HLURB	Housing and Land Use Regulatory Board
HR	Human Resource
HT1	Hybrid Tier 1
IACTS	Inter-Agency Committee on Trade in Services
IAS	International Accounting Standards
IC	Insurance Commission
ILF	Intraday Liquidity Facility
ILO	International Labor Organization
IMF	International Monetary Fund
IRIS	Integrated Regional Information System
ISO	International Organization for Standardization
ISP	Internet Service Provider
IT	Information Technology
ITS	Integrated Tax System
ITR	Income Tax Return
JPEPA	Japan-Philippine Economic Partnership Agreement
JVAs	Joint Venture Agreements
KBs	Commercial Banks
LCs	Letters of Credit
LFS	Labor Force Survey
LGUs	Local Government Units
LTO	Land Transportation Office
M3	Domestic Liquidity
MAP	Micro-Agri Product
MB	Monetary Board
MCD	Mission-Critical Departments
MFJ	Ministry of Finance of Japan
MFSM	Monetary and Financial Statistics Manual
MLT	Medium- and Long-Term
MOA	Manual of Accounts
MORMS	Middle Office Risk Management System
MSEP	Management Skills Enhancement Program
MTP	Major Trading Partner
NBFIs	Non-Bank Financial Institutions
NBQBs	Non-Bank with Quasi-Banking Functions
NG	National Government
NIR	Net International Reserves
NPAs	Non-Performing Assets
NPC	National Power Corporation

NPCC	National Price Coordinating Council
NPLs	Non-Performing Loans
NSO	National Statistics Office
NTC	National Telecommunication Commission
NTMs	Non-Tariff Measures
OBUs	Offshore Banking Units
OFWs	Overseas Filipino Workers
OMOs	Open Market Operations
OY	Operating Year
PAS	Philippine Accounting Standards
PCA	Prompt Corrective Action
PDEx	Philippine Dealing and Exchange Corporation
PDEX	Philippine Dealing and Exchange
PDIC	Philippine Deposit Insurance Corporation
PDS	Philippine Dealing System
PFRS	Philippine Financial Reporting Standards
PhilPaSS	Philippine Payments and Settlements System
PHISIX	Philippine Composite Stock Index
PIC	Public Information Campaign
PFRS	Philippine Financial Reporting Standards
PNOC	Philippine National Oil Company
PPM	Post-Program Monitoring
PPS-FES	PhilPass Front-End System
PRAISE	Program Awards and Incentives for Service Excellence
PSE	Philippine Stock Exchange
PSEi	Philippine Stock Exchange Index
QMS	Quality Management System
R.A.	Republic Act
RATE	Run After Tax Evaders
RATS	Run After the Smugglers
RDA	Reserve Deposit Account
REER	Real Effective Exchange Rate
RIPS	Revenue Integrity Protection Service
RP	Repurchase
ROPOA	Real and Other Properties Owned or Acquired
RoSS	Registry of Scripless Securities
ROW	Rest of the World
RP	Repurchase
RRP	Reverse Repurchase
RTGS	Real-Time Gross Settlement
RVAT	Reformed Value Added Tax
SAP	System Application and Products
SDA	Special Deposit Account
SDRs	Special Drawing Rights
SEACEN	South East Asian Central Banks
SEANZA	South East Asia, New Zealand and Australia
SEC	Securities and Exchange Commission
SED	Supervision and Examination Department
SEG	SEACEN Expert Group
SEM	Security Engineer Machine

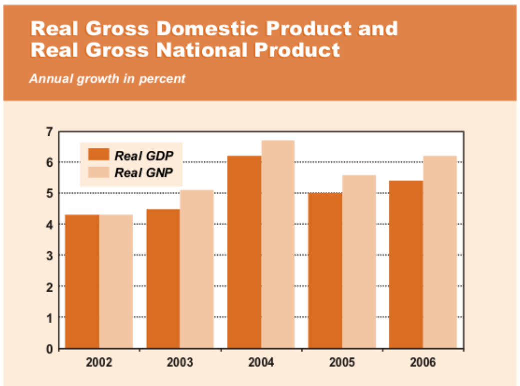
SFOM-1	Senior Finance Officials' Meeting
SNA	System of National Accounts
SMS	Short Messaging System
SOAR	Sustaining Outstanding Accomplishments and Results
SPC	Security Plant Complex
SPEI	Selected Philippine Economic Indicators
SPV	Special Purpose Vehicle
STP	Straight Through Processing
Sub-COTT	Sub-Committee on Tourism and Trade
T-bills	Treasury Bills
T-bonds	Treasury Bonds
TCWM	Technical Sub-Committee on WTO Matters
TESDA	Technical Education and Skills Development Authority
TLRC	Technology and Livelihood Resource Center
TOR	Terms of Reference
TWG	Technical Working Group
UAT	User Acceptance Test
U/KBs	Universal and Commercial Banks
UNCTAD	United Nations Conference on Trade and Development
VAT	Value-Added Tax
WC-AFAS	Working Committee on AFAS
WGs	Working Groups
WTO	World Trade Organization

PART ONE: THE PHILIPPINE ECONOMY

Domestic Economy

The Philippine economy continues to expand

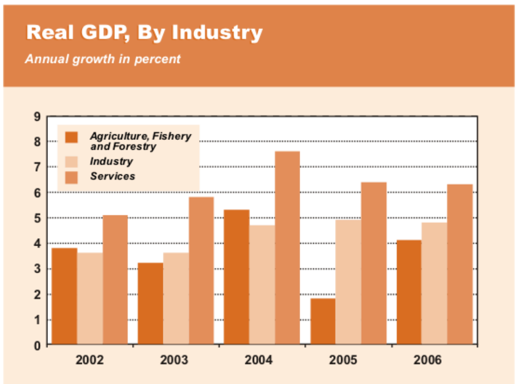
The Philippine economy continued to expand in 2006, propelled by the resurgence of agriculture production and resilience in services and industry. On the demand side, the expansion was driven by sustained consumption, strong exports and the recovery of investment. Gross Domestic Product (GDP) grew by 5.4 percent – surpassing the 5.0 percent growth rate achieved in 2005. However, this rate of growth was slightly below the lower end of the Government's target of 5.5-6.1 percent set for 2006 (Table 1).



Aggregate Output and Demand

Services and industry drive economic growth

The growth in the domestic economy was driven by the upbeat performance of agriculture in the first three quarters of the year and the continued growth of industry and services. On the demand side, personal and government consumption expenditures exhibited stronger growth in 2006 (Table 1). Exports grew at a faster pace relative to 2005 while investments rebounded.



The services sector continued to lead growth from the supply side in 2006, expanding by 6.3 percent, and representing 48.3 percent of total GDP. This translated to a 3.0 percentage points contribution to the 5.4 percent GDP growth for the year. Outperforming their 2005 growth levels, strong performances were registered by subsectors in private services particularly by business process outsourcing (BPO), hotel and restaurant activities, as well as government services and real estate. Positive growth rates were registered in transport and communications owing to the strong performance of land transport and trade. Finance also contributed to the expansion in services due mainly to the surge in stock market activities.

The industry sector, which expanded by 4.8 percent in 2006, accounted for 32.8 percent of total GDP and contributed 1.6 percentage points to total GDP growth rate. Following the increased demand for office spaces and housing, remarkable growths were seen in the construction and electricity, gas and water subsectors. Manufacturing underperformed slightly due to continued weakness in machinery manufactures. The expansion of industry was weighed down by the large decline in mining and quarrying in the last quarter of 2006 due largely to environmental concerns which slowed down this subsector's growth.

The agriculture, fishery and forestry sector (AFF) achieved a 4.1 percent growth, outperforming its 2005 growth rate of 1.8 percent. The AFF accounted for the remaining 18.8 percent of overall GDP, translating to a 0.8 percentage point contribution in total growth rate. Agriculture production led this sector's growth due primarily to the expansion of harvest areas, use of high yielding seed varieties, and favorable prices.

Consumption spending supports growth on the demand side

On the demand side, growth was supported primarily by personal expenditures, on the back of strong remittance inflows (Table 1a). Government spending also registered strong growth due to higher revenue collections in the early part of 2006, as well as the upturn in spending in the final quarter of 2006 following the passage of the Supplemental Budget. Furthermore, sustained low inflation and interest rates boosted consumer spending as well as investments. The rebound in investment expenditure reflected the reversal of the performance of construction and durable equipment, and the improving investment climate in the country. Following the recovery in the economic growth of Japan and Europe, as well as the continuing strength of the US economy, total exports accelerated by 12.1 percent, with merchandise exports growing by 12.9 percent.

Labor, Employment and Wages

Overall labor market conditions continue to be resilient

Employment conditions continued to be resilient in 2006. Using quarterly average sourced from the National Statistics Office (NSO), total employed persons reached 33.0 million in 2006 (Table 2).[1] Employment growth was spread evenly during the year, except in the fourth quarter of 2006, which registered the lowest gain. This was a reversal of the 2005 trend when employment peaked during the fourth quarter. Using the January 2007 Labor Force Survey (LFS) by the NSO, total employed persons increased by 1.5 million year-on-year.

Using the new definition of unemployment, the four rounds of LFS in 2006 showed an average unemployment rate of 7.9 percent, which translated to about 2.83 million unemployed persons.[2] Based on the LFS, the highest rate of unemployment in 2006 was recorded in the first and second quarters at 8.1 percent each, while the lowest unemployment rate at 7.3 percent was recorded in the fourth quarter of 2006. An unemployment rate of 8.0 percent was reported in the third quarter of 2006.

Employment in 2006 was driven by the strong performance of the services sector, which rose by 3.1 percent, and the modest expansion in the combined AFF sector, which increased by 1.6 percent. Employment in the industry sector fell slightly by 0.4 percent from the year-ago level.

Prices

Inflation trends downward

Lower oil prices, strong peso and robust food output drive inflation down

Inflation averaged lower in 2006 compared to its year-ago level, reflecting the easing of oil prices, a stronger peso, and generally stable food prices. Headline inflation for

[1] Computed as the average of the results of the four rounds of Labor Force Survey (i.e., January, April, July and October) for 2006.

[2] Starting April 2005, the new LFS questionnaire was used to estimate the unemployed, which included all persons who were 15 years old and over as of their last birthday and were reported as without work, currently available for work, and seeking work or not seeking work due to valid reasons. The old unemployment definition did not consider the criterion on availability for work. The inclusion of the availability criterion in the new definition was aimed at fully adopting the international standards prescribed by the International Labor Organization (ILO).

2006 based on the 2000 consumer price index (CPI) series averaged 6.2 percent, a deceleration from 7.6 percent in the previous year as price pressures in all commodity groups for both food and non-food moderated. While the headline inflation rate was higher than the government's target range of 4.0-5.0 percent for 2006, the deceleration in inflation starting April, which was earlier than expected, supported the BSP's earlier assessment of a generally declining path of inflation for 2006. By November and December 2006, inflation at 4.7 percent and 4.3 percent, respectively, had dropped to within the target range for the year.

Food and non-food inflation rates decline

The average inflation for food, beverage and tobacco (FBT) slowed down to 5.5 percent from 6.4 percent in 2005. Food inflation eased reflecting mainly the slowdown in the rise in the prices of most food items (rice, cereal preparations, meat, fish, and dairy products), even with the start of implementation of the higher consumption tax in February and the effects of weather-related disturbances.

Non-food inflation likewise eased by 1.7 percentage points to 7.0 percent from 8.7 percent last year. All commodity groups of the non-food index registered slower inflation in 2006, with steep price declines noted for fuel, light and water (FLW), as well as transport and communication services. The decline in international oil prices, which triggered reductions in local pump prices, continued to be the main influence on non-food inflation.

Headline inflation both for Metro Manila and areas outside of Metro Manila during the year fell to 7.0 percent and 6.0 percent, respectively. The decline in Metro Manila headline inflation was linked mainly to the decline in FLW as well as services.

Core inflation similarly eases

Meanwhile, core inflation—defined as headline inflation excluding selected food and energy products—also eased in 2006. The annual average core inflation measure slipped to 5.5 percent in 2006 from 7.0 percent in the previous year. Alternative measures of core inflation estimated by the BSP also trended downward during the year.

Core Inflation Measures
Year-on-Year Change

	2000=100	
	2005	2006
Official Measure [1]	7.0	5.5
Trimmed Mean [2]	6.2	5.4
Weighted Median [3]	5.6	5.0
Net of Volatile Items [4]	6.0	4.9

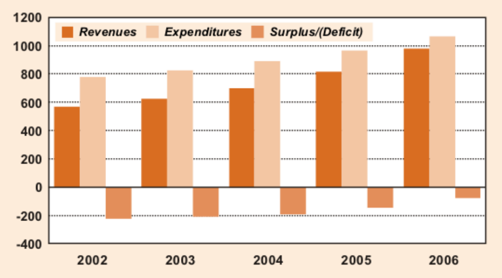
[1] *The official definition excludes 18.4 percent of the CPI basket as follows: rice, corn, fruits & vegetables, fuel items (gas, LPG, kerosene, gasoline and diesel).*
[2] *The trimmed mean represents the average inflation rate of the (weighted) middle 70 percent in a lowest-to-highest ranking of year-on-year inflation rates for all CPI components.*
[3] *The weighted median represents the middle inflation rate (corresponding to a cumulative CPI weight of 50 percent) in a lowest-to-highest ranking of year-on-year inflation rates.*
[4] *The net of volatile items method excludes the following items: educational services, fruits and vegetables, personal services, rentals, recreational services, rice and corn.*

Operations of the National Government

Strong revenue collections and restrained spending improve NG's cash position

The National Government (NG) operations in 2006 exhibited notable gains in fiscal consolidation. The NG deficit in 2006 declined to 1.1 percent of GDP, lower than the programmed ceiling of 2.1 percent of GDP and below the 2.7 percent of GDP recorded in 2005. The NG recorded a deficit of ₱64.8 billion, way below the ceiling of ₱124.9 billion projected for the year and lower than the ₱146.8 billion incurred in 2005. The lower deficit was a result of strong revenue collections, partly as a result of the Reformed Value Added Tax (RVAT) law, and restrained spending as a result of spending constrained by the non-passage of the 2006 proposed budget and the delayed passage of the supplemental budget. Revenues grew by 20.0 percent to ₱979.6 billion, exceeding the target by 0.6 percent. Expenditures likewise increased to ₱1,044.4 billion during the year but fell below the programmed level by 5.0 percent (Table 4).

National Government: Cash Operations
In billion pesos



The tax revenue gains were attributable to the implementation of new tax laws, particularly the increase in the VAT rate starting February 2006. Likewise, administrative measures of the Bureau of Internal Revenue (BIR) and the Bureau of Customs (BoC) contributed to higher revenues. These measures included the following: (1) enhancing the Integrated Tax System (ITS) of the BIR including the electronic tax filing of companies; (2) conduct of taxpayer compliance verification drives; (3) adoption of industry benchmarks in measuring taxpayers' compliance; (4) filing of charges against tax evaders under the Run After Tax Evaders (RATE) program of the BIR and the Run After the Smugglers (RATS) program of the BoC; and (5) prosecution, suspension and dismissal from office of officials who deprive revenue generation office of revenues due from the government under the Revenue Integrity Protection Service (RIPS). Efforts to boost collection efficiency resulted in the improvement of the NG revenue effort from 15.1 percent of GDP in 2005 to 16.3 percent. Likewise, tax effort rose to 14.3 percent in 2006 from 13.0 percent in 2005. Non-tax revenues also increased as the Bureau of the Treasury (BTr) exceeded its target in terms of higher investment and interest income.

Total NG expenditures increased by 8.5 percent, lower than the programmed level for the year. Allotments to the Local Government Units (LGUs) exceeded both the year-ago and the programmed levels. Interest payments rose by 3.4 percent, but was below the target level by 8.8 percent due to lower interest rates and the stronger peso. The NG's interest payments dropped to 5.2 percent of GDP in 2006 from 5.5 percent in 2005. Thus, NG expenditures as a percentage of GDP declined to 17.4 percent in 2006 from 17.8 percent in 2005.

The deficit was financed mainly from domestic sources which covered 57.8 percent of the total financing requirement. The share of domestic borrowings, however, was slightly lower than the targeted 58.4 percent of the financing mix due to the availability of external financing that carried concessional interest rates and longer maturities.

Monetary and Financial Conditions

Domestic liquidity expands on strong foreign exchange inflows

Demand for money continued to grow in 2006, driven mainly by strong external inflows from exports, foreign investments and overseas Filipino workers' (OFWs) remittances, which contributed to the buildup in the net foreign assets of both the BSP and the financial system. Domestic credit activity has started to pick up during the last quarter of the year.

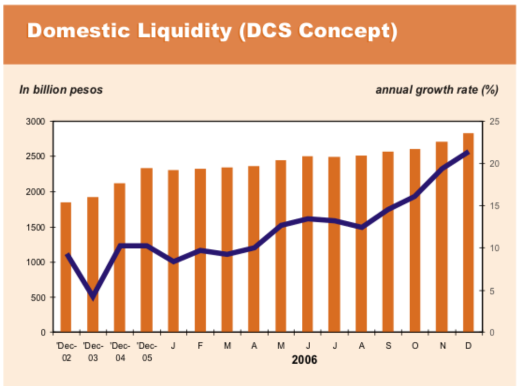
The Philippine financial system continued to show broad improvements in key financial indicators in 2006. The continued expansion in economic activity, easing of inflationary pressures, strengthening of the peso and strong inflow of capital from abroad buoyed sentiment in the banking system, bond market and the local bourse.[3]

Monetary Conditions

Monetary Aggregates

Domestic liquidity accelerates

After posting single-digit growth rates for the first three months of 2006, domestic liquidity or M3 growth posted double-digit rates starting April to peak at 21.4 percent in December (Table 5).



Domestic liquidity expansion during the year was driven mainly by strong foreign exchange inflows from exports, foreign investments and OFW remittances. These foreign inflows allowed the BSP to build up its reserves and for the BSP and the NG to prepay their foreign obligations.

[3] Please refer to Box Article 1 for a broader view of Philippine financial developments and flow of funds.

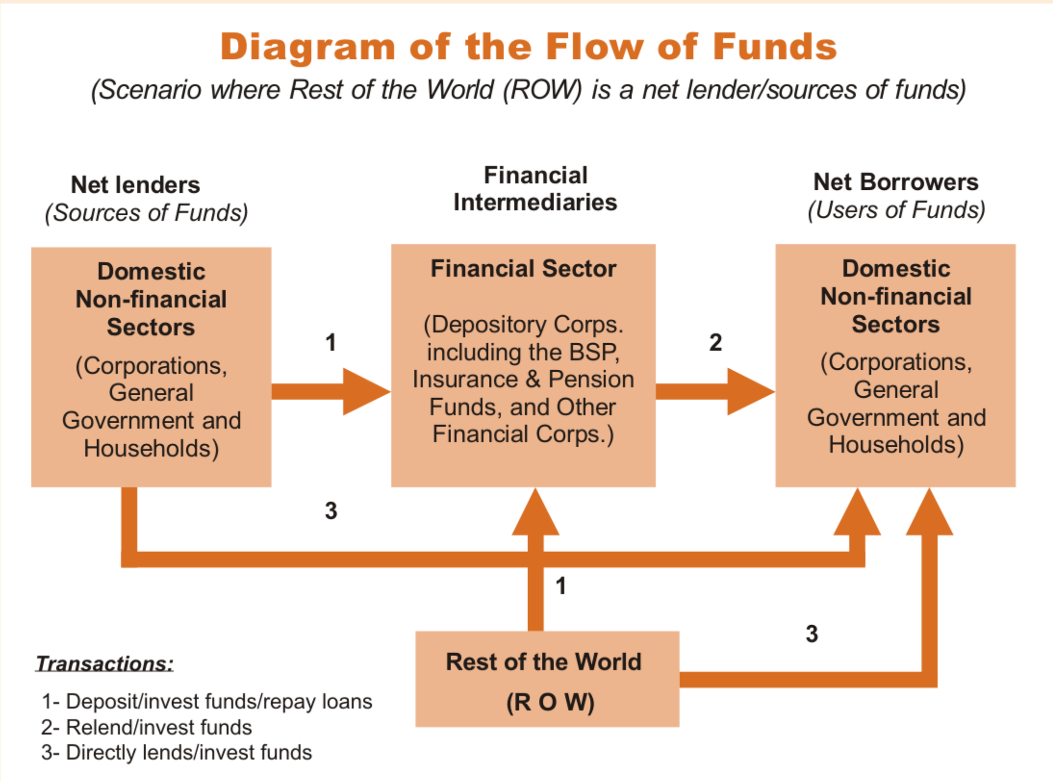
Box Article 1:

THE PHILIPPINES FLOW OF FUNDS

On December 5, 2006, the BSP released the preliminary 2000-2004 FOF statistics of the Philippines. In contrast to the 1980-1999 FOF, this series reflected the recommendations of the latest versions of international economic accounting manuals, i.e., the 1993 System of National Accounts (SNA), the 2000 MFSM, and the Balance of Payments Manual, Fifth Edition (BPM5).

Theoretical Framework

The Flow of Funds (FOF) presents the financial transactions among the different institutions of the economy, and between these institutions and the rest of the world. The FOF also shows the various financial instruments in which institutions transact with each other. More importantly, the FOF identifies which institutions are net borrowers and net lenders in the series of transactions. Institutions are categorized into four (4) types, namely: financial corporations, non-financial corporations, general government and household sector. The FOF can be used to validate results of the National Accounts. Below is a diagram on the role of financial institutions in financial investment and fund raising of the non-financial sectors.



FOF Developments: 2000-2004

The FOF data showed that all sectors were savers during the five-year period, except for the general government. The household sector was consistently the largest saver averaging ₱353 billion annually until 2003. This could be attributed to the continuous inflow of remittances from OFW and profits from the operation of household-based enterprises. By 2004, non-financial corporations became the prime saver due to increased profits of private non-financial corporations. It was also noted that for this year, capital transfers had become a significant source of financing, particularly for public non-financial corporations following the absorption by the NG of the ₱200 billion debt of the NPC.[1]

The domestic economy's capital formation and other capital accumulation expanded at an average annual rate of 6.5 percent in 2000-2004.[2] The non-financial corporations and the households emerged as the top investors during the period. The non-financial corporations' investments were mostly in construction and durable equipment, as well as in real estate, particularly land for business operations and expansion. Meanwhile, households' investments were largely in dwelling units.

The data also indicated that the country reversed from being a net borrower from the rest of the world at ₱88 billion in 2000 to a net lender beginning 2003 at ₱20 billion.[3] Among the domestic sectors, households were consistently the major net lender in the domestic economy, largely in the form of securities.

On the other hand, the general government was persistently in deficit during the review period, relying heavily on the issuance of government securities for financing. With the NG's assumption of NPC's debt in 2004, the public non-financial corporations' obligation was greatly reduced. As a result, the non-financial corporations became the key net lender in 2004 after years of being a net borrower.

The financial corporations' net financing also made a turnaround from being a borrower in 2000-2002 to a lender in 2003-2004. The surpluses were placed mainly in securities and loans receivables.

For the total domestic economy, in general, securities, loans and other accounts receivables were the widely used instruments during the period under review. Transactions in these instruments almost always ended in surplus, whether the domestic economy was a net lender or a net borrower.

Future Plans for the Philippine FOF

The BSP, after resolving the statistics-related problems and theoretical issues, will now focus on facilitating the timely release of the succeeding annual FOF statistics. Developmental activities will also be undertaken to provide more analytical uses of the FOF. The BSP shall pursue the compilation of the detailed FOF matrix which will show for each sector, not only the financial asset/liability by financial instrument but also the sectors where the investments were made and the sectors providing the financing. Likewise, measures to show the corresponding stock data will be pursued to provide more depth in the analysis since asset and liability structure could be better analyzed by stock data than flow data. Since these proposed efforts on the FOF will likely be constrained by data gaps, these will be tried initially for those institutions with adequate data support and will be shown as satellite accounts.

Endnotes:

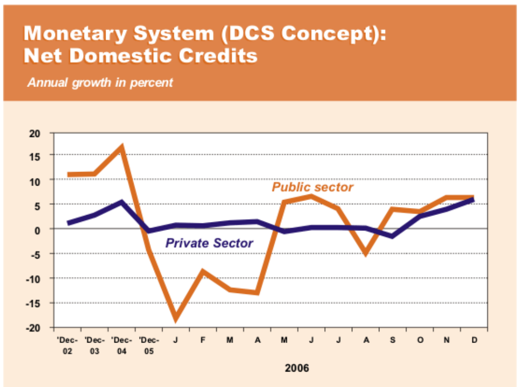
[1] The NG absorbed the ₱200 billion debt of the NPC pursuant to the Republic Act No. 9136 (also known as Electric Power Industry Reform Act (EPIRA)) and Executive Order No. 370.
[2] Other capital accumulation includes purchase and sale of patents, copyrights, trademarks, and franchises. Purchase and sale of land are also included but would only be covered in transactions among the domestic sectors and will cancel out in the process of national consolidation. It may be noted that details on this variable became available for most of the data source beginning in 2002 only.
[3] Conversely, therefore, ROW shifted its position from a net lender to the domestic economy in the earlier years to a net borrower in 2003 and 2004 (Annex A).

Annex A

Net Lenders in the Economy		Net Fund Provision/Availment (in ₱ Billions & %)	Net Borrowers in the Economy	
Sector	**Net Lending in ₱ Billions & %**		**Sector**	**Net Borrowing (in ₱ Billions & %)**
		2000		
Households	**121**		General Government	**164**
	58%	**210**		78%
Rest of the World	**88**		Non-Financial Corporations	**9**
	42%			4%
		100%	Financial Corporations	**37**
				17%
		2001		
Households	**126**		General Government	**141**
	59%	**213**		66%
Rest of the World	**87**		Non-Financial Corporations	**59**
	41%			28%
		100%	Financial Corporations	**13**
				6%
		2002		
Households	**169**		General Government	**141**
	92%	**184**		76%
Rest of the World	**16**		Non-Financial Corporations	**24**
	8%			13%
		100%	Financial Corporations	**19**
				10%
		2003		
Households	**264**		General Government	**162**
	95%	**277**		59%
Financial Corporations	**14**		Non-Financial Corporations	**95**
	5%			34%
		100%	Rest of the World	**20**
				7%
		2004		
Households	**95**		General Government	**332**
	22%	**425**		78%
Non-Financial Corporations	**300**		Rest of the World	**92**
	71%			22%
Financial Corporations	**29**	100%		
	7%			

Notes:
(1)Details may not add up to total due to rounding
(2) Summary matrices and technical notes on the Philippine FOF 200-2004 are available at the www.bsp.gov.ph

On the liabilities side, growth in liquidity was reflected in the accelerated expansion in demand, savings and time deposits.



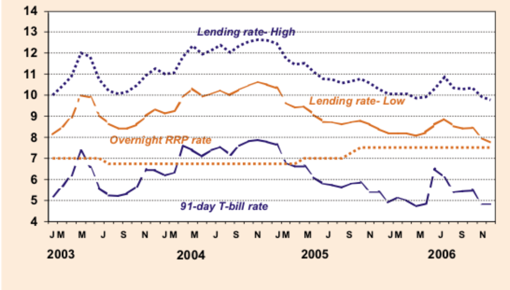
The expansion in domestic credit also contributed to the strong growth in domestic liquidity. Public sector credit accelerated by 6.7 percent in December, a reversal of the 4.1 percent contraction last year. Credit to the public sector increased following a 5.5 percent rise in credit extended to the NG. Similarly, private sector credit accelerated to 6.4 percent, a reversal of the previous year's negative growth, on the back of increased lending to private individuals and companies.

Interest Rates

Market interest rates decline on ample liquidity

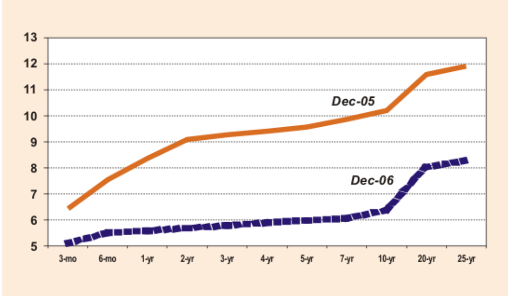
Market interest rates declined in 2006 due to ample liquidity in the system and lower supply of government securities (GS). Rates of Treasury bills ended lower during the year as investor sentiment turned positive due to solid fiscal gains, plentiful liquidity and evidence of decelerating inflation. Notable in the observed decline in interest rates were the significantly larger reductions in the longer-tenor GS. This reflected investor expectations of low inflation for the long term. Interest rates in the secondary market followed the same downtrend. Concerns over the expectations of further hikes in US interest rates and the sustainability of revenue gains from the implementation of the RVAT caused an episode of market interest rate hikes in mid-2006. The concern over the further hikes in US interest rates followed the global market jitters in May/June as investors reassessed their view of global financial conditions.

Domestic Interest Rates



Secondary Market Yield Curve

End-of-period, in percent

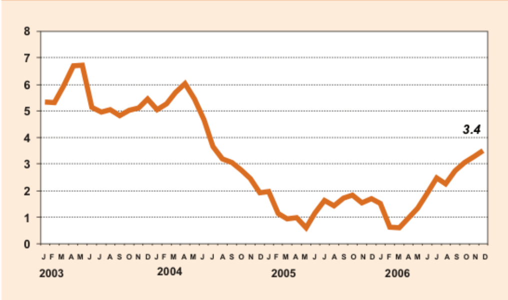


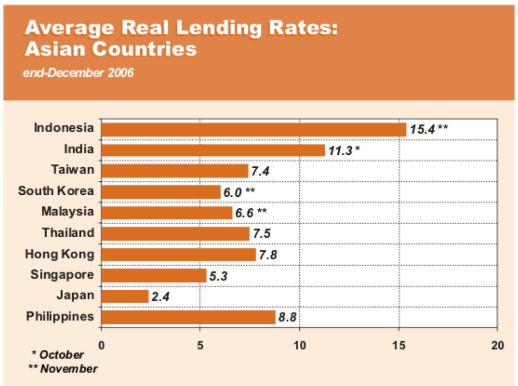
Real lending and borrowing rates increase on lower inflation

Bank lending and borrowing rates also declined, spurring gains in the credit market. However, real lending and borrowing rates increased in 2006 compared to a year ago due largely to lower inflation. Meanwhile, the Philippines' real lending rate placed in the middle of the range of lending rates of a sample of ten Asian countries.

Real Lending Rates: Philippines

Average bank lending rate less CPI Inflation





BSP's policy rates remain unchanged

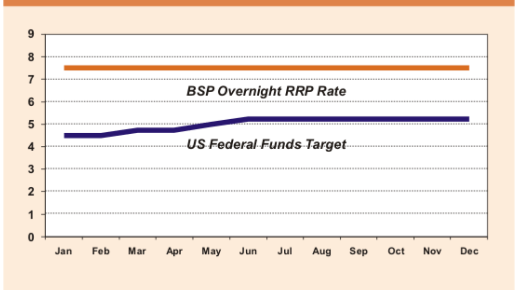
The BSP's policy rates were kept unchanged at 7.5 percent for the overnight borrowing or reverse repurchase (RRP) rate and at 9.75 percent for the overnight lending or repurchase (RP) rate during the year. However, starting in November, the Monetary Board adopted a tiering scheme on banks' aggregate placements with the BSP under the RRP and special deposit account (SDA) windows. Banks' placements with the BSP under the said windows were subject to the following interest rates: the applicable BSP published rate (RRP or SDA) for the first ₱5 billion; the applicable BSP published rate less 200 basis points for the next ₱5 billion; and the applicable BSP published rate less 400 basis points for amounts in excess of ₱10 billion. The restoration of the tiering scheme was intended to encourage banks to seek alternatives to placing their excess funds with the BSP, such as lending to the public.

2006	BSP RRP Rate (%)	US Fed Funds Rate (%)	Differential (basis points)
Jan	7.50	4.50	250
Feb	7.50	4.50	250
Mar	7.50	4.75	275
Apr	7.50	4.75	275
May	7.50	5.00	250
Jun	7.50	5.25	225
Jul	7.50	5.25	225
Aug	7.50	5.25	225
Sep	7.50	5.25	225
Oct	7.50	5.25	225
Nov	7.50	5.25	225
Dec	7.50	5.25	225

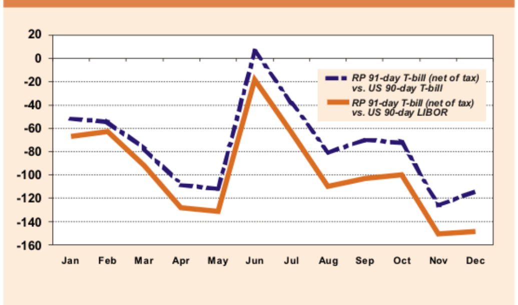
Differentials between RP and US interest rates narrow slightly

The differential between the BSP's overnight borrowing rate and the US federal funds target rate narrowed slightly in 2006 as the BSP's policy rate was unchanged while the US federal funds rate increased by a total of 100 basis points. The differentials between Philippine (RP 91-day T-bill rate) and US interest rates (US 90-day LIBOR and US 90-day T-bill rate) similarly narrowed due to the decline in the Philippines interest rates and the increase in the US interest rates. Net of tax, the differential was negative.

**BSP Policy Rate vs.
US Federal Funds Target Rate**
2006



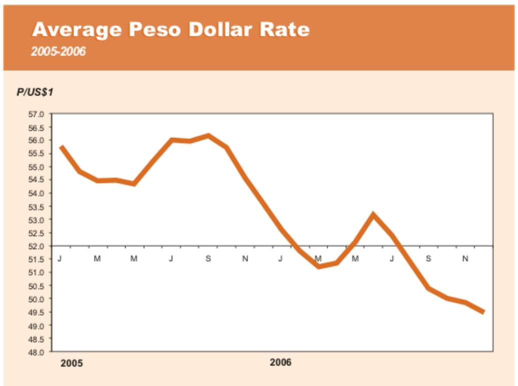
Domestic and Foreign Interest Rate Spreads
2006, in basis points



Exchange Rate

Peso gains on OFW remittances, export earnings, and capital flows

The peso strengthened markedly in 2006. Strong dollar inflows from portfolio and direct foreign investments as well as from remittances by OFWs and export earnings were mainly behind the peso's appreciation. The continued uptrend in dollar inflows reflected positive investor sentiment, which was reacting to the country's strong economic fundamentals and better-than-expected fiscal performance. Based on its average value for the year, the peso appreciated by 7.35 percent to ₱51.31/US$1 in 2006 (Table 7).[4]



The peso generally maintained its strengthening trend during the year. The local currency started the year with renewed vigor, breaching the ₱51/US$1 mark on 6 February 2006. A series of favorable events boosted the peso during the first quarter, including the implementation of the second phase of the RVAT law, the upgrading of the country's credit outlook by the largest pension fund in the US, and its retention of the Philippines in its list of permissible investment markets, and the rising dollar reserves.

The peso weakened slightly during the second quarter of 2006, influenced by negative market perception on the stability of the economy due to political concerns arising from impeachment initiatives, and concerns about the sustainability of the fiscal position. Moreover, the increased volatility in global financial markets during the May-June 2006 sell-off also adversely affected the peso. The peso's fall was mitigated by foreign exchange inflows from foreign investments and export earnings combined with remittances by OFWs.

The peso bounced back during the third quarter, even reaching a high of ₱50.106/US$1 on 22 September 2006. Strong and stable economic fundamentals, as evidenced by the solid pace of economic growth and improved fiscal performance as well as a relatively high level of foreign reserves buoyed the peso.

The peso continued its streak in the fourth quarter, breaking the ₱49/US$1 level on 27 October 2006.

[4] Dollar rates or the reciprocal of the peso-dollar rates were used to compute for the annual percentage changes.

Continued improvements in the fiscal and balance of payments (BOP) situation, along with increased net foreign inflows to the stock market provided ample support that allowed the peso to consolidate its gains. Moreover, the credit outlook revision by Moody's Investors Service to stable from negative further improved the peso's position. The outlook upgrade was brought about by the Government's progress in trimming the fiscal deficit in 2006 and in easing its dependence on external financing.

A broad-based buying of Asian currencies amid the US dollar's weakness, particularly towards the latter part of the fourth quarter, further buoyed the peso's performance. The relatively weaker performance of the US dollar vis-à-vis the Asian currencies was caused partly by the general adjustment of dollar positions; the observed diversification of central banks' foreign exchange reserves away from the US dollar; and market expectations that the Federal Reserve's stance of keeping interest rates steady would remain until mid-2007, while more interest rate increases were expected in the Euro-zone. The strong rally of the Asian currencies along with the positive domestic economic conditions allowed the peso to reach a four-and-a-half year high of ₱49.66/US$1 on 28 November 2006.

Year-to-date movements validated the strength and resilience that marked the performance of Asian currencies in 2006. Most of the Asian currencies appreciated (with the exception of the yen), the peso being one of the top gainers. In particular, the end-of-period exchange rate of the peso appreciated by 8.28 percent in December 2006 compared to the year-ago level.

Changes in Selected Asian Currencies

Asian Currency	*Appreciation/Depreciation (-) 29 Dec 2006 vs. 30 Dec 2005*
Thai baht	13.91
Indonesian rupiah	9.34
South Korean won	8.66
Singaporean dollar	8.58
Philippine peso	**8.28**
Malaysian ringgit	7.31
Chinese yuan	3.36
New Taiwan dollar	0.92
Japanese yen	-0.97

The peso maintains its competitiveness relative to competitor countries in the narrow series but real appreciation leads to some weakening in external competitiveness in the broad series

The peso largely maintained its external price competitiveness against competitor countries in the narrow series, despite the nominal appreciation of the peso as other regional currencies similarly strengthened. However, the peso's nominal appreciation, combined with the widening of price differentials with respect to the currencies of its major trading partners (MTPs) and competitor countries in the broad series, resulted in the general appreciation of the peso on a real, trade-weighted basis vis-à-vis these baskets of currencies.

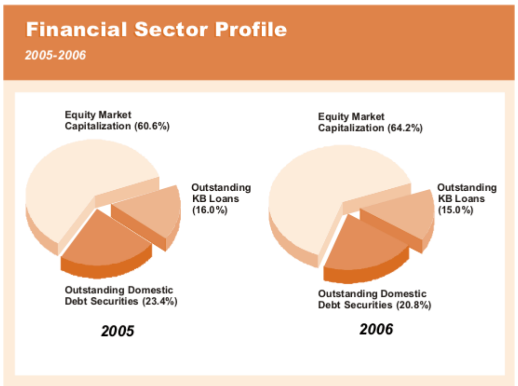
Specifically, on a year-on-year basis, the peso's real effective exchange rate (REER) index remained broadly unchanged vis-à-vis competitor countries in the narrow series, sustaining the peso's external competitiveness against the said series. By contrast, the peso exhibited a higher REER index by 12.19 percent and by 5.69 percent against the currencies of MTPs and competitor countries in the broad series, respectively (Table 7a). This suggests some loss of external price competitiveness against these baskets of currencies.

Financial Conditions

Positive macroeconomic developments lift key financial indicators

The banking system continued to exhibit growth in the midst of the rapidly changing financial services industry. Performance indicators showed strong asset expansion in 2006 on the back of a growing deposit base, pick-up in bank lending growth, strengthening capitalization and further improvements in bank asset quality. Positive market sentiment and ample liquidity also spurred demand for domestic debt instruments, which continued to be dominated by government issuances. NG bond swaps during the year further lengthened the maturity profile of government debt and created additional liquidity in the system.[5] Similarly, trading at the local bourse was at its highest in almost 10 years since the 1997 Asian crisis. Strong macroeconomic fundamentals coupled with upgrades in the country's ratings outlook accounted for the generally bullish market.

[5] The Philippines' domestic bond-swap program in 2006 saw the exchange of eligible outstanding debt papers into new three-, five-, and seven-year Benchmark bonds in February/March 2006 and new 10-year Benchmark bonds in August 2006.



Close to two-thirds of total funding requirements comes from the stock market

The Philippine stock market provided the bulk of funds required by the economy in 2006. Close to two-thirds of the aggregate amount of funds raised and invested in the financial system in 2006 were sourced from the stock market. The debt securities market and banking sector provided 20.8 percent and 15.0 percent, respectively, of the total funds required by the economy in 2006.

Performance of the Banking System

Philippine banking system remains healthy

The banking industry showed significant progress during the year as reflected in the rise in the deposit base, capital and total resources, along with lending activity. The banking sector's asset quality also exhibited notable improvements as shown by the downtrend in NPL and NPA ratios. The restructuring of the banking system, which included merger and consolidation of banks, also continued as reflected in the decline in the number of banking institutions registered during the year. The strong performance of the corporate sector, the easing inflationary environment, the improving fiscal situation and strong peso helped boost the system's overall performance. Policy changes in the areas of capital adequacy, corporate governance and transparency, risk management, among others, also helped enhance confidence in the banking system.

Selected Banking Indicators

	2005	2006 [P]	Growth Rate (%)
Deposits (₱ Billion)	2,933.5	3,436.9	17.2
Resources (₱ Billion)	4,464.1	4,943.4	10.7
KB's Loans Outstanding (₱ Billion)	1,539.4	1,695.3	10.1
Banking Institutions (Number)	879	862	-1.9
KB's NPL to Total Loans (%)	8.6	6.6	
Capital Adequacy Ratio (%) (Consolidated basis)	17.6	18.3 (Jun)	

[P] *Preliminary*

Deposit Generation

Outstanding deposits increase

Outstanding deposits of the banking system registered an increase of 17.2 percent at end-December 2006, higher than the 7.3 percent growth posted in 2005 (Table 8). Commercial banks' (KBs) deposits, which accounted for 88.1 percent of the deposit base, registered a higher growth of 16.8 percent during the year. There was also an increase in the thrift banks' deposit base in 2006 which grew by 22.5 percent as banks extended their services to micro and small enterprises.

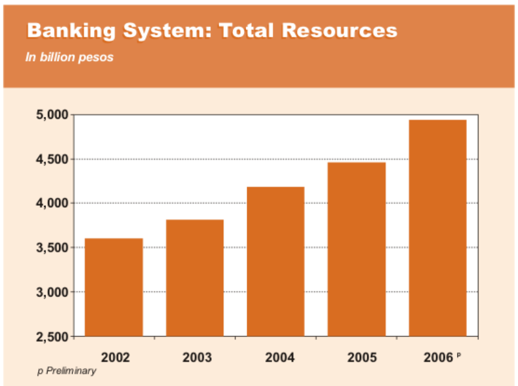
For the banking system as a whole, savings deposits which continued to account for more than half (52.1 percent) of the banks' funding base, posted a 14.1 percent growth from the end-2005 level. Similarly, demand and time deposits grew by 26.6 percent and 18.4 percent, respectively.

Despite the decline in time and savings deposit rates during the year, savings mobilization remained upbeat due to a liquid financial market traced, in turn, to the country's favorable economic environment. The average time deposit rate fell from 5.2 percent in 2005 to 4.9 percent in 2006, while the savings deposit rate dropped from 3.9 percent to 3.2 percent.

Resources

Higher loans and discounts boost total resources

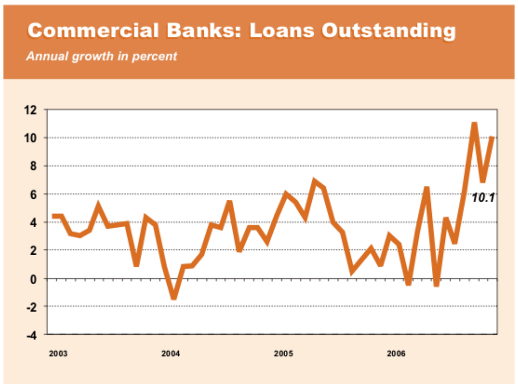
In line with the growth in deposit base, total resources of the banking system grew by 10.7 percent to reach ₱4,943.4 billion at end-December 2006 (Table 9). The growth in the system's resources can be traced to the 10.0 percent rise in loans and discounts account, which comprised the bulk of its resources at 42.6 percent. However, investments (mostly in government securities) which account for more than a quarter of the system's resources, declined by 1.2 percent.



Lending Operations

Lending growth accelerates

Commercial bank lending operations grew by 10.1 percent year-on-year to ₱1,695.3 billion in December 2006, higher than the 2.1 percent growth recorded in the same period last year. The faster growth in lending indicated the corporate sector's higher demand for loans given the declining costs of lending funds and the stronger economy.



FIREBS posts rapid growth

The main driver of loan growth was the financial institutions, real estate and business services sector (FIREBS), which accounted for 31.7 percent of total loan volume and grew at an increased pace of 28.0 percent in December 2006. Likewise, double-digit growth in lending to the Community, Social and Personal Services (14.7 percent) and Wholesale and Retail Trade (13.5 percent) sectors were registered. By contrast, loans to the manufacturing sector, which accounted for almost a quarter of total commercial bank loans, tempered overall credit growth as it contracted by 8.7 percent.

Commercial Bank Loans by Economic Activity
December 2006

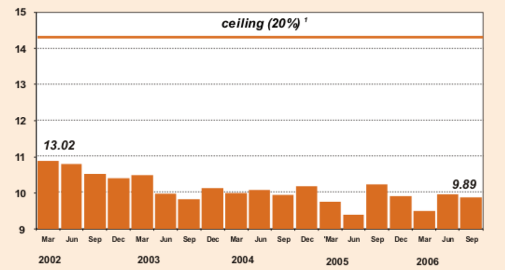
	KB loans (₱ B)	Percent to Total	Annual Growth Rate (%)
Agriculture, Fishery & Forestry	97.3	5.7	2.8
Mining and Quarrying	9.7	0.6	-15.0
Manufacturing	376.8	22.2	-8.7
Electricity, Gas & Water	75.5	4.5	7.7
Construction	25.9	1.5	-0.8
Wholesale & Retail Trade	219.6	13.0	13.5
Trans., Storage & Com.	75.3	4.4	8.8
Financial Institution, Real Estate & Business Services	538.2	31.7	28.0
Community, Social & Personal Services	277.0	16.3	14.7
TOTAL	**1,695.3**	**100.0**	**10.1**

Source: BSP

Exposure to the real estate sector remains below prescribed ceiling

The ratio of KBs' real estate loans to total loans decreased as of end-September 2006 compared to its level for the same period in 2005. KBs' real estate exposure went down to 9.9 percent of total loans in September 2006 from 10.2 percent a year ago. The ratio continued to remain below the BSP's 20 percent ceiling on bank lending to the real estate sector.

Commercial Banks
Real Estate Loans/Total Loans
Without IBL, In percent



¹ Set in June 1997

About 62 percent of the loans to the real estate sector were for the acquisition of residential properties and the acquisition and development of commercial properties. The development of subdivisions for housing (13.0 percent), construction of infrastructure projects (11.0 percent), construction of residential condominiums (2.5 percent), construction of office condominiums (2.3 percent), development of parks and other purposes (8.9 percent), accounted for the balance of the lending to the real estate sector during the year.

Credit card receivables increase

The KBs' credit card receivables (CCRs) as of end-September 2006 grew by 4.3 percent to ₱83.3 billion from the end-December 2005 level of ₱79.9 billion, reflecting increased consumer spending as well as aggressive marketing of credit card products. Of the total KBs' CCR, ₱62.3 billion was due from their bank proper, while the remaining amount was due from their subsidiaries. The ratio of CCRs to total loan portfolio remained steady at 4.0 percent. The KBs' CCR past due accounts, likewise, remained unchanged at about 19.8 percent of total CCRs relative to that in 2005.

Auto loan receivables also increase

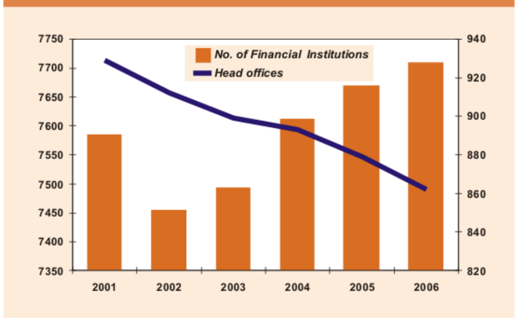
The total auto loans receivables were up by 13 percent to ₱63.1 billion as of end-September 2006 from the end-December 2005 level of ₱55.9 billion. As a ratio to total loan portfolio, auto loans stood at 3.0 percent. Only 4.4 percent of total auto loans were past due.

Institutional Developments

Consolidation in the banking industry continues

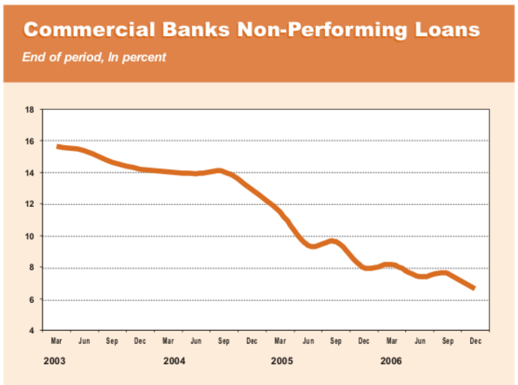
The continued efforts of BSP to establish a more robust financial system and a healthy competition encouraged greater consolidation in the banking industry. The number of banking institutions declined from 879 in 2005 to 862 in 2006, which consisted of 39 commercial banks, 84 thrift banks and 739 rural banks (Table 9a). The operating network of the banking system, consisting of head offices and branches, increased by 40 to 7,710 as of end-2006 due to the rise in the number of branches/agencies of thrift banks and rural banks. As of October 2006, there were 12 mergers, consolidations and acquisitions recorded in the banking system.

Number of Financial Institutions



Banks' asset quality improves

The banking system's asset quality improved significantly in 2006 as the NPL ratio – the ratio of NPLs to total loan portfolio – dipped to 6.6 percent as of end-December 2006. This ratio moved closer to the pre-crisis level of about 4 percent, marking improvements of 2.0 percentage points from the year ago's 8.6 percent ratio. This development was due to the 12.2 percent growth in total loan portfolio and the 13.9 percent decline in NPLs.



The Philippines' NPL ratio of 6.6 was lower than Indonesia's 8.8 percent and Thailand's 8.3 percent.[6] However, the country's NPL ratio remained relatively higher than Malaysia's 5.4 percent and Korea's 0.8 percent. The lower NPL ratio in other Asian countries may be traced to the publicly-owned asset management companies' (AMCs) purchases of the bulk of NPLs in these countries.

Moreover, the banking system's real and other properties acquired (ROPA) dropped by 5.3 percent as of September 2006 versus the same period last year. The lower NPLs and ROPA translated to an improvement in the non-performing assets (NPAs) ratio which went down to 8.3 percent as of September 2006, lower than the 8.9 percent recorded in 2005. NPAs consist of NPLs and ROPA.

Distressed assets, which comprised of NPAs and restructured loans, likewise fell to 18.5 percent as of end-September 2006, from 21.8 percent during the same period in 2005.[7]

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[6] Asia Economic Monitor 2006, ADB. Commercial banks only, data as of June 2006

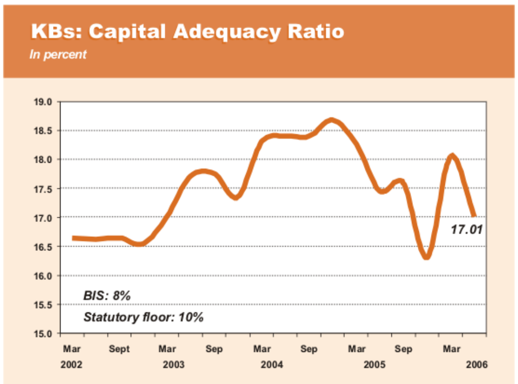
[7] Restructured loans refer to those that are current in status while restructured loans that are past due are part of NPAs.

Loan-loss provisioning rises substantially

Loan-loss provisioning also improved in 2006. The coverage of KBs' NPLs increased substantially to 80.2 percent in December 2006 from 77.5 percent in 2005. However, the coverage for KBs' NPAs contracted minimally from 41.2 percent in December 2005 to 40.4 percent a year after. The country's coverage ratios reflected banks' cautious provisioning stance against possible losses.

CAR remains above statutory level

Using the new risk-based framework, banks remained adequately capitalized as of end-June 2006. The industry's capital adequacy ratio (CAR) was at 17.0 percent on a solo basis and 18.3 percent on a consolidated basis. These ratios were lower than the end-March 2006 CARs of 18.0 percent and 19.4 percent on solo and consolidated basis, respectively. The industry's CAR continued to exceed the statutory level set by the BSP at 10.0 percent and the Bank for International Settlements (BIS) standard of 8.0 percent. This is reflective of the banking system's improved ability to cover risky assets. In particular, the increase in the banking system's qualifying capital was traced to higher retained earnings of banks and issuance of Hybrid Tier 1 (HT1) capital.[8]



The Philippines' CAR remained comparatively higher than that of Thailand (14.2 percent), Korea (13.1 percent), and Malaysia (12.7 percent).[9] Indonesia posted the highest CAR in the region at 20.5 percent as of June 2006.

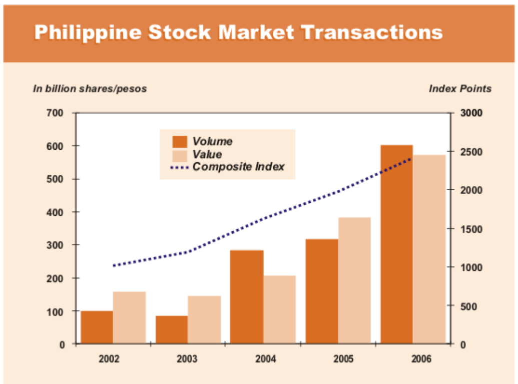
8 HT1 capital instruments are debt-like in form but mimic the characteristics of equity instruments, such as perpetual maturity, non-cumulative dividend feature and subordination in the event of liquidation.

9 Asia Economic Monitor 2006, ADB. Commercial banks only, data as of June 2006

Stock Market Developments

Bullish sentiment boosts demand for equities

Bullish sentiments boosted the demand for Philippine equities in 2006. Year-on-year, the average composite index rose by 21.6 percent to 2,412.3 index points in 2006 (Table 10).[10] However, year-end levels show that the Philippine Stock Exchange Index (PSEi) surged to 2,982.54 index points in end-December 2006, about 42.3 percent higher than the level posted at end-2005. Moreover, total trading value jumped by 49.3 percent to ₱572.6 billion, while the aggregate volume of transactions nearly doubled, posting an 89.2 percent growth to 601.0 billion shares in 2006. Foreign participation continued to outpace that of local placements as foreign investors accounted for about 55 percent of market transactions.



Selected Philippine Stock Exchange Data

Year	Composite Index (year-end)	Market Capitalization (₱M)	Ave. Daily Turnover [a] Value (₱M)	Ave. Daily Turnover [a] Vol.(mil shares)
2002	1,018.41	2,083,156.0	649.3	405.9
2003	1,442.37	2,973,832.0	588.5	348.0
2004	1,822.83	4,766,260.0	836.3	1,151.2
2005	2,096.04	5,948,370.0	1,565.4	1,296.5
2006	2,982.54	7,172,837.0	2,318.4	2,433.4

[a] *The Average Value Turnover is measured as the ratio between total value of transaction for the year and the number of trading days during the year. The Average Volume Turnover is measured as the ratio between the total volume of transactions for the year and the number of trading days during the year.*

Source: PSE, BSP Computation for average turnover

[10] In March 2006, the PSE Board renamed its benchmark index from the Philippine Composite Index (PHISIX) to the PSEi as part of efforts to boost brand recognition, and revised the 30-stock composition of the index to more accurately reflect the movement of stock prices in the local bourse. It is hoped that these revisions, combined with the new sector classification of listed firms, will help promote more stock market growth and, in turn, enhance the value of the stocks. The new index name was implemented on the first trading day of April.

Boosting local and foreign investor appetite for local equities during the year were a string of positive macroeconomic developments, foremost of which were as follows: robust economic growth, strong corporate profits, decline in inflation, appreciation of the peso, and improved fiscal performance. Likewise, successful initial and secondary offerings,[11] upgrades in the country's ratings outlook,[12] as well as implementation of reforms by the Philippine Stock Exchange (PSE) management helped shore up the value of share prices during the year and propelled the local bourse into trading at levels seen only immediately prior to the Asian crisis. However, there were also developments that served to dampen market sentiments intermittently throughout 2006, as follows: political and security concerns in January and February; fears of interest rate hikes due to oil price pressures; drop in global stock markets in May that exerted a downward pull on the local bourse; and the unexpected move by the Bank of Thailand in December to curb currency speculation.

Top Ten Fastest Growing Stock Exchanges

In Domestic Market Capitalization in US$ (End-Nov. 2006/End-Nov. 2005)

1. Shanghai SE	158.1
2. Ljubljana SE	85.6
3. Shenzhen SE	78.4
4. Jakarta SE	70.3
5. Warsaw SE	69.3
6. Luxembourg SE	65.9
7. NSE India	60.9
8. Bombay SE	59.0
9. Philippine SE	58.0
10.Hong Kong Exchanges	51.5

Source: Focus (December 2006) , World Federation of Exchanges

Nonetheless, amidst predominantly bullish sentiments, the PSE was able to raise ₱57.2 billion in capital through initial and secondary stock offerings in 2006, up by 10.7 percent from the ₱51.7-billion proceeds of the stock offerings in 2005. This was the biggest amount of capital raised by the local bourse since 1994, when the PSE was

[11] Several firms had their initial public stock offering in 2006, including those of Philippine National Oil Company (PNOC)-Energy Development Corporation, Alliance Tuna International, Inc., Citiseconline.com, Inc., and First Gen Corporation, among others.

[12] In early November 2006, Moody's Investors Service upgraded its outlook on the Philippines from negative to stable. Moody's was the last of four major credit rating agencies to update its outlook on the Philippines since the VAT rate was increased from 10 percent to 12 percent in February 2006 to help close the government's budget gap and improve its debt profile. Earlier in the year, Fitch Rating, Standard & Poor's and the Japan Credit Rating Agency upgraded their outlook on Philippine sovereigns from negative to stable following the VAT rate hike.

granted a license to operate as a stock exchange. The increased interest of foreign investors was also evident in the 191.2 percent jump in Net Foreign Buying to ₱68.5 billion in 2006 from ₱23.5 billion in 2005.[13] Subsequently, total stock market capitalization rose to ₱7,172.8 billion in end-December 2006, over 20 percent higher than the ₱5,948.4 billion capitalization recorded in end-2005. The World Federation of Exchanges noted this good performance in its December 2006 report, observing that the Philippine stock market recorded the 9th fastest growth in market capitalization at 58 percent in US dollar terms (November 2006/November 2005).[14] Compared with the rest of Asia, the PSE posted the second fastest growth in the main index (42.3 percent) and the third most rapid hike in value turnover (49.1 percent).[15]

In terms of contribution to stock market capitalization, the financial sector remained the biggest sector in the stock market, capturing over three-fifths (61.3 percent) of the capital sourced from the local bourse in 2006. This was followed by the services sector (12.4 percent), the industrial sector (10.2 percent), holding firms (8.6 percent), the property sector (6.6 percent), and the mining and oil sector (0.9 percent).

In terms of the growth of indices, holding firms constituted the fastest growing sector during the year (73.1 percent), followed by the mining and oil sector (63.4 percent), property sector (50.2 percent), services sector (49.1 percent), the financial sector (34.1 percent), and the industrial sector (19.7 percent).

The stock market volatility spiked in 2006 compared to 2005 partly because of extreme market reaction to developments, whether positive or negative.[16] From a modest start of 20.7 index points in January, the daily volatility of stock price indices rose sharply to 105.5 points in May and then fluctuated at high levels from May through September, before settling at 47.3 points in December. Alternately positive (e.g., the increase in first quarter corporate earnings, improved fiscal performance, the buying frenzy on mining stocks due to rising gold prices and prospects of better first quarter GDP outlook)

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[13] Net foreign buying is the difference between the PSE's data on total foreign buying and total foreign selling. In terms of foreign portfolio investments registered with the BSP, inflows rose by 45 percent to US$7.977 billion in 2006 from US$5.496 billion from 2005. Of these investments, over 70 percent or about US$5.725 billion were in shares of stocks listed in the PSE, which expanded by 50 percent from their 2005 levels.

[14] Source: FOCUS, December 2006-No. 166; a publication by the World Federation of Exchanges.

[15] Source: PSE

[16] Market volatility is measured as the standard deviation of daily stock indices.

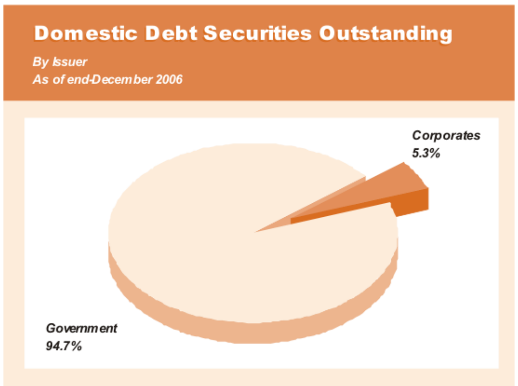
and negative developments (e.g., the rise in crude oil prices, which raised fears of a rate hike, and the drop in stock markets abroad) caused the highest spike in volatility of 105.5 index points in May.

There were 313 listed issues being traded at the exchange in December 2006, compared to 310 issues in the previous year.

Debt Securities Market Developments

Government securities continue to dominate the market

As of end-December 2006, outstanding government securities (GS) amounted to ₱2.2 trillion, 69.5 percent of which were regular issuances (e.g., Treasury bills and Fixed Rate Treasury bonds (FXTBs)). FXTBs comprised the bulk of regular issuances (56.8 percent) at ₱868.9 billion. GS continued to dominate the Philippine bond market, accounting for 94.7 percent of the market at end-2006. However, corporate issuances have been increasing steadily and aggregated ₱122.7 billion during the review period, accounting for 5.3 percent of total domestic debt securities from only 0.9 percent in 2003.[17] The domestic bond market accounted for 38.8 percent of GDP as of end-2006 from 42.4 percent at end-2005.



Notwithstanding the declining trend in interest rates, investors continued to swamp the government securities market as total oversubscriptions reached almost three times the offered amount for short-term government securities (₱338 billion) and more than 1.5 times the offering for the longer-dated T-bonds (₱286 billion).[18] As part of the Government's thrust to improve the maturity profile of government debt, the Auction Committee

[17] Credit-rated commercial paper lines/bonds/companies sourced from PhilRatings. Corporate issues include long-term and short-term commercial papers, fixed-rate corporate notes, bonds and asset-backed securities.
[18] Oversubscription is the gap between the amount tendered and the amount offered for a given instrument.

cancelled the December 2006 auctions for T-bills, citing preference for longer-dated instruments over short-term government securities. Bond swaps during the year further lengthened the maturity profile of government debt and created additional liquidity in the system.[19]

Meanwhile, at the newly-established Fixed Income Exchange (FIE), the Philippine Dealing and Exchange Corporation (PDEx) completed all the necessary interconnection for the efficient trading of government securities through the "straight through processing" (STP) of government securities traded at the FIE.[20] In addition, PDEx launched the peso-dollar trading platform on 2 October 2006 to centralize foreign exchange trading with the FIE. The new foreign exchange trading platform replaced the Philippine Dealing System in providing the main reference rate for the US dollar-Philippine peso transactions used for foreign exchange conversions to local currency.

Investment in GS grows stronger

During its second year of operation, trading volume for government debt papers at the FIE grew by 80 percent over last year to ₱787.4 billion, covering 10,652 trading transactions. Fixed Rate Treasury Notes (FXTNs) were the most liquid instruments, accounting for more than 90 percent of all transactions at the Exchange during the period. The strong performance of the FIE in 2006 helped enhance liquidity and depth in the fixed income market.

Results of GS Auctions, 2006
In billion pesos

Quarter	Offering	Tenders	Accepted Bids	Rejected Bids
T-bills	**124.0**	**461.7**	**108.6**	**353.1**
First Quarter	37.0	163.9	30.5	133.4
Second Quarter	21.0	80.8	17.0	63.8
Third Quarter	42.0	151.5	41.0	110.6
Fourth Quarter	24.0	65.5	20.2	45.3
T-bonds	**162.0**	**448.0**	**150.6**	**297.3**
First Quarter	38.0	96.4	35.7	60.7
Second Quarter	28.0	82.7	20.6	62.1
Third Quarter	42.0	121.3	42.0	79.3
Fourth Quarter	54.0	147.6	52.3	95.2
TOTAL	**286.0**	**909.7**	**259.3**	**650.4**

Source: Bureau of the Treasury

[19] The Philippines' domestic bond-swap program in 2006 saw the exchange of eligible outstanding debt papers into new three-, five-, and seven-year Benchmark bonds in February/March and new 10-year Benchmark bonds in August.

[20] In an STP, the buyer and seller exchange cash and securities ownership simultaneously. This eliminates the need to encode separately instructions to the RoSS and trade transactions.

External Sector

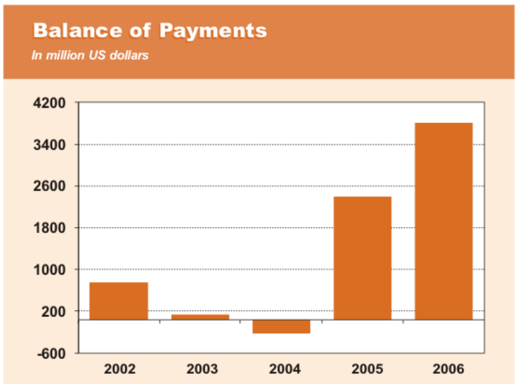
The overall BOP position for the full year 2006 continued to be in a surplus.[21] In 2006, overall BOP surplus reached US$3,769 million, 56.4 percent higher than its level in 2005. Strong foreign exchange inflows helped raise the country's gross international reserves and strengthened the peso.

Meanwhile, the country's external debt as of end-September 2006 declined from the end-September 2005 level due mainly to the increase in net loan repayments.

Balance of Payments

Bullish performance of the current account leads to a BOP surplus

The country's overall BOP registered a surplus of US$3,769 million in 2006, the highest level attained since 1999 when the BSP adopted the new framework for BOP compilation. The 56.4 percent improvement in the BOP position in 2006 from its year-ago level was traced to the strong performance of the current account, which more than offset the reversal in the capital and financial account following the higher bond and loan repayments and prepayments.



Goods and services exports and current transfers support current account surplus

The current account surplus in 2006 reached US$5,022 million, more than 1.5 times its level in 2005. The sustained increase in the country's current account surplus, which represented 4.3 percent of GDP during the review period, was ascribed to the marked improvement in the goods and services and current transfers accounts.

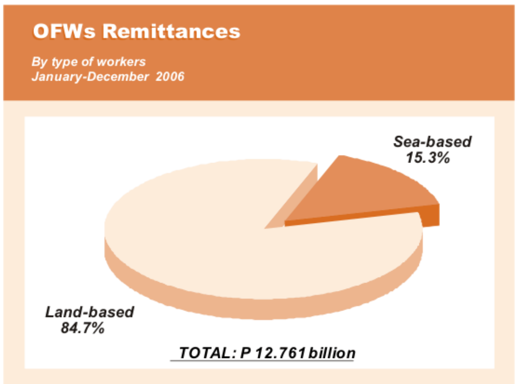
[21] Based on the change in the BSP's NIR, net of non-economic transactions, such as gold monetization and revaluation adjustments.

The trade-in-goods posted a shortfall of US$6,955 million in 2006, lower by 10.5 percent from its level in the comparable period in 2005. Exports grew by 14.6 percent while imports expanded by 10.6 percent. Most major items of exports showed an accelerated rate of expansion with mineral products and petroleum products registering the highest growth levels at 151.2 percent and 46.2 percent, respectively. The country's exports of mineral products surged in 2006 as the commercial operations of several priority-mining projects in the country shifted to high gear. Nonetheless, electronic products and other electronics remained the top export of the country accounting for 67.5 percent of total exports. On the other hand, the significant increase in the prices of petroleum crude and other products contributed largely to the expansion in imports. Imports of mineral fuels and lubricants rose by 29.3 percent in 2006 from its year-ago level of US$6,281 million to reach US$8,121 million. Likewise, other major items of imports increased in 2006 with growth rates of 1.7 percent (capital goods), 9.2 percent (consumer goods) and 10.1 percent (raw materials and intermediate goods). The United States, Japan and China were the top three destinations for Philippine exports while the United States, Japan and Singapore were the main sources of imports for the country.

The deficit in trade in services declined substantially to US$669 million during the review period from US$1,340 million in 2005. The tapering of the deficit in the trade in services account was traced to higher net inflows from travel, communication, insurance, financial and computer and information services as well as higher net receipts in the other services such as miscellaneous business, professional and technical services, merchanting and other trade-related services, operational leasing and audio-visual related services.

In 2006, the income account posted a higher deficit of US$543 million compared to US$294 million in 2005. The widening shortfall in the income account was brought about by the increased net outlays of dividends and profits to direct investors and rise in interest payments by the general government on its bond and notes issues.

The net inflows in the current transfers account reached US$13,189 million in 2006, higher by 15.8 percent than its year-ago level. The expansion in the current transfers was traced to the sustained growth in the net receipts from sectors other than the government. Transfers in the other sectors were largely comprised of workers' remittances from OFWs which amounted to US$12,481 million during the review period. This denotes a 17.0 percent rise from its level in 2005. The increase in workers' remittances is traced to the continued deployment of Filipino workers overseas. Remittances from land-based Filipino workers accounted for 84.7 percent of total remittances while sea-based Filipino workers contributed the remaining 15.3 percent. There has been a shift to higher-skilled Filipino workers being sent abroad. Demand for Filipino workers in the international labor market remained strong owing to their education, competence and the relatively high quality of service these workers provide. The consistent efforts by financial institutions to encourage OFWs to remit their salaries through the banking channels equally contributed to the higher level of remittances channeled through the banking system. These efforts focused on the introduction of improved system of money transfer, establishment of remittances centers abroad and arrangements with foreign financial institutions to service the banking needs of overseas workers.



Capital account reverses to a net outflow due mainly to net bond repayments, including prepayments

The capital and financial account reversed to a net outflow of US$1,722 million in 2006 from a net inflow of US$2,229 million in 2005 (Table 11). This developed as both the portfolio and other investment accounts weakened during the year in review, which offset the notable rise in the direct investment account (Box Article 2).

The net inflow in the capital account increased to US$136 million in 2006 from US$40 million a year earlier. The improvement was due mainly to the rise in inflows from private capital transfers.

Net inflows from direct investments likewise grew on account of strong equity capital placements by non-residents combined with the substantial improvement in the other capital account. Net direct investment inflows rose by 34.7 percent to reach US$2,242 million in 2006. These inflows were channeled mainly to manufacturing, services, real estate, financial intermediation, mining and construction industries. The major investors during the review period were from the U.S., Japan, Netherlands, the U.K., Switzerland and Germany.

The portfolio investment account continued to post a surplus of US$2,744 million in 2006 albeit lower by 21 percent compared to the US$3,475 million net inflow posted in 2005. The decline resulted mainly from: (1) higher resident investments abroad, particularly domestic banks' investments in foreign-issued bonds and notes (US$565 million); and (2) net bond repayments made by the NG (US$1,094 million), the BSP (US$147 million) and the private sector (US$581 million). Part of these outflows was used to prepay some bonds and notes of the NG and the BSP ahead of their maturities.

The deficit in the other investment account widened in 2006 to US$6,706 million from US$2,908 million a year ago. Accounting for the higher deficit were the following: (1) higher residents' investments abroad, particularly short-term loan and deposit placements by banks and private corporations; (2) loan repayments made by the BSP and the NG; and (3) net withdrawal by non-residents of their deposits with local commercial banks and other sectors.

International Reserves

BSP's foreign exchange operations and income from investments abroad and NG's deposits boost GIR

The BSP's gross international reserves (GIR), including the reserve position in the International Monetary Fund (IMF), rose to US$22.97 billion as of end-December 2006 (Table 12). This was 24.2 percent or US$4.48 billion higher compared to the end-December 2005 level of US$18.49 billion. It likewise exceeded the 2006 target by US$1.0 billion. The end-2006 GIR level was adequate to cover 4.4 months' worth of imports of goods and payment of services and income. Alternatively, this level of reserves is 4.0 times the amount of the country's short-term external debt based on original maturity and 2.3 times based on residual maturity. [22]

[22] Residual maturity refers to outstanding short-term debt based on original maturity plus principal payments on medium- and long-term loans of the public and private sectors falling due in the next 12 months.

Box Article 2:

POLICY OPTIONS FOR MANAGING CAPITAL FLOWS

Introduction

Financial globalization, specifically the free movement of capital across borders, has provided significant benefits to developing economies. It offers developing countries and other regions the means to utilize potential investment opportunities while allowing savers the means to earn higher returns and to minimize risks through international portfolio diversification. Moreover, the availability of international capital permits economies to smooth expenditures especially in the advent of adverse exogenous shocks. Foreign capital also brings "collateral" or indirect benefits which could be as important, if not more so, than its direct benefits, namely: a deeper financial system, better-run companies and a more disciplined macroeconomic policy (Kose, et al, 2006).

Capital mobility, however, has created challenges in the conduct of domestic macroeconomic policies, including monetary management. The macroeconomic challenges of surges in capital inflows were highlighted by the Asian crisis which exemplified the "impossible trinity" problem in action.[1]

Recent Trends

The recent peso appreciation is attributable to sustained foreign exchange inflows from strong exports and OFW remittances and the surge in capital inflows. Statistics show that OFW remittances and total capital inflows reached 10.9 percent and 6.7 percent of GDP, respectively, in 2005. OFW remittances are expected to grow strongly with relative stability in the near term caused mainly by altruism of OFWs. The recent surge in capital inflows was driven by renewed investor confidence due to the positive economic outlook following recent fiscal reforms and stable macroeconomic performance exhibited by low inflation, robust economic growth, and rising international reserves (see Table 1).

However, these capital inflows have likewise led to an increase in liquidity, which, if sustained, could potentially complicate the achievement of the inflation target. In the event of sudden risk reversals, potential costs of market corrections could be massive as what had happened in Asia during the 1997 regional crisis. Hence, it is prudent for monetary authorities to identify policy options for managing capital flows.

Policy Options

Implementing appropriate policy response depends on the clear understanding of the true causes of surge in capital inflows, i.e. knowing the relative importance of "push" and "pull" factors.[2] The issue is not whether capital flows are good or bad; the challenge is to conduct monetary policy so as to ensure that the additional resources provided by foreign capital inflows are used to promote growth and development. The critical objective is not just to react to short-run surges but to manage the economy in a way that will encourage stable long-term flows.

Briefly, policy options available to the BSP in limiting the liquidity impact posed by capital inflows include:

- **Increasing the reserve buffer.** The build up of foreign exchange reserves would enable policymakers to counter sudden capital flow reversal when they threaten to bring unwelcome changes in the value of domestic currency.[3] An adequate level of reserves can also enhance creditworthiness as it builds the credibility of an economy to service its foreign obligations.

- **Allowing greater exchange rate flexibility.** Svensson (2004) notes that, in responding to exchange rate movements, good monetary policymaking should begin with an analysis of the underlying source of the currency appreciation and an assessment of whether the shock is temporary or persistent. From there, authorities can evaluate the impact of the inferred shock on the inflation and output gap forecasts over the policy horizon and decide, given the shift in inflation and output gap forecasts, what changes, if any, are needed in the interest rate setting in order to bring inflation and the output gap toward desired levels. If the foreign exchange movement affects the attainment of the inflation target or the output gap path over the policy horizon, central banks must act by adjusting the policy rate (e.g., non-sterilized intervention). One important complication is that foreign exchange market interventions tend to have an offsetting impact on the monetary base.[4]

  Greater exchange rate flexibility forces the market participants to take cognizance of exchange rate risks in cross border financial transactions. It also promotes the development of exchange risk management instruments by the market, and allows for monetary independence of the central bank (Intal, 2005).

- **Sterilization policy.** Sterilization is the typical response to a surge in capital inflows, regardless of its cause. It can be implemented quickly and can provide some breathing space to policymakers, allowing them to assess whether inflows are transitory or permanent. Sterilization can take a range of forms e.g., exchange of bonds, increases in reserve requirements on all or selected parts of bank deposits, various types of central bank borrowing from KBs, and curtailing access to rediscount facilities. However, as inflows persist, authorities must reduce reliance on sterilization for several reasons: (1) it carries large quasi-fiscal costs - the difference between the interest earned on foreign exchange reserves and the costs of financing the sterilization; (2) aggressive sterilization through open market operations increases domestic interest rates; and (3) by sustaining high domestic interest rates, sterilization deprives the economy of the benefits of inflows – higher domestic investment and growth (Schadler, 1994).

- **Increasing the demand for foreign exchange.** Demand for foreign exchange can be increased through voluntarily accelerating prepayment of external debt and relaxing rules on capital outflows during periods of surplus.[5]

- **Decreasing the supply of foreign exchange.** Supply of foreign exchange can be decreased by encouraging the national government and market players to shift from foreign borrowing to domestic borrowing – thereby helping develop the domestic capital market in the process.

- **Adopting other complementary measures.** Mechanisms to encourage productivity increases should be fostered to moderate the effects of a real exchange rate appreciation. Likewise, macroeconomic and fiscal discipline should be observed to avoid any need for tight monetary policy so that domestic interest rates will not rise.

Table 1: OFW Remittances and Composition of Total Capital Inflows in the Philippines (as % of GDP)

	OFW Remittances	Exports of Goods and Services	Capital and Financial Inflows	Foreign Direct Investment Inflows	Portfolio Investment Inflows	Other Investment Inflows
1990-1992	3.6	26.9	4.3	1.3	-0.2	3.2
1993-1995	4.8	32.8	8.1	2.7	3.0	2.4
1996-1998	7.6	48.1	9.7	1.8	1.9	5.9
1999-2001	8.5	50.5	3.5	1.6	2.4	-0.7
2002	9.0	49.3	2.5	2.0	1.8	-1.2
2003	9.5	48.6	1.4	0.6	1.7	-1.0
2004	9.9	49.4	0.8	0.8	-0.9	1.0
2005	10.9	45.4	6.7	1.4	3.7	1.7
2006 Q1-Q3	11.0	46.2	2.8	2.0	4.3	-3.4

Note: OFW remittances are drawn from Table 11 of BSP-Selected Philippine Economic Indicators (SPEI) which reports only cash remittances coursed through the banking system while total capital inflows are taken from Table 1 of SPEI which shows the balance of payment statistics (credit balance only), as of end-December 2006

Endnotes:

[1] The Mundell-Fleming model states that it is impossible to meet simultaneously and in a sustained manner the following three conditions, namely: perfect capital mobility, fixed exchange rate and monetary independence.
[2] "Pull" factors are country-specific while "push" factors are external to the country and beyond its control. Falling international interest rates, recessions in industrialized countries and realignments among major currencies are examples of "push" factors while some "pull" factors include, among others, the autonomous increase in domestic money demand, raise in productivity and capital account liberalization.
[3] The country's GIR posted an all-time high of US$23.0 billion as of end-December 2006. In terms of reserve adequacy, the end- year GIR level could cover about 4.4 months of imports of goods and payments of services and income, and equivalent to 2.3 times the country's short-term external debt based on residual maturity.
[4] Authorities must strike the balance between the desire to stem the peso appreciation and mop up the excess liquidity in the financial system when faced with the possibility of sustained appreciation.
[5] In December 2006, the BSP prepaid its outstanding obligations to the IMF in the amount of US $ 220 million, marking its exit from the post-program monitoring (PPM) arrangement with the Fund.

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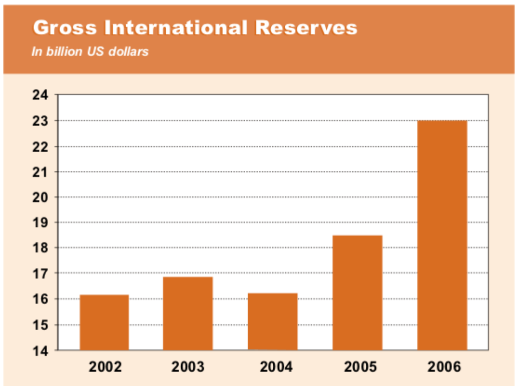
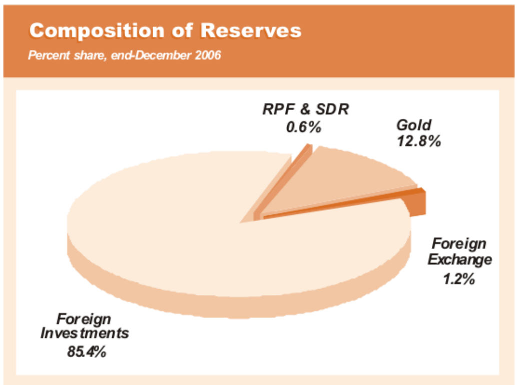




The increase in the end-December 2006 GIR level was due mainly to the BSP's foreign exchange operations and income from investments abroad as well as NG's deposit of the proceeds of various program loans. The end-year level of reserves ended higher even after the BSP's prepayment of its remaining credit to the IMF amounting to US$220 million as well as the NG's prepayment of ADB loans worth US$72 million.

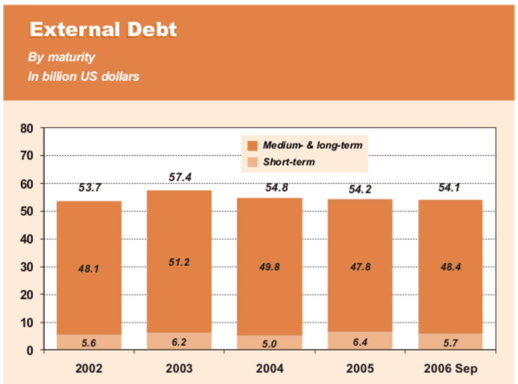
The bulk of the reserves was in the form of foreign investments (85.39 percent), with the balance in gold (12.81 percent), foreign exchange (1.22 percent), and combined Special Drawing Rights (SDRs) and reserve position in the IMF (0.58 percent).

The net international reserves (NIR) likewise rose to US$22.97 billion, US$5.31 billion higher compared to the end-2005 level of US$17.66 billion.

External Debt

Outstanding external debt declines

The country's outstanding external debt amounted to US$54.1 billion as of end-September 2006, a US$1.4 billion or 2.6 percent decline from the end-September 2005 level of US$55.5 billion (Table 13).



Year on year, the decline in debt stock could be attributed mainly to the net loan repayments of US$1.3 billion (availments of US$19.4 billion relative to principal repayments of US$20.8 billion, of which US$1.8 billion represented prepayments[23]) and negative foreign exchange revaluation adjustment (US$277 million), which were offset partially by positive audit adjustments amounting to US$133 million.

Medium- and long-term (MLT) loans fell by US$850 million as of end-September 2006 from US$49.2 billion a year ago. The share of MLT loans to total debt stock climbed to 89.5 percent during the period from 88.7 percent a year ago. Similarly, ST obligations dropped by US$569 million to US$5.7 billion in 2006 from US$6.2 billion in 2005 with the share of ST obligations to total debt stock falling to 10.5 percent as of end-September 2006 from 11.3 percent in 2005 (Table 14).

Weighted Average Based on Original Maturity of MLT Debt
As of end-September 2006

	No. of years
Total MLT Debt	17.9
Public sector	20.4
Private sector	9.4

[23] Prepayments made from January to September 2006 pertained to maturities in 2007 and beyond.

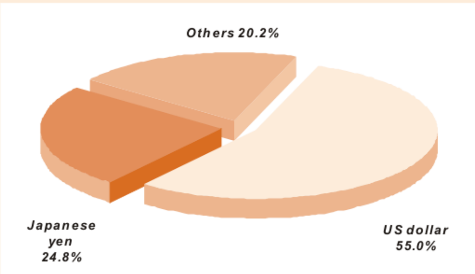
Public sector debt dropped by US$82 million to US$37.6 billion as of end-September 2006 from US$37.7 billion as of end-September 2005 with the share to total external debt rising slightly to 69.6 percent from 67.9 percent in 2005. Likewise, private sector debt fell by US$1.3 billion to US$16.5 billion as of end-September 2006 from US$17.8 billion in the same period in 2005 with its share to total falling to 30.5 percent from 32.1 percent, respectively.

By creditor profile, official creditors (consisting of multilateral and bilateral institutions) accounted for 37.9 percent of the total external debt, followed by foreign holders of bonds and notes (35.6 percent), and banks and other financial institutions (19.9 percent). The remaining creditors, which consisted of suppliers and exporters, represented 6.6 percent of the country's total external liabilities.

By currency mix, the country's external borrowings remained denominated largely in the currencies of major trading partners, namely: the US dollars (55.0 percent of total external borrowings) and Japanese yen (24.8 percent).

External Debt

By currency, percent share, end-September 2006



The country's external debt as of end-September 2006 represented 44.5 percent of GNP and 48.5 percent of GDP. These ratios were lower than the end-September 2005 ratios of 54.2 percent and 58.6 percent, respectively.

Preliminary estimates showed that the ratio of debt service to exports of goods and receipts from services and income (including workers' remittance receipts) fell to 12.0 percent in 2006 as against 13.5 percent (Table 14). This ratio is considered manageable relative to the international benchmark for debt sustainability, which is a debt service ratio of 20.0 to 25.0 percent. Similarly, debt burden as a percentage of current account receipts went down to 11.4 percent in 2006 from 12.6 percent in 2005. Likewise, the ratio of debt service burden to GNP dropped to 6.2 percent in 2006 vis-à-vis the previous year's 7.2 percent.

Selected External Debt Indicators
2002-2006, In percent

	2002	2003	2004	2005	2006
External Debt to GNP	65.6	67.2	58.7	50.8	44.5*
External Debt to GDP	69.8	72.1	63.3	55.1	48.5*
DSB to XGSI	17.08	16.88	13.81	13.51	11.98 p
DSB to CAR	15.81	15.68	12.89	12.61	11.38 p
DSB to GNP	9.49	9.30	7.73	7.15	6.18 p

p Preliminary
** As of End-September 2006*
Note: DSB – debt service burden; XGSI – exports of goods and receipts from services and income; CAR – current account receipts

PART TWO: THE OPERATIONS OF THE BSP

Monetary Stability

BSP keeps policy rates steady; restores tiering system

The decelerating path for inflation and the expectations of a manageable inflation environment over the policy horizon allowed the BSP to keep a steady hand on monetary policy settings (Box Article 3).

The monetary authorities also revived the tiering system on banks' placements with the BSP in the latter part of 2006 as a means of encouraging banks to use their excess funds for lending with a view to fostering business activity.

The BSP kept its key policy interest rates unchanged at 7.5 percent for the overnight RRP rate and 9.75 percent for the overnight RP rate in 2006. The policy interest rates were last changed on 20 October 2005.

During its policy meetings, the Monetary Board noted a number of factors which supported the case for keeping policy interest rates steady. The impact of the two-percentage point hike in the VAT rate in February 2006 was expected to be limited to one-off price increases and was therefore not likely to result in a sustained rise in inflation. Actual headline inflation decelerated while inflation forecasts were on a declining path with the likelihood of within-target inflation in 2007 in the absence of further adverse shocks. Favorable food prices, alongside a strengthening peso, were also seen to provide some stability to overall consumer prices. Moreover, the sustained easing in core inflation pointed to reduced generalized pressures on prices.

The monetary authorities revived the tiering system on banks' placements with the BSP under the RRP and SDA windows effective 2 November 2006.

Under the tiering system, banks' placements with the BSP were subject to the following interest rates: the applicable BSP published rate (RRP or SDA) for the first ₱5 billion; and the applicable BSP published rate less 200 basis points for the next ₱5 billion; and, the applicable BSP published rate less 400 basis points for amounts in excess of ₱10 billion. The restoration of the tiering system was expected to encourage banks to seek alternatives to placing their excess funds with the BSP, such as lending to the public.

Emerging forecasts indicate that average inflation is likely to be within the 2007 and 2008 targets

For 2007, average inflation was projected to settle within the Government's target range of 4-5 percent in the absence of further adverse shocks. Limited demand-based price pressures, as suggested by the sustained slowdown in core inflation, and manageable inflation expectations support this outlook. Latest forecasts also indicated that average inflation in 2008 is likely to be within the 4.0 percent ± 1 percentage point target.

Despite recent benign readings in inflation, the BSP remained watchful of the potential risks to inflation. These included the impact on food prices of the El Niño dry spell, upward adjustments in domestic power costs and wages, and volatility in world oil prices. In view of these risks, the BSP remained vigilant against potential second-round effects on price- and wage-setting behavior and possible adverse shifts in the public's inflation expectations. The BSP continued to pay close attention to a possible sustained buildup in liquidity conditions that could lead to price pressures in the future.

BSP conducts OMO to mop up liquidity

Open market operations (OMOs) were conducted in line with the BSP's monetary stance aimed at ensuring that liquidity in the financial system is consistent with the economy's growth and inflation objectives. In 2006, such operations consisted mainly of borrowing and lending under the RRP and RP facilities, an expansion in banks' SDA balances with the BSP, and increases in the BSP's holdings of T-bills as banks surrendered maturing T-bills previously held as liquidity reserves as a result mainly of the change in the mode of compliance with the liquidity reserve requirement to placing term deposits in the Reserve Deposit Account (RDA).

BSP strengthens transparency and communication of monetary policy

The BSP strengthened further the transparency and communication of monetary policy in 2006. The BSP disclosed and explained its monetary policy decisions through press statements and publication of the highlights of the Monetary Board meetings on the policy stance, as well as the Quarterly Inflation Report. These mechanisms allowed the BSP to communicate to the public its assessment of the inflation outlook and the measures it has adopted to better manage inflation.

Box Article 3:

SUPPLY SHOCKS AND THE CONDUCT OF MONETARY POLICY IN THE PHILIPPINES

The role of supply shocks in the current trend and outlook in inflation had been emphasized in the various policy pronouncements of the BSP. This article identifies the issues faced by policymakers regarding supply shocks and highlights the important lessons gleaned from the recent Philippine experience.

Policy Issues

Issues concerning supply shocks are linked to the various questions confronting policymakers, namely (1) whether or not to respond to the shock (the identification problem); (2) when to respond to the shock (second-round effects); and (3) how to respond to shocks (output-inflation tradeoff).

Identification problem. The identification problem refers to the uncertainty of the true cause of a shock, whether it is demand-side or supply-side shock, or a mixture of both. The uncertainty arises from the fact that often the only observable variable is the increase in prices.

Over the past few decades, sophisticated econometric tools have been developed to isolate different types of shocks from macroeconomic data. However, different identification methods also tend to produce different conclusions. This problem is compounded by structural change in the economy, which implies that traditional macroeconomic relationships may suffer a break. As pointed out by Jean-Claude Trichet (2004) "real-time identification remains central banks' Holy Grail."[1]

Second-round effects. Conventional wisdom holds that if a negative supply shock (e.g. higher oil prices) raises inflation, central banks can afford to tolerate this uptrend on the premise that authorities should ignore one-off changes in the prices of things they cannot control. However, the ultimate effects of supply shocks on inflation and output dynamics crucially depend on the reaction of economic agents in products and labor markets. Thus, if the public begins to expect prices to continue rising – meaning there is a feedthrough impact on price and wage setting, then the central bank may need to respond to these second-round effects.

Tradeoff between output and inflation. Unlike in a demand shock, prices and output are negatively correlated in a supply shock which means that the required policy response is not as straightforward. A negative supply shock involving oil prices, for example would tend to raise inflation and depress output. Thus, policymakers will need to make a choice between bringing down inflation and raising output growth.

Fortunately, the inflation targeting framework makes clear that inflation always takes precedence over output considerations. This principle is borne out of the practical experience of central banks and supported by the economic literature.[2]

However, supply shocks remain an issue of considerable importance to inflation targeters, particularly emerging economies. Not only are they prevalent but they are also acute in small open economies and economies undergoing structural changes.

Inflation Performance under Inflation Targeting

Supply shocks played a considerable role in the inflationary process in the Philippines. In particular, shocks to food and energy prices contributed to breaches of inflation targets. Table 1 summarizes the experience of the Philippines under inflation targeting.

Table 1: Dealing with supply shocks under inflation targeting regime

Inflation Performance	*Reasons for the Target Breach*	*Monetary Policy Response*
2002-2003 Actual < Target Inflation	Supply: favorable agricultural output performance Demand: low domestic demand-side pressure and global economic downturn	• Policy rate (RRP) reduced by 75 bps in 2002 Q1 and by another 25 bps in July 2003 • Liquidity reserve requirements on bank deposits reduced by 200 bps in 2002
2004-2006 Actual > Target Inflation	Mostly supply shocks: oil price hikes, weather disturbances plus changes in tax regime (VAT in November 2005 and February 2006)	• In 2004, policy rate unchanged due to limited demand pressure • Policy rate raised in April, September and October 2005 • Reserve requirements raised in July 2005 to reduce domestic liquidity

In dealing with both positive and negative supply shocks, the overall policy stance of the BSP was characterized as essentially cautious but also growth-supportive. The undershooting of the inflation targets in 2002-2003 was mainly due to lower food prices and subdued demand conditions. In 2004, breaches of the upper end of the target induced by food and energy shocks were not met with a monetary response since demand-driven inflationary pressures remained limited given fairly high unemployment, modest credit growth, and indications of spare capacity in the manufacturing sector.

The BSP did not respond aggressively to the recent oil-driven supply shock.[3] The policy interest rate was raised a total of only 75 basis points since 2004 due to concerns that cost-push pressures were already feeding into inflation expectations. This muted response was grounded in the Monetary Board's belief that the inflation uptrend was largely temporary.[4] Moreover, the available evidence suggested that inflation expectations were, for the most part, well-anchored throughout the period. This was in large part due to the constant efforts of the BSP to explain the nature of the oil price shock to the public and the fact that supply-side shocks can be better addressed directly through non-monetary action. Thus, the policy statements of the BSP during the period emphasized the Bank's support for the National Government's real sector measures to address supply-side risks to food and energy prices, namely: timely importation of key basic commodities; and measures to promote energy conservation and develop alternative sources of fuel/energy, including indigenous sources.

Lessons

The recent experience of the Philippines under inflation targeting in the presence of supply shocks offers us with some important lessons, namely:

- Emerging economies may be more susceptible to supply-side shocks, because of structural or institutional factors – the operating environment for emerging economy central banks may be more challenging compared to advanced economies.

- The prevalence of supply shocks in emerging markets also implies that monetary action may be usefully complemented with real sector measures which have also helped to ease supply-side pressures on consumer prices.

Endnotes:

[1] In an inflation-targeting regime, policymakers cope with the identification problem by utilizing several quantitative tools and relying on wide array of economic variables and information – which serve as inputs to the policy assessment process.
[2] As Gov. Dodge (2005) of the Bank of Canada has remarked, “a low stable and predictable inflation rate is probably the best contribution a central bank can make to the welfare of the nation. Blanchard (2006) notes “… Central banks should indeed just focus on stabilizing inflation… if they succeed they will automatically generate the optimal level of activity.” He refers to this as “divine coincidence”.
[3] See for example David Walton (2006) for discussion on how the recent oil price shocks differ from the previous episodes.
[4] This strategy proved to be appropriate as inflation has continued to decelerate and has fallen to 4.3 percent as of December 2006; and expected to be within the 4-5 percent target in 2007 in the absence of adverse shocks.

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Dodge, David (2005), “70 Years of Central Banking in Canada”, Remarks delivered to the Canadian Economics Association, Hamilton, Ontario, 27 May.

Trichet, Jean-Claude (2004), “Issues in monetary policy: views from the ECB,” speech delivered at a luncheon organized by the Economic Club of New York, New York, 26 April.

Walton, David (2006), “Has Oil Lost Its Capacity to Shock?”, Speech delivered to the University of Warwick Graduates’ Association Senior Directors’ Forum at the Commonwealth Club, London, 23 February.

Communications with the public concerning the monetary policy stance emphasized that inflation in 2006 was driven mainly by supply-side pressures, particularly oil prices. Likewise, the BSP highlighted the temporary impact on consumer prices of the VAT rate hike in February 2006. Expectations of mainly one-off price increases from the VAT were borne out by the sustained deceleration in inflation beginning the second quarter of 2006, supported also by the significant decline in oil prices in the second semester and the strengthening of the peso against the US dollar. The BSP also expressed continuing support for the Government's use of non-monetary measures to address supply-side risks to basic commodity prices. These measures helped the public understand better the scope of monetary policy and helped keep the public’s inflation expectations well-contained.

Other forms of communication highlighted the BSP’s commitment to price stability and its accountability for actual inflation outturns. On 19 January 2007, following the release of official data confirming that the 2006 average inflation rate at 6.2 percent exceeded the 4-5 percent target, the BSP submitted an open letter to the President to explain the reasons behind the deviations of actual inflation from the government target. The letter discussed the monetary policy responses and the logic behind such decisions, as well as the BSP’s continuing efforts to ensure price stability. The BSP also sent letters to the President when the growth in domestic liquidity or M3 breached the 15 percent ceiling prescribed in the BSP Charter starting October 2006. The letters apprised the President on the factors that contributed to domestic liquidity growth and the policy actions taken by the BSP to forestall possible inflationary fallout from excess money supply.

The BSP also continued the conduct of press briefings and regional information campaigns to increase the public’s awareness on inflation and monetary policy developments, as well as the role of monetary policy in economic growth.

BSP introduces improvements in inflation targeting framework

To further improve the conduct of monetary policy, the BSP introduced improvements to the inflation targeting framework.

On 23 June 2006, the Monetary Board announced the lengthening of the decision period for monetary policy meetings from four weeks to six weeks and the shortening of the publication lag of the highlights of the policy meetings from six weeks to four beginning July 2006. The longer decision period allowed the Monetary Board to consider a wider set of macroeconomic data in its policy discussions and have more time for analysis and evaluation of the economic evidence. Meanwhile, the shorter publication lag of the highlights of policy meetings further enhanced the transparency of monetary decision-making and conveyed to the public the Monetary Board's overall thinking about its policy stance in a more timely manner.

On 29 November 2006, the Development Budget Coordination Committee (DBCC), the Government's inter-agency economic planning body, approved the inflation target for 2008 to be 4.0 percent, plus or minus 1 percentage point. This is in line with the 8 November 2006 DBCC decision to respecify the Government's inflation target from a range target to a point target with a tolerance interval of ± 1 percentage point.

The shift from a range inflation target to a point target with a tolerance interval effectively widens the BSP's target band. A broader target band is seen to provide added flexibility to monetary authorities in steering inflation, particularly in the Philippine setting where consumer prices are subject to large supply shocks because of the sizeable share of food items in the consumer basket. It helps ensure that the design of the inflation target is more consistent with the country's economic circumstances, and safeguards the credibility of the inflation targeting framework. It also helps align monetary policy practices in the Philippines with those in other inflation targeting countries.

Financial System Stability

BSP continues to strengthen the financial system

The BSP sustained its efforts to strengthen the financial system to further enhance the capability of banks to face the challenges of a globally integrated domestic financial market.[24] During the year, policy measures were implemented to address the challenges faced by the financial system. First, the BSP supported the passage of the two-year extension of the Special Purpose Vehicle Law to allow further asset cleanup and bring the banking industry's asset quality ratios to their pre-crisis levels. Guidelines on an alternative mode for speedier disposal

[24] Please refer to Box Article 4 for an assessment of the current state of financial integration in Asia.

of banks' non-performing assets were also issued allowing banks' tie-ups with real estate developers.

Another challenge faced by the industry is the compliance with the international accounting and financial reporting standards and the new capital accord under Basel II. To help the industry face this challenge, the BSP issued regulations to further align existing regulations with international standards as well as strengthen bank capitalization.

BSP continues efforts to align banking practices with international norms

Various initiatives were undertaken by the BSP to further align banking practices with international standards. The BSP continued to prepare the banking system for the phased-in implementation of the capital adequacy framework compliant with the provisions of the Basel II framework. In 2005, the exposure draft for the new risk-based adequacy framework was issued for comment by financial institutions under the supervision of the BSP. The exposure draft contains the implementing guidelines for the local adoption of the Basel II accord. Existing provisions on the adoption of the current risk-based capital adequacy framework were also revised to gradually phase in the new framework including giving lower risk weights for highly-rated corporate exposures and higher risk weights for past due claims.

In 2006, the BSP issued the guidelines on the implementation of the revised risk-based capital adequacy framework for the Philippine banking system which will take effect on 1 July 2007. This regulation effectively revises BSP's existing risk-based capital adequacy regulations and incorporates the three pillars under the Basel II approach. Major revisions include the addition of specific capital requirements for credit derivatives, securitization exposures, counterparty risk in the trading book and operational risk. The guidelines also include the imposition of a capital requirement on foreign currency denominated credit exposures to the Philippine NG or "ROPs" on a staggered basis.

A parallel run of the existing and the revised regulations was scheduled on the last quarter of 2006 until the second quarter of 2007 to test the likely impact of Basel II implementation in the Philippines prior to 1 July 2007. Banks were instructed to create implementation teams who shall be responsible for the conduct of these trial runs in coordination with BSP.

Financial reporting standards and auditing practices were also aligned progressively with international standards. A new Financial Reporting Package was unveiled which was designed to align the Manual of Accounts (MOA) and the BSP reportorial requirements with the provisions of Philippine Financial Reporting System (PFRS) and Philippine Accounting Standards (PAS).

Guidelines on accounting for appraisal increment reserves and Real and Other Properties Acquired were also revised to align them with internationally-accepted standards.

Other prudential regulations were strengthened to address three vital areas of concern: enhancing risk management, strengthening corporate governance, and promoting greater transparency. Moving beyond banking reforms, the BSP continued to actively support the development of the capital market to provide an alternative pillar to the financial system.

Efforts to further improve asset quality continue

The BSP continued its drive to bring the current asset quality indicators closer to pre-crisis levels. During the first quarter of the year, the BSP sustained its efforts in lobbying for the extension of the Special Purpose Vehicle (SPV) law. Following the passage of the amended law on 24 April 2006, the BSP issued the procedures in availing the incentives provided under the law.

Moreover, the BSP has decided not to wait at the sidelines and let market forces drive the asset cleanup. Apart from the SPV-related dispositions, banks were allowed to enter into Joint Venture Agreements (JVAs) with real estate developers as a means to convert idle real estate and other acquired properties into income generating assets. The BSP expects that this initiative will provide banks with an effective means of reducing their foreclosed real estate assets.

BSP issues further measures to shore up banks' capital

The BSP came out with additional guidelines on the issuance of unsecured subordinated debt to further encourage banks to use hybrid financial instruments to shore up their capital. Under the new regulation, banks are allowed to include as part of Upper Tier 2 capital the amount of HT1 capital instruments in excess of the maximum allowable limit of 15 percent of total Tier 1 capital.

BSP issues additional regulations to reinforce capability of banks to manage risks

During the year, the BSP issued regulations to further enhance the capability of banks to manage effectively the various risks attendant to their operations. Regulations on supervision by risk were issued to provide guidance on how financial institutions should identify, measure, monitor and manage risks. The guidelines set out the expectations of the BSP with respect to the management of risks and are intended to provide more consistency on how the risk-focused supervision is applied to these risks.

Specific guidelines on the management of technology, liquidity and market risks were likewise issued. The guidelines are designed to ensure that banks are adequately guided and informed about managing these types of risks.

BSP enhances corporate governance framework of its supervised institutions

Various guidelines were implemented to further enhance the corporate governance framework in BSP-supervised institutions. These measures were intended to safeguard the institutions against excessive risk-taking, ensure fair exercise of business transactions, promote consumer protection and make the board of directors fully accountable to its shareholders and the public.

During the year, the BSP fortified the role of bank directors as corporate decision makers by amending its regulations on the fit and proper rule. The new regulation identified the criteria for the permanent and temporary disqualification of persons holding a director position.

BSP tightens disclosure rules

The BSP amended the rules and regulations governing the accreditation of external auditors such that in cases where there are no fraud, dishonesty or breach of laws to report, the external auditor is required to submit directly to the BSP a notarized certification that there are no adverse matters to report.

The rules governing the utilization and submission of audited financial statements (AFS) of banks were amended to require banks to present their AFS side by side on a solo basis and on a consolidated basis.

The BSP issued guidelines governing the disclosure of remittance charges and other relevant information regarding remittance transactions. The rules aim to promote transparency in the remittance business for better consumer choice as well as promote the efficient delivery of competitively-priced remittance services by banks and other remittance service providers.

BSP pursues reform initiatives to develop capital market

The BSP continued to pursue various reform initiatives to expedite the development of the domestic capital market. Reform efforts to fully implement the third party custody system were institutionalized with the issuance of guidelines for custodianship agreement between the owner/purchaser of the security and the BSP-accredited third party custodian of his choice. The guidelines aim to promote transparency and discourage proliferation of manipulative practices to gain investor confidence in the securities market.

Meanwhile, the Philippine Dealing System (PDS) completed all the necessary interconnection for the efficient trading of government securities. Under an agreement formalized between the BSP, the PDS and the BTr, the STP of government securities traded at the FIE will now be possible. This complete system linkage will eliminate the need for the manual encoding of settlement transactions, thus minimizing operational risk.

The BSP also initiated further reforms to boost the trust business with the issuance of the guidelines on living trust accounts and rules on the acceptance, management and administration of trust funds of pre-need companies.

The BSP likewise continued to push for the passage of key legislations intended to accelerate the development of the domestic capital market. The BSP strongly supported the creation of a centralized credit information bureau to improve the quality of financial information to investors, expand private sector access to credit, and minimize exposure to risks of financial intermediaries.

The BSP also continued to support other legislative initiatives to hasten the development of the Philippine capital market, including the amendments to the BSP Charter, Corporate Recovery Act, Revised Investment Company Act and the Personal Equity Retirement Act.

BSP adopts measures reinforcing supervisory processes

Improvements in the PCA framework were instituted to enhance BSP's supervisory process. The framework sets forth conditions and events that would trigger the enforcement of PCA, the measures that may be taken as PCA, sanctions for non-compliance with the plan and the conditions for the lifting of the PCA status.

Consistent with the Basel II committee recommendations on effective banking supervision, the BSP pursued the full implementation of the consolidated and risk-based supervision framework. The new process provides examiners the flexibility and discretion in developing the appropriate examination strategy that will respond to existing and emerging risks of the institution.

The BSP reinforced supervisory capacity and technology through various initiatives, such as examiner training, institutional reorganization and enhanced risk rating systems. The structured training program for BSP's examiners and supervisors was continued to enhance the capacity of the BSP examiners in the conduct of risk-based supervision.

To complement its efforts in implementing risk-based on-site examinations of banks, the BSP continued to improve off-site surveillance functions. The BSP pursued the full implementation of the Data Warehouse project which is designed to centralize the handling and exchange of information on financial and non-financial data of BSP-supervised institutions.

Regular off-site surveillance was performed in 2006. Periodic reports submitted to BSP were verified and analyzed, including a full review of the Consolidated Statement of Condition of banks. Various bank reports were also reviewed and evaluated to monitor any unusual movement in the accounts and to determine compliance with specific provisions of banking laws, rules and regulations.

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

Payment and Settlement System

Initiatives to improve further the financial infrastructure continue

The BSP continued to implement changes in the Philippine Payments and Settlements System *(PhilPaSS)* during the year to ensure efficiency in the conduct of large-value financial transactions. This is in support to the overall thrust to improve the country's financial infrastructure. The volume of financial transactions that passed through the *PhilPaSS* grew by 19.2 percent to

439,028 valued at ₱122.0 trillion from the previous year's ₱53.9 trillion. The expansion in the volume of transactions was largely on account of the increase in the Bureau of the Treasury's Delivery versus Payment (DvP) of government securities, interbank and Payment versus Payment (PvP) transactions such as purchase and sale of US dollars. Transaction fees were posted higher at ₱46.79 million in 2006 from the previous year's ₱42.48 million.

Period	Volume of Transactions	Value of Transactions (in trillion ₱)	Transaction Fees Collected (in million ₱)
2005	368,138	53.9	42.48
2006	439,028	122.0	46.79
Percent (%) Change	19.2	126.3	10.2

The following refinements to the system were put in place during the year:

(1) Implementation of the Electronic Cash Withdrawal System (ECWS) in the Cash Department of the BSP to eliminate the use of checks by banks when withdrawing from their Demand Deposit Accounts (DDAs) with the BSP;

(2) Inclusion of withdrawals via ECWS in the Daily *PhilPaSS* Summary Report to help in classifying/identifying ECWS transactions of banks;

(3) Enhancement in the reports generation of the *PhilPass* to provide information on the nature/reason for a transaction's rejection;

(4) Automation of End-of-Day processing and posting of *PhilPaSS* fees in the respective core Financial Accounting System-DDAs (cFAS-DDAs) of *PhilPaSS* participants to allow for the immediate processing of transactions at the end of the day;

(5) Enhancement of the Electronic Funds Transfer Instruction System-DDA (EFTIS-DDA) Module to provide banks online-access to details of quarterly interest payments credited to their DDAs;

Box Article 4:

FINANCIAL INTEGRATION IN ASIA: PROGRESS AND ISSUES

Financial integration is a gradual process through which cross-border capital flows increase and product prices and market infrastructures converge to common standards.[1] Financial integration is widely expected to provide economic benefits to regions such as in Asia and is considered to be a key factor in the development of countries' financial systems. It creates economies of scale and increases the supply of funds for investment opportunities that lead to lower intermediation costs and a more efficient allocation of capital. These ultimately increase the potential for greater and more sustainable non-inflationary economic growth.

However, financial integration carries risks that must be anticipated and managed (e.g., it can lead to greater volatility of capital flows, which may result in sharp changes in interest and exchange rates, which can have negative consequences for the real economy).

Thus, it is important for domestic institutions to adopt an integrated and sustainable macroeconomic policy environment and a strong prudential framework for the financial sector that will allow financial intermediaries and market participants to properly assess and manage risks and to implement complementary structural reforms to ensure that a more open, integrated financial system does not create new areas of vulnerability.

Harmonizing regulatory regimes and coordinating supervision of cross-border financial activities are likewise important. Initiatives that will promote the adoption of a common set of framework or market conventions and norms will help narrow the prevailing economic disparity among countries by facilitating the free flow of investment across borders and providing one of the necessary foundations for regional financial integration.

Current state of financial integration in Asia

A comparison of the trends on intra-regional linkages of Asian economies with the experience of other regions would help assess the progress of financial integration in Asia.

A marked increase in intraregional trade flows in Asia has been behind the region's greater interdependency over the past two decades. Intraregional trade currently accounts for about 40 percent of Asia's trade. This represents a significant increase from less than 30 percent in the 1980s. With the rapid growth of China and India, there is room for further expansion in intraregional trade.

Table 1: Exports of Selected Asian Countries by Region (% of Total Exports)

	1990	1995	2000	2005
Selected Asian Countries*	23.9	35.4	35.4	40.6
Latin America**	1.0	1.8	1.8	1.8
United States	24.0	19.9	19.9	14.2
Euro Zone	6.8	10.0	10.0	10.2
Japan	15.2	10.2	10.2	7.7
Rest of the World	29.0	22.7	22.7	24.7

** Includes Hong Kong, Malaysia, Philippines, Korea, Singapore, Thailand and China*
*** Includes Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Mexico, Nicaragua, Paraguay, Peru, Uruguay, Venezuela*
Source: Banco de Mexico presentation on "Monetary and Exchange Rate Policy in Asia and Latin America", September 2006. (Data source: UN Statistics Division, COMTRADE)

In comparison, at the time of the establishment of the European Economic Community in 1958, intraregional exports among the European countries already accounted for 46 percent of their total exports.[2] This process of trade integration continued for many years with the single market established in 1993.[3] Currently, in the euro area, intraregional trade accounts for close to 70 percent of total trade.[4]

A strengthening of regional demand and trade growth will independently stimulate Asian asset markets and tighten regional interconnections. Better-linked regional financial systems could provide funding and hedging instruments to support the region's trade activities. Overall, Asia's growing intraregional trade will catalyze greater financial integration and, in turn, be stimulated by it.

However, integration in short-term financial flows remains limited. Evidence from data on intra-regional flows suggests that financial sector integration in the region has been steady in recent years. The share of intra-regional flows in the total portfolio investments entering East Asia[5] increased from 14 percent to 16 percent during the 2001-2004 period. However, this share is relatively small compared to those accounted by the EU (35 percent in 2004) and the US (35 percent in 2004). Similarly, the share of portfolio investments from East Asia invested within the region also increased, from 15 percent to 18 percent during the same period, but remains relatively small.[6] Moreover, for the entire 47 regional member countries of the Asian Development Bank, the share of intra-regional portfolio assets likewise remained constant at about 9.0 percent between 2001-2004.[7]

Nevertheless, while financial integration remains limited in general,[8] there are indications of deepening integration in the international bond markets. It has been observed that a significant amount of US dollar- and euro-denominated debt issued by selected Asian countries are bought by Asian investors. Analysis of 178 US dollar- and euro-denominated prime bond issues by the aforementioned Asian economies[9] indicates that during August 2002-August 2005, 47 percent (in value term) were bought by Asian investors (Table 2).[10]

Table 2: Foreign Currency-Denominated Debt Instruments Issued by Selected Asian Issuers and Bought by Asian Investors August 2002-August 2005

	Sample of 178 bond issuances (US$ billion)
Total amount of issuance	84.3
Total Investors in selected Asian countries	39.4 (46.7%)

The sample covers bond issuance from PRC, Hong Kong, Indonesia, Korea, Malaysia, Philippines, Singapore, Thailand
Source: Euroweek and Finance Asia as reported in Asia Bond Monitor, November 2005

Challenges and Issues

Asia’s financial integration has been relatively slow partly due to several structural and institutional limitations to cross-border investments within the region. Also, Asian economies are in varying stages of financial development, with a number still having relatively small bond and stock markets. With insufficient depth and liquidity in domestic markets, Asian issuers and investors continue to view international financial markets outside the region as important sources of funding.

Financial integration in Asia, as compared to trade integration, is complicated by a wider set of institutional and regulatory frameworks, especially on cross-border capital flows. Moreover, the Asian financial crisis has led to a more cautious policy approach on capital account liberalization because of the risk of capital flow reversals and the deterioration of external financial positions. Furthermore, regulatory and tax regimes are not harmonized in Asia. There is also no linkage between the clearing and settlements systems. These institutional and regulatory factors tend to hold back greater financial integration in the region.

Thus, additional steps are needed to foster the development of financial systems in the region. Further developing capital markets requires reforms to strengthen issuers, broaden the investor base, and build market infrastructures (including clearing and settlement systems and credit-rating agencies).

Banking supervisory and regulatory norms need to be on par with international best practices. A framework for consolidated supervision needs to accompany cross-border consolidation, in order to help ensure stability of financial systems in the face of international capital flows arising from greater integration and globalization.[11]

Across developing Asian countries, supervisors are in the early stage of implementing consolidated supervision (based on domestic and global practices). Beyond national borders, however, there should be deeper cross-border linkages and improved cross-border supervision and cooperation. Home and host supervisors will also need to work together to ensure effective oversight and crisis management. As such, cooperation between supervisors is important when dealing with problems faced by regionally or globally active financial institutions. In order to benefit fully from ongoing regulatory reviews and reforms, it is necessary that there are discussions in various regional forums. There should also be a scope for more formal planning at the technical level to coordinate crisis management and contingency plans. Along these lines, a strong and effective framework for prudential regulation and supervision is important as financial integration progresses.

Some areas which should also be harmonized to minimize difficulties encountered in regional integration include: (1) taxation structures; (2) restrictions on foreign investment in local financial markets; (3) uniform credit rating system; and (4) payments and settlements systems.

Building of institutional arrangements can help foster regional financial integration. Steps towards building firmer institutional structures to develop resilient and robust regional financial markets have accelerated the pace of Asian financial integration. The region has, for instance, made commendable achievements in financial cooperation including enhanced information exchange and policy dialogue and regional capital market development. These include the initiatives in the Association of Southeast Asian Nations (ASEAN) and the ASEAN+3, namely, the Asian Bond Market Initiative (ABMI), Chiang Mai Initiative, Economic Review and Policy Dialogue and Roadmap for Monetary and Financial Integration as well as the Executives' Meeting of East Asia-Pacific Central Banks' (EMEAP) Asian Bond Funds (ABF) I and II.

The development of Asian bond markets. Initiatives have been taken to develop Asian bond markets in view of the need to channel a vast pool of savings to long-term investments for growth and development within the region. These efforts reflect the recognition that the financial system in Asia has been too dependent on bank financing domestically and on foreign-currency financing externally and, hence, needs to be diversified through the development of national and regional bond markets. To stimulate the demand side, EMEAP established ABF1 and ABF2. Meanwhile, to stimulate the supply side of local-currency denominated markets, the ASEAN+3 created the ABMI.

The creation of a regional liquidity support facility through the Chiang Mai Initiative (CMI). The Asian crisis highlighted the importance of establishing an effective financing facility that will reduce the risk of liquidity shortage and limit regional currency attacks, contagion and crises. Under the CMI, the network of 16 bilateral currency swap arrangements among central banks totaling $75 billion has been created.

The introduction of policy dialogue and economic surveillance. This involves the assessment of macroeconomic and financial conditions and policies of member economies, the identification of the vulnerable aspects of the economy and finance, the setting up of early warning signals, and the recommendation of appropriate policy responses. The process requires frank and candid exchanges of views and policy discussions among member economies, and is intended to induce good policies through peer pressure. The most notable surveillance process is that of the ASEAN Finance Ministers and the ASEAN+3 Finance Ministers, whose focus are primarily on global, regional and national economic surveillance, macroeconomic and financial risk assessment and policies to reduce such risks.

Future Directions: Toward monetary integration?

Advances in financial integration and intraregional trade could be seen as heralding eventual adoption of a regional common currency and the establishment of an Asian monetary union—following the euro model. Europe's experience shows that a monetary union imposes such stringent demands on policy coordination and institution building that Asia may well need a clear political will, sustained over generations. The region still faces different degrees of trade and financial market liberalization, not to mention the diversity of exchange rate regimes, legal and tax structures and corporate governance arrangements. Differences in production patterns and levels of development are particularly problematic because they increase the likelihood of asymmetric shocks that call for different monetary responses at the national level (which would be impossible within a monetary union). At this stage, monetary union for Asia remains, at best, a distant goal.

Moving forward, the experience in Europe during the establishment of the euro area provides some valuable lessons on how to further encourage the intra-regional linkages in Asia.

First, the European integration experience involved the desire for political integration. Is there such motivation in Asia? However, political integration is not necessary for economic and financial integration. Instead, what is necessary is the political commitment to reach agreements on regional economic measures and institutions.

Second, which is closely related to the necessity of political commitment, is the importance of establishing regional institutions. A number of initiatives for regional cooperation have generally been undertaken through a network of agreements. Perhaps it may be useful to explore the possibility of building more regional institutions. An example could be the strengthening of the CMI and economic surveillance. Among other modes, the creation of a centralized, professional organization that manages the

CMI operation, conducts economic surveillance and prepares comprehensive policy assessments could be considered.

Third, while Asia may draw lessons from the EU experience, it must be recognized that the region has different initial conditions which affect the strategic approach it has to take towards greater integration. Asia is diverse in terms of economic and institutional development. Under these circumstances, a practical approach could be a multi-polar or cluster approach which would allow a subgroup of similar economies to pursue certain integration efforts at their own pace. This approach addresses the differences in the level of development and structures of economies. As economic conditions and structures converge across clusters, the integration process becomes more inclusive to involve larger clusters.

Moreover, central banks should intensively promote international cooperation. The increasing cross-border supply of financial services requires close cooperation among national authorities, particularly in supervising financial players that operate across borders. To date, Asian countries have engaged in regional financial cooperation, unprecedented in history. Meetings between finance ministers and central bank officials are more frequent and formalized than ever before and have produced concrete projects and programs, including, among others, the CMI, the ABF I and II and regional policy dialogues.

Conclusion

Asia has come a long way in opening its financial system. Nonetheless, many challenges remain and the policy agenda is extensive. In the course of forging the path ahead, regional policymakers will tackle difficult issues, including the appropriate sequencing of reforms, the desirable balance between domestic and regional priorities, possible trade-offs between global and regional financial integration, and the relative roles of governments and markets in shaping the process. The combination of favorable economic conditions and a clear commitment to integration can provide a fitting environment in which the policy debate can flourish—and Asia's financial integration can continue to advance.

Endnotes:

[1] Cowen D. and R. Salgado et al. (2006). "Financial Integration in Asia: Recent Developments and Next Steps?" IMF Working Paper WP/06/196

[2] The six founding member countries of the European Community are Belgium, France, West Germany, Italy, Luxembourg and Netherlands.

[3] As of the time of the establishment of the single market in 1993, the European Union (established in 1992 by the Treaty on European Union (the Maastricht Treaty)), has 12 members, namely: Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, UK.

[4] The Eurozone (also called Euro Area, Eurosystem or Euroland) is the subset of European Union member states which have adopted the euro. Currently, members comprised of Austria, Belgium, Finland, France, Germany, Greece (joined in 2001), Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain.

[5] East Asia refers to data for China, Hong Kong SAR, India, Indonesia, Japan, Korea, Malaysia, Philippines, Singapore, Taiwan, and Thailand.

[6] IMF and MAS (2006), Briefing Pack for Seminar on Asian Integration

[7] Data from <http:aric.adb.org/indicator.php>

[8] Eichengreen and Park (2005); Kim, Lee and Shin, (2005); and Park and Bae (2002)

[9] Reported in EuroWeek and FinanceAsia as contained in ADB (2005)

[10] ADB (2005). Represents percentage allocated to investors in primary offerings, excluding secondary market activity.

[11] Cowen D. and R. Salgado et al. (2006). "Financial Integration in Asia: Recent Developments and Next Steps?" IMF Working Paper WP/06/196

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(6) Updating of the Philippine Payment System-Front End System (PPS-FES) with SWIFT's validation rule regarding message types, thus eliminating the manual intervention over transactions of non-SWIFT user banks and SWIFT user banks;

(7) Switching to the use of the AS400 DDA Inquiry Module which helped hasten the monitoring and confirmation of balances that are transferred from cFAS to the Central Accounting System (CAS);

(8) Instructing electronically member banks with unsettled electronic funds transfer instruction caused by certain data error to retransmit such transfer for settlement; and

(9) Settling of GS traded in the PDEx Trading System through the *PhilPaSS* DvP system.

Other Key Operations of the BSP

Loans and Credit

New lending policies under the BSP's credit windows reinforce its ability to influence the volume of credit consistent with the price stability objective

The overall guiding principle in the grant of rediscounts, discounts, loans and advances by the BSP is to influence the volume of credit consistent with the Bank's price stability objective. In addition, the BSP also ensured that the risks involved in such lending operations are manageable.

The BSP undertook a comprehensive review of its various credit windows during the year. The review culminated in the compilation of a comprehensive manual on the BSP's lending policies under its various credit windows namely: rediscounting, emergency loans, overnight clearing line, and loans to Philippine Deposit Insurance Corporation (PDIC). The Manual, which is referred to as the BSP Omnibus Lending Policy, contained the overall policy and implementing guidelines/circulars on said credit facilities.

To ensure that the risks undertaken by the BSP are manageable, the following policies were formulated:

1. Definition of the pre-conditions, requirements, and limits for the grant of emergency loans and loans to PDIC.

2. Prescription of interest rates that are enough to cover at least the BSP's cost of funds for loans to PDIC;

3. Inclusion of additional documentary requirements to facilitate the registration of collateral documents in case of foreclosure proceedings; and

4. Standardization of the terms and conditions of the Exporters Dollar and Yen Rediscount Facility (EDYRF).

The BSP also adopted several measures to enhance the timely and effective delivery of credit to productive sectors, as follows:

1. Implementation of Credit Information System (CRIS) to determine the rediscounting line of each borrower bank during the year;

2. Launching of the Electronic Rediscounting (eRediscounting), an online internet-based rediscounting facility available to all active and qualified banks nationwide. The scheme provides immediate availability of credit to banks in various parts of the country, allowing them to conduct their rediscounting transactions and inquiries with the BSP in an on-line, real time basis at the convenience of their own bank premises; and

3. Adoption of the new Credit Examination Manual for rediscounting loans extended by the BSP which contains the procedures for the conduct of post-audit examination for banks with rediscount loans.

As of 31 December 2006, the total rediscounting loan portfolio of the BSP stood at ₱115.7 billion, ₱1.0 billion or 0.9 percent higher than the previous year's level of ₱114.7 billion.

Regular peso and dollar yen rediscounting granted in 2006 reached ₱36.3 billion.

Based on the type of institution, outstanding rediscount credits as of end-December 2006 extended to thrift banks reached ₱3.1 billion or 40.2 percent of the regular rediscounts, followed by commercial banks at ₱3.0 billion or 39.0 percent and rural banks at ₱1.6 billion or 20.8 percent.

Classified by type of activity, regular peso rediscount loans granted during the year reached ₱36.3 billion and were largely channeled to import/export financing (₱18.8 billion), followed by commercial/industrial and quedan loans (₱13.1 billion), production credits (₱2.4 billion), housing (₱1.7) billion and others (₱0.3 billion).

Asset Management

New approaches in assets administration and disposal enhance further asset management

The BSP has acquired assets which it administers, preserves and disposes properly. This develops as private banks assign to BSP their receivables, including collateral which could be in the form of real properties when availing of the loan facilities of the BSP. The BSP forecloses these real properties upon failure of these banks or their borrowers to pay their loans. Banks also pay their loans with properties under a dacion en pago agreement.[25]

The book value of the BSP's acquired assets as of end-December 2006 stood at ₱13.9 billion, ₱1.1 billion or 8.5 percent higher than the previous year's level. Similarly, the number of real property titles acquired increased by 60.9 percent or 13,123 titles to 34,680 titles.

The BSP improved its administration of foreclosed properties through the implementation of a new approach in property valuation and the revision of its guidelines in disposing the acquired properties. These included the following:

1. Use of market data and cost approaches in the valuation of the BSP acquired properties;

2. Amendments relating to: (a) computation of the redemption price for collaterals on foreclosed properties; (b) conditions for restructuring; and (c) approving authority for the extension of the redemption period for foreclosed properties not exceeding ₱10.0 million;

3. Reduction of the interest rate charge for late rental payment on BSP's acquired properties to 2.0 percent per month from 3.0 percent per annum; and

4. Sale of the BSP acquired assets to BSP employees and to other government employees.

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[25] "dacion en pago" refers to a payment whereby property, whether real or personal, tangible or intangible, is alienated in favor of the creditor, which could either be a Financial Institution (FI) or an SPV, in satisfaction of an NPL.

To further improve the disposal of assets, the BSP adopted the following measures:

1. Sale of acquired assets through public auction. Ten properties with a total selling amount of ₱5.1 million were successfully bidded out during the year;

2. Sale of acquired assets on negotiated basis. Properties were disposed with an aggregate price of ₱696.8 million;

3. Sale through the Housing Fair Program. BSP acquired assets were offered for sale to government employees, including BSP personnel, during the period from October 2006 to April 2007.

4. Sale through the Provident Fund Office. Properties numbering 36 with a total selling price of ₱63.0 million were sold to BSP personnel and other government employees assigned to the BSP.

5. Sale of acquired assets to their previous owners. A total of 42 properties amounting to ₱56.4 million were redeemed by owners during the year.

In addition, the conveyance of real property dividend to the NG through the Department of Finance (DOF) was approved and completed during the year.

International Reserve Management

Reserve management strategy focuses on yield enhancement, optimal utilization and diversification

The BSP was able to achieve an adequate level of international reserves in 2006 to cushion against any unforeseeable demand for foreign currencies. This was achieved by adhering to its reserve management strategy of yield enhancement, optimal utilization and diversification. The country's GIR level increased considerably in 2006 on account of the BSP's foreign exchange operations and income from investments abroad.

The BSP likewise implemented during the year a number of measures aimed at enhancing further existing procedures in reserves management. These included the following: (1) adoption of a benchmarking process and methodology for the Bank's internally-managed portfolio (excluding gold); and (2) commencement of the Middle Office Risk Management System (MORMS) project, which would allow for a more efficient management of reserves through systematic risk identification, measurement, monitoring and control.

International Operations

Evaluation of foreign borrowing proposals continues to ensure sustainability of foreign debt and orderly debt servicing

The BSP continued to evaluate foreign borrowing proposals from both the public and private sectors to help ensure the sustainability of the country's foreign debt and orderly debt servicing. The BSP's external debt management framework aims to obtain loans at favorable terms and conditions and to channel proceeds to priority projects/activities.

As of end-September 2006, outstanding BSP-approved/registered Philippine external debt stood at US$54.1 billion, 2.6 percent lower than the year-ago level of US$55.5 billion. Net loan repayments amounting to US$1.3 billion largely accounted for the decline in external debt stock during the period.

In terms of debt sustainability, the country's major external debt indicators continued to improve. Preliminary estimates showed that the external debt service ratio (or the percentage of principal and interest payments to total exports of goods and receipts from services and income) dropped to 12.0 percent in 2006, from 13.5 percent in 2005. Similarly, the debt service burden ratio as a percentage of GNP dropped to 6.2 percent in 2006 from 7.2 percent year-on-year. These developments indicate the country's improving capacity to service maturing obligations on a sustained basis.

The favorable maturity profile of the country's external debt, together with the continuing build-up of the BSP's GIR have also resulted in a substantial improvement in the country's liquidity position. This was evidenced by the near doubling of the ratio of GIR to short-term debt based on remaining maturity since the highs achieved during the Asian crisis, from 96 percent at end-1997 to 234.9 percent at end-2006.

BSP implements capacity building/systems improvement to enhance debt management capability

As part of the BSP's capacity building/systems improvement program, the Monetary Board approved the acquisition of the Debt Management and Financial Analysis System (DMFAS) of United Nations Conference on Trade and Development (UNCTAD). The DMFAS is an external debt monitoring software meant to enhance the debt management capability of the BSP.

The UNCTAD-DMFAS Programme Preparatory Mission (Phase I) arrived in Manila in October 2006 to discuss technical and project-related matters with the BSP. During the visit, the mission produced a draft document outlining the activities required for the final phase (Phase II) of the project. The project document is currently being reviewed, and is expected to be finalized in early 2007.

Inward foreign investments increase

BSP regulations require registration of inward foreign investments if the foreign exchange needed to service repatriation of capital and the remittance of dividends, profits and earnings which accrue thereon, shall be sourced from the domestic banking system.

In 2006, inward foreign investments (both direct and portfolio) registered by the BSP totaled US$12.4 billion, an increase of 55 percent from the previous year's total of US$8.0 billion.[26] Registered foreign direct equity investments amounted to US$986 million, posting an increase of 78 percent from the US$553 million registered in 2005. Meanwhile, registered foreign portfolio investments reached an all-time high of US$11.4 billion, up by 54 percent from US$7.4 billion in 2005, and even exceeded the previous peak of US$10.3 billion registered in 1997.

Under existing policy, importations under DA/OA arrangements are deemed registered when reported by banks to the BSP. The BSP regularly conducts a post-audit of said bank reports, against the supporting documents submitted by importers.

Import availments rise on account of oil price hikes while import payments decline

In 2006, import availments under DA/OA arrangements totaled US$10.5 billion, up by 5.8 percent from the 2005 figure. The increase was accounted for by oil imports (US$6.1 billion), which grew by 15.4 percent partly due to the increase in oil prices. Outstanding liabilities under DA/OA arrangements rose to US$1.3 billion from US$995 million the previous year. Meanwhile, import payments under Letters of Credit (LCs) amounted to US$4.3 billion in 2006, down by 6.5 percent from US$4.6 billion recorded during the previous year.

During the year, LCs opened and telegraphic transfers effected to service the BSP's own foreign exchange obligations amounted to US$63.6 million and US$2.8 million, respectively, for a total of US$66.4 billion. This amount is higher by 41 percent from the previous year's

[26] Including foreign investments in equities listed in the PSE that were registered by custodian banks on behalf of the BSP based on delegated authority.

level, mainly due to the increase in the LCs opened for the procurement of raw materials used in the production of Philippine banknotes and purchase of coin blanks.

Notes and Securities Printing

Actual production and delivery of notes nearly equal target for 2006

The BSP's Banknotes and Securities and Printing Department printed a total of 801.5 million pieces of notes for 2006, representing 92.3 percent of the year's target of 868.5 million pieces. The total delivery of notes to the Cash Department of the BSP for the year was 1,061.9 million pieces, equivalent to 93.2 percent of the 1,139.0 million pieces ordered in 2006.

The BSP produced 2,820,131 passport booklets or 98 percent of the year's target of 2,878,550 booklets. A total of 2,291,111 passport booklets were delivered to the Department of Foreign Affairs (DFA) during the year, equivalent to 100 percent of the DFA's requirement.

Mint and Refinery

Mint and refinery operations continue to be conducted in the most economic, efficient and secure ways

The BSP's mint and refinery operations in 2006 produced circulation coins as well as special coinage and medals in the most economic, efficient and secure way. It also manufactured and supplied presidential medals and state decorations; purchased gold from small-scale miners in accordance with Section 17 of Republic Act (R.A.) No. 7076, otherwise known as "People's Small-Scale Mining Act of 1991" and from other sources; and refined the gold purchased into forms acceptable in the international bullion markets. In 2006, the BSP purchased 977 thousand troy ounces (tr. oz.) of panned gold, which contained 953 thousand tr. oz. of fine gold. Gold purchases declined by 6.8 percent in 2006 relative to 2005. The decline in gold purchases could be attributed to the following: (1) the strict implementation of the ban on the use of explosives and cyanide; and (2) prolonged rainy season and calamities in gold rush areas. The BSP has five existing buying stations located in Quezon City, Baguio City, Davao City, Naga City and Zamboanga City.

The production of refined gold totaled 3,089 pieces "good delivery" gold bars which contained 1.23 million tr. oz. of gold. Each bar had a minimum assay of 99.6 percent. The refined gold production during the year was higher-than-target by 45.1 percent as accumulated gold purchases from 2001 were processed/cast into "good delivery" gold bars in 2006.

The BSP Mint produced 1.140 billion circulation coins in 2006, consisting of 10-Piso, 5-Piso, 25-Sentimo, 10-Sentimo, 05-Sentimo and 01-sentimo denominations. The output in 2006 was higher by 68.9 percent compared to the previous year's output of 674.9 million coins.

The BSP Mint also produced and delivered 420 sets of various presidential medals and state decorations to the Office of the President, Civil Service Commission, National Commission for Culture and Arts, National Academy of Science and Technology, Supreme Court of the Philippines and for ASEAN Summit National Organizing Committee.

Currency Issuance and Retirement

Currency Issuance

Currency notes issued declines

Total currency notes issued as of 31 December 2006 amounted to ₱448.9 billion (2,068.55 million pieces), declining by 2.1 percent from its year-ago level. During the same period, total coins issued stood at ₱13.0 billion (12,131.81 million pieces).

Currency Retirement

Total value of unfit notes that were retired increases

A total of ₱25.47 billion (463.28 million pieces) processed/verified cancelled unfit notes were retired through the Security Engineer Machine (SEM) Disintegrator in 2006, an increase of ₱2.46 billion (4.82 million pieces) from ₱23.01 billion (458.46 million pieces) in 2005. Meanwhile, a total of ₱66.61 billion (110.05 million pieces) were retired on-line, higher by 84.15 percent than its level during the previous year.

Information campaigns to preserve and maintain currency integrity successful

In line with the 2006 BSP operational plan for service excellence and to further intensify information campaign to preserve and maintain currency integrity, experts from the Currency Analysis and Redemption Sub-Group and the Investigation Sub-Group of the Cash Department conducted information campaigns to law enforcers and cash handlers of banks and business establishments nationwide as well as to local government units and market vendors. As a result of this information drive, the mass exports of 1-piso legal tender coins which are misdeclared as scrap metals was stopped. The BSP, in close coordination with the BoC, undertook a series of successful operations to end this illegal operation.

Economic Research, Statistical, and Information Dissemination Activities

The restructuring of the Department of Economic Research (DER) and the creation of the Department of Economic Statistics (DES) and Center for Monetary and Financial Policy (CMFP) in 2005 strengthened the thrust towards more in-depth research activities at the BSP. These changes aim to foster quality research in monetary policy-making and to communicate to the public the role of the BSP under the inflation targeting framework.

During the year, policy papers on the stance of monetary policy were prepared regularly by the Advisory Committee and submitted to the Monetary Board. The policy papers contained an assessment of the economic condition and outlook, and presentation of topical issues which affect the conduct and setting of monetary policy. The policy papers benefited from regular economic monitoring activities, quantitative policy simulations as well as from thorough research at the BSP.

Various research activities support monetary policy making

Technical notes, policy briefs and other papers produced in 2006 covered a wide area of issues. Topics included the reasons behind the apparent disconnect between the three-month Treasury bill rate and the current bank lending rates, review of global banking and financial policies, transmission mechanism of monetary policy in emerging economies, macroeconomic management in the context of internal and external imbalances, asset price cycles, and global imbalances and financial stability. In addition, comments and notes were also made to reflect the BSP's position on the proposed issuance by the Republic of the Philippines of local currency-pegged bonds in the international market, prices of financial assets in the Philippines, and development of asset management industries in ASEAN. There were also research on the challenges to the Euro area and Asia, history of Asian monetary and financial cooperation, globalization of production and intermediation of capital.

Other research requested by the Monetary Board in support of the operations of the BSP and in response to questions and issues raised by domestic and international institutions included studies on the yuan revaluation and impact of peso appreciation on the Philippine economy; remittances, financial development and growth.

The BSP also contributed comments and positions on proposed legislations and policy actions of government agencies and economic papers from foreign institutions and individuals. Other economic papers and reports commented on were related to financial stability, planned changes in IMF governance and surveillance as well as policy reviews, and the regular IMF Article IV assessment of the Philippine economy.

The BSP shored up its working relation with the academe and showed its support to research on monetary policy and improvement of statistics through the establishment of the Professorial Sterling Chair in Monetary and Banking Economics in the UP School of Economics, and the Professorial Sterling Chair in Government and Official Statistics in the UP School of Statistics.

Econometric modeling takes on new challenges

Econometric modeling, forecasting and simulation activities formed part the pool of information used for monetary policy formulation, economic policy analysis, and the setting of macroeconomic assumptions used for the national budget exercise. In line with this, the BSP continued the refinement of the multi-equation model; conducted preparatory activities for the construction of a dynamic stochastic general equilibrium (DSGE) model; proceeded with the review of parametric and non-parametric approaches to early warning system for a currency crisis; and made progress in the refinement of the long-term macro economic model. The BSP also conducted the study on Output Gap Estimation for Inflation Forecasting: The Case of the Philippines, which showed the estimates of the output gap and its benefits as one of the determinants of future inflation.

The conduct of inflation targeting changes

The BSP implemented some changes in the operational procedures in the conduct of monetary policy. The BSP invited a panel of three international experts from late 2005 to mid-2006, to review the BSP operating procedures for monetary policy. Some of the recommendations from the three independent studies on the Review of the BSP's Inflation Forecasting Models and Operating Procedures Under the Inflation Targeting Framework were subsequently adopted by the BSP. Moreover, some of the recommendations made by the international experts were included in the BSP's research agenda.

Issue-focused fora help in shaping monetary policy decisions

The Bangko Sentral invited experts from the banking community, private sector, and academe in four separate fora to share their insights on selected topics. The discussions in these Environmental Scanning Exercises (ESEs) served as inputs in the assessments undertaken by management and the Monetary Board regarding various economic issues. The following topics were discussed during the year's ESEs: economic impact of large foreign exchange inflows; bank lending trends and outlook; macroeconomic outlook under the proposed economic and other changes in the Constitution; and competitiveness of Philippine industries in light of developments in China.

The knowledge shared by the speakers and the information gathered from the discussions between and among the BSP officials and the invited speakers during the ESEs served as useful inputs in the research of the BSP; provided material for the BSP's information campaign program; and more importantly, served as reference in monetary policy discussion and formulation.

Early warning system aids in economic monitoring

The BSP's EWS on currency crisis uses a signal approach to help monitor foreign exchange pressure and predict the occurrence of currency crisis in the future. Indicators and weighted sectoral indices have thresholds which are computed from historical data on currency crises. Actual data are compared with the thresholds so that signals for a crisis or no crisis can be generated.

A review of the thresholds used as basis for the signals was completed. Reports on the results of the model were generated and presented regularly during the policy meetings of the Advisory Committee and the Monetary Board.

In February 2006, the EWS model on debt sustainability was approved by the Monetary Board. The model provides a framework that incorporates an assessment of the sustainability of the country's current debt and prospective borrowings.

Improvements in data collection and management continue

The BSP continued to conduct monthly, quarterly, and annual surveys to complement regular reports, fill up data gaps, and gather market expectations on key economic indicators. Monthly surveys for use in the BOP compilation included the survey on intercompany accounts with non-residents, survey on positions and transactions on accounts with non-resident banks, and survey on transactions of build-operate transfer companies. Quarterly surveys covered the business expectations survey (BES), the consumer expectations survey (CES), and the survey on foreign direct investment and related data. The coordinated portfolio investment survey (CPIS) and benchmark survey on IT-enabled services are annual surveys conducted by the BSP. The latter was introduced in 2006 covering 2004-2005 data. Increasing demand for microdata on household wealth, savings and debt used as reference in the formulation of monetary policy led to the preparations in 2006 for the conduct of the consumer finance survey (CFS) starting in 2007.

The BSP also continued to conduct its regular dialogue with exporters to afford the BSP a broader perspective from which to assess the outlook on the export sector.

Published reports reflect transparency and enhance public awareness

Efforts to foster greater transparency in its operations and to enhance the awareness of the public on the role of the BSP in promoting price and financial stability continued in the form of published regular and special reports on economic and financial developments in the country. These included the quarterly BSP Inflation Report, the Quarterly Report on Economic and Financial Developments, Status Report on the Philippine Financial System, BSP Annual Report, Regional Economic Developments in the Philippines and the BSP Working Paper Series. Other BSP publications and reports included the quarterly balance of payments reports, quarterly business expectations reports, quarterly consumer expectations reports, monthly selected Philippine economic indicators, updated primers on inflation targeting and microfinance as well as updates on frequently asked questions on economic and financial issues.

The Bangko Sentral Review continued to be published as a major vehicle for in-depth research output. The research articles in this publication are also intended to increase public awareness of the activities of the BSP and its view on relevant economic and financial issues. The issue of the BS Review in 2006 covered topics on the impact of BSP policy rates on market interest rates, technical assistance program of the IMF, and early warning systems on the macroeconomy.

The BSP constituted a review committee to assess the research outputs for the release of Working Paper Series in 2006. Research in the working papers are preliminary materials intended to stimulate discussion and solicit critical insights through peer review or refereeing. The two working papers in 2006 contained topics on BSP modernization, and modeling the impact of overseas Filipino workers remittance on the Philippine economy. A paper on the relationship between exchange rate and interest rate differential in the Philippines is due for release in 2007.

BSP continues to participate actively in inter-government agency committees and international conferences

The contributions and participations of the BSP in inter-agency committees involved presentations and discussions on economic policies and macroeconomic targets, including inflation, external payments positions, trade, international reserves and peso-dollar exchange rate assumptions at the DBCC and at the National Price Coordinating Council (NPCC); the Philippine position on matters related to international trade in banking services being coordinated by the Inter-Agency Committee on Trade and Services (IACTS); the stance of the BSP on industry petitions for tariff modifications presented at the Committee on Tariff and Related Matters (CTRM); the stance of the BSP on various proposals emanating from both private and public sectors as well as international/regional bodies which were discussed at the Technical Sub-Committee on WTO Matters (TCWM) of the NEDA Committee on CTRM; and discussions on non-tariff measures (NTMs) at the Sub-Committee on Tourism and Trade (Sub-COTT).

In the international front, the BSP participated in conferences and meetings organized by regional/multilateral organizations to discuss issues/proposals pertaining to monetary, finance and other economic development matters. The BSP also provided technical support to the Philippine delegation in various regional and multilateral meetings and conferences, particularly in the areas of monetary policy, banking and finance.

Supervisory Policy Development and Banking Statistical Activities

Studies on international standards, best practices and quantitative tools result in deeper insights on financial system's behavior and trends

The BSP conducted exploratory studies on international standards and best practices particularly on risk management, developed financial models and utilized other quantitative analytical tools to gain deeper insights into the dynamics of financial system behavior. Developments in the financial system were analyzed to monitor emerging trends and to determine potential crises that may trigger systemic risk. The BSP also continued to develop and review existing banking policies and monitored compliance reports vis-à-vis prudential regulations.

In 2006, several policies were implemented aimed at improving risk management systems in banks, promoting safe and sound banking practices, strengthening regulations, and improving bank services. Policy issuances pertained to the following: enhancement of corporate governance in financial institutions; acceleration of capital market development; promotion of compliance with the anti-money laundering law in coordination with the Anti-Money Laundering Council; improvement in the chartering of new banks and other financial institutions under the supervision of the BSP.

Several reports were also issued on the status of the Philippine financial system; impact of the adoption of PFRS/PAS on U/KBs; banks' exposures to real estate loans, auto loans and credit card receivables; and performance of OBUs and the Foreign Currency Deposit Unit (FCDU) System.

The BSP continued to collect banking data and validate banks' reports for storage and statistical generation.

The BSP pursued the following major bank statistical activities/projects in 2006: (1) development and implementation of the final stage of the Data Warehousing Project (DWP) that included the following sub-stages: execution testing of pre-defined reports, navigation testing, creation and execution testing of Ad hoc reports and performance testing; (2) testing and development of Financial Reporting Packages (FRP) submitted by the banks; (3) preparation of various reports such as bank performance reports of U/KBs, selected information on the Philippine banking system and 2005 annual Factbook on the Philippine Financial System; (4) processing of reports submitted by BSP-supervised/regulated entities; (5) maintenance of the Central Information Files which contain the masterlist of directors/officers/employees of banks/NBFIs with derogatory information, masterlist of interlocking directorships/ officerships of banks/NBFIs, biographical data and credit and equity exposure of banks and NBFIs; (6) monitoring of reporting profiles of BSP-supervised/regulated entities by establishing an inventory of non-reporting or late reporting banks; (7) issuance to all banks of the implementing guidelines on the submission of FRPs and the revised deadlines on the parallel submission of the new FRPs; and (8) continuous systems enhancement to sustain the expanding needs of the BSP.

Branch Operations

The BSP continues to provide central banking services in the regions

The BSP, through its three (3) regional offices[27] and eighteen (18) branches[28] continued to provide basic central banking services in the countryside that helped facilitate monetary and financial transactions in the regions in 2006.

To enhance its crisis management system, the regional offices and branches ensured that they remained compliant with the BSP Business Continuity Program, by maintaining sufficient level of liquidity, among others. Moreover, contingency plans were updated continuously after the occurrence of emergency situations, such as power outages, typhoons, and flash floods.

The regional offices and branches of the BSP continued to play a pro-active role in the conduct and implementation of various BSP advocacy programs, particularly those that promote economic and financial literacy,[29] currency integrity,[30] social responsibility,[31] and organizational efficiency.[32] These offices were also involved actively in the processing of the business expectations survey as well as in the generation of the bi-annual report on regional economic developments.

Advocacy Programs

Microfinance

Microfinance initiatives in 2006 focus on increasing the scale and scope of banking sector participation in microfinance

The BSP focused its microfinance initiatives for 2006 on increasing the scale and scope of microfinance in the country, specifically within the banking sector. At the same time, the BSP maintained the three-pronged approach on microfinance program, namely: (1) provide the enabling policy and regulatory environment to promote micro finance activities; (2) increase the capacity of the BSP and banking sector on microfinance operations; and (3) promote the development of sound and sustainable microfinance operations.

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[27] La Union, Cebu, and Davao.
[28] Zamboanga, Tuguegarao, Tacloban, Ozamiz, Naga, Lucena, Legazpi, Kalibo, Iloilo, General Santos, Dumaguete, Dagupan, Cotabato, Cagayan de Oro, Cabanatuan, Batac, Bacolod, and Angeles.
[29] These include advocacy campaigns on inflation targeting, anti-money laundering, microfinance, year-end economic briefing and anti-pyramiding and text messaging scams.
[30] Public information campaigns on the clean-note policy, coin recirculation program and anti-counterfeiting were conducted at the regional level.
[31] This includes promoting good governance, and advocacy program known as “Tulong Barya Para Sa Eskwela”.
[32] Advancing organizational efficiency means promoting SOAR and conducting values enhancement programs.

As most of the regulations are already in place, the BSP focused on reviewing the implementation of the existing regulations (i.e., rediscounting, branching and licensing) as well as welcomed innovations in service delivery and product designs.

Approval of Text-a-Payment/Text-a-Deposit Platforms. In September 2006, the monetary authorities approved the use of the short messaging system (SMS)/electronic cash platforms for clients to make deposits to their accounts. This innovation in service delivery aims to cut cost for both the institution and the client as well as provide convenience and flexibility. The willingness of the BSP to be open to technological innovations while balancing the need for adequate risk management systems has received international attention.

Approval of the Micro-Agri Product (MAP). In January 2006, the monetary authorities approved the MAP which allowed banks with microfinance operations to extend credit to those with small agricultural activities. The MAP will allow banks to serve the unmet needs of small farmers using microfinance technology.

Review of the Policy Governing Microfinance Involvement of Commercial Banks. The BSP is continuously looking at the policy environment by which KBs can engage in microfinance. Presently, 10 KBs are involved in wholesale windows for microfinance.

Savings: The Other Side of the Microfinance Coin. The BSP has contracted the services of a Consultative Group to conduct an assessment of saving patterns and behaviors in the Philippines. This would allow the BSP to create a database on geographic trends, patterns and profiles for future policy recommendations.

Improving the Remittance Environment. The BSP has created four Working Groups to facilitate initiatives on improving the environment for OFW remittance flows, namely: (1) Working Group on Payments and Settlement System; (2) Working Group on Financial Savings and Investment; (3) Working Group on Advocacy Campaign; and (4) Working Group on International Relations. An Executive Committee is tasked to ensure that the following objectives are met: (1) reduce remittance costs in the Philippines and in host economies to facilitate remittances through formal channels; and (2) channel foreign exchange savings to micro-enterprise activities and other alternative financial instruments.

BSP undertakes initiatives to enhance capacity to undertake and appreciate microfinance

The BSP remains committed to increasing the skills, capacity, understanding and appreciation of microfinance. Toward this end, several initiatives were undertaken in 2006.

Capacity Building within the BSP. The BSP conducted seminars and courses to provide policymakers, officers and staff a deeper appreciation of the operations of microfinance, procedures in microfinance examination, computer-assisted examination techniques, information technology audit for microfinance and capture and reporting of data for microfinance to aid a more responsive policy agenda for microfinance. In 2006, around 234 officers and staff of the BSP participated in the following microfinance-related activities: (1) Exposure Trip to various types of microfinance business enterprises; (2) Training of Microfinance Examiners on Microfinance Procedures; (3) Special Training on Computer-Assisted Examination Techniques for Microfinance; (4) Microfinance Appreciation for Supervisors of Examination Divisions; (5) BSP-wide Microfinance Appreciation Course; and (6) Institutionalization of Microfinance Data Capture.

Capacity Building within the Banking Sector. The BSP continued to conduct seminars on the Computation of Portfolio at Risk, Provisioning and Internal Controls for all banks with microfinance operations. In 2006, microfinance was included as part of the curriculum in the Basic Rural and Thrift Banking Course.

BSP promotes linkages among financial institutions to better leverage resources and skills

The BSP focused its advocacy on promoting linkages that will help develop microfinance and achieve growth. In fostering linkages between the large banks and retail financial institutions to better leverage the resources and skills of frontline institutions, several initiatives were undertaken by the BSP in 2006.

Networking Meeting. To acquaint large banks with successful retail institutions and identify partnership models among them, the BSP conducted a networking meeting on 24 May 2006. As a result, partnerships were established with several financial institutions, thereby contributing to further commercialization of microfinance.

Briefings on Microfinance to Commercial Banks and International Investors. The BSP conducted presentations and orientations on microfinance to KBs and international investors. These paved the way for discussions on various avenues and opportunities by which banks and investors can be involved in microfinance activities.

BSP coordinates with other government agencies in promoting microfinance

Likewise, the BSP coordinated with the Department of Trade and Industry (DTI), Technical Education and Skills Development Authority (TESDA) and Technology and Livelihood Resource Center (TLRC) to assist microenterprises in increasing the scope and scale of their businesses as well as expand their business operations by tapping the export market. Toward this end, several initiatives have been undertaken by the BSP in 2006.

Microfinance Seminar for Clients. The BSP in collaboration with DTI conducted seminars in Pampanga, Davao, Bulacan and Cagayan de Oro to over 1,000 participants. The seminar aims to increase the awareness of potential clients to the various microfinance services as well as technical assistance and business development services that are available to them.

Microfinance Caravan for Clients. The BSP took an active role in the caravan that focused on potential microfinance clients in urban centers (i.e., Quezon City, Valenzuela City and Marikina City).

Various Entrepreneurship Fairs. The BSP also took part in various initiatives geared toward increasing the skills and capacity of micro, small and medium entrepreneurs.

Search for the 2006 Microentrepreneur of the Year. The BSP, together with the Citigroup and the Microfinance Council of the Philippines, conducted anew the search and awarding of the 2006 Microentrepreneur of the Year. This provides inspiration for microfinance clients and institutions in the country.

The BSP also continued its advocacy on microfinance through various speaking engagements and presentations to the academe, other central banks and mass media, among others. For 2006, the BSP conducted briefings on the developments of microfinance in the Philippines to delegations from nine central banks of the following countries: Angola, Bangladesh, China, Indonesia, Mongolia, Nigeria, South Africa, Tanzania and Vietnam.

Economic Information

Public information campaign contributes to increasing awareness on the role of BSP in economic development

The BSP continued to pursue PICs in 2006 to increase awareness on the role of the BSP in the country's economic development and enhance further the transparency of monetary and financial sector policies. As in the previous years, the 2006 PICs covered the following topics: (1) recent economic and financial developments; (2) inflation developments and inflation targeting; (3) Anti-Money Laundering Act; and (4) a choice of one additional topic (either Microfinance, Special Purpose Vehicle Act or Rediscounting). In 2006, the PIC utilized audio visual presentations on the role of the BSP in the Philippine economy and the different BSP Advocacy Programs, which included *Tulong Barya Para Sa Eskwela*, Clean Note Policy and the Credit Operations of the BSP. The BSP conducted PICs in the cities of Dipolog, Cebu, Lipa, Angeles (Pampanga), Tagbilaran, Davao, Naga, Dumaguete, Puerto Princesa and Laoag in 2006. The BSP also tapped schools as additional venues for the conduct of the PIC.

The BSP also conducted the Users' Fora in Tacloban and Baguio cities in October 2006. The fora served as venue for the presentation of the BSP-produced statistics among various data users and agencies in the country to coincide with the celebration of the National Statistics Month held every October since it started in 2002. The topics covered in the forum include monetary and financial statistics, balance of payments, core inflation and business and consumer expectations surveys. The fora have been conducted in 14 cities with participants totaling around 700.

Dialogues with exporters provide BSP a broader perspective from which to assess the outlook on the export sector

In April 2006, the BSP held a dialogue with exporters. Discussions focused mainly on trends and outlook in both the global and domestic economy, status of the scorecards on government commitments with exporters and the challenges faced by exporters, particularly the appreciation of the peso. Dialogues with exporters are organized by the BSP twice a year. However, for 2006, the forum for the second semester was replaced by the DTI-organized Export Competitiveness Summit which looked into the wider concerns of the exporters.

Clean note policy and currency familiarization campaigns educate public on counterfeit detection

In 2006, the BSP re-launched the Nationwide Campaign for Effective Implementation of BSP's Clean Note Policy (CNP) in cooperation with the Bankers Association of the Philippines, the Chamber of Thrift Banks and the Rural

Bankers Association of the Philippines. The CNP encourages the public to exchange/deposit their unfit/dirty notes with the banks. Through this, the public can easily detect counterfeits among fairly clean notes.

The BSP continued to conduct information campaigns before various sectors on currency familiarization, proper handling of currency notes and coins and counterfeit detection of genuine Philippine/other acceptable foreign currencies. The BSP conducted briefings before about 1,000 vendors/consumers in 10 Metro Manila markets in 2006.

The BSP also launched the Reward System where the BSP encourages the population to furnish information on person/groups responsible for the manufacture/passing of counterfeits.

Coin recirculation campaign merges BSP's corporate social responsibility and operational objective

The coin recirculation campaign of the BSP merged corporate social responsibility and its operational objective of ensuring that there is adequate supply of notes and coins to facilitate economic transactions. In particular, the *Tulong Barya Para sa Eskwela*, sought to raise funds for the benefit of public elementary schools in the country and to promote coin recirculation through the regular use of coins.

The campaign, which was launched in 2006 in 40 places covering 15 regions in the country, was conducted in coordination with the Department of Education (DepEd), the bank associations, Philippine Retailers Association, media networks, Cinema Advertisers Association of the Philippines and other stakeholders. The support of these institutions ensured the participation of schools, banks, and retailers, and provided media mileage that brought the campaign before a wider audience in the country.

The six-month *Tulong Barya Para sa Eskwela* campaign, which ended on 31 December 2006, met its objectives by increasing public awareness of the need to regularly use coins. At the same time, the campaign was able to flush out 5.9 million pieces of coins equivalent to production savings of ₱7.2 million at ₱1.2195 weighted average per piece. Likewise, the campaign raised funds amounting to about ₱6 million for the benefit of public elementary schools in the country.

Financial Literacy

BSP continues to embark on consumer education program for better financial literacy of the general public

The BSP continued to take a proactive stance in embarking on consumer education program that aims to improve the basic financial literacy of the general public.

The BSP forged partnerships with the DepEd and Economic Policy Reform and Advocacy (EPRA) to lay the groundwork for the integration of lessons in savings and money management in the elementary curriculum. The BSP prepared concept materials on saving, money management and basic economics that will serve as basis for various initiatives on promoting financial literacy. Meanwhile, EPRA will finance a writeshop/workshop to develop a teachers' guide on conducting basic financial literacy course to be held in April 2007. EPRA commissioned the Philippine Center for Policy Studies, a consultancy group, to provide lecturers for the writeshop/workshop.

On the part of DepEd, curriculum experts from the Bureau of Elementary Education have included in the scope and sequence in teaching *Heograpia, Kultura at Sibika* (*HEKASI)* or Social Studies and *Edukasyong Pangkabuhayan at Pantahanan* (EPP) the needed learning competencies in saving, money management and basic economics based on the concept materials submitted by the BSP.

In February 2006, the BSP launched the Financial Literacy Program (FLP) for OFWs. The advocacy drive aims to raise the volume of OFW remittances used in development activities by urging OFWs and their families to save and to invest in financial instruments or business ventures. The undertaking is also in pursuit of Executive Order No. 446 dated 12 July 2005, the intent of which is to integrate efforts of government involving OFWs and to optimize the gains from their remittances through sustainable income generating activities like small and medium enterprises. Pinpointed as the lead agency for bank-related OFW initiatives, the BSP is undertaking the information drive with partners from the government and private sector. In 2006, the BSP conducted the FLP for OFWs in 8 cities where around 759 OFWs and their beneficiaries participated.

The BSP stepped up efforts toward greater synergy with the Department of Trade and Industry's Bureau of Trade Regulation and Consumer Protection (BTRCP), the Anti-

Money Laundering Council and other government agencies in responding to consumer complaints, consolidating documentation, and increasing public awareness on consumer rights.

The BSP continued to promote consumer rights awareness and protection through its linkage with an inter-agency group, ConsumerNet.[33] In 2006, the BSP attended to 726 complaints, of which 271 have been resolved. Over one-third of the complaints were on credit card matters and a significant number were on negligence/fraudulent transactions involving banks and text scams.

Institutional Building

Corporate Planning

The BSP continues to undertake initiatives on strategic management

In line with the BSP's six-year planning horizon, the Corporate Planning Office organized the conduct of the 2006 BSP Strategic Planning conference which was held on 16-18 June 2006. The conference sought to achieve the following objectives: (1) focus on key strategic issues, which will be identified with the guidance of recent business developments, external and internal organizational assessment and policy implications of implementation bottlenecks; and (2) formulate strategies and operational plans to address strategic imperatives.

Prior to the conduct of the planning conference, a total of 24 pre-conference meetings were held including an environmental/organizational climate assessment which provided the opportunity for the working groups participating in the BSP Strategic Planning conference to assess the operating environment and come up with relevant strategic issues for the conference. Three relevant strategic concerns were taken up for discussion, namely: (1) how to ensure more effective and more timely communication both internally and externally (Communication); (2) how to build inspiring and effective leadership (Leadership); and (3) how to ensure the BSP's financial sustainability (Financial Sustainability).

[33] In an effort to protect consumers from unscrupulous parties, a group of national government agencies worked together to facilitate the resolution of consumer complaints and disseminate information regarding consumer rights. These government agencies are as follows: (1) BTRCP of the DTI; (2) DepEd; (3) BSP; (4) Department of Agriculture (DA); (5) Department of Interior and Local Government (DILG); (6) Energy Regulatory Board (ERB); (7) Department of Health (DOH); (8) SEC; (9) National Telecommunication Commission (NTC); (10) Housing and Land Use Regulatory Board (HLURB); (11) Insurance Commission (IC); (12) BIR; (13) Land Transportation Office (LTO); and (14) Department of Justice (DOJ). The ConsumerNet website is www.i-reklamo.ph.

The result of the annual planning exercise was communicated by the Governor to the entire organization in October 2006 during the conduct of Sustaining Outstanding Accomplishments and Results (SOAR) 2006 for the Head Office, Security Plant Complex (SPC), the three regional offices (La Union, Cebu and Davao) and three regional branches (Iloilo, Cagayan de Oro and Naga).

In the second year of a three-year project on promoting strategic management thinking, the third offering of the Executive Forum Series (EFS) was held with "change management" as topic. The forum, dubbed "Walk the Talk: Driving the Force of Change" was conducted on 23 May 2006.

Information Technology

Gains in information technology contribute to a more efficient financial infrastructure

In line with the goals and objectives of the BSP 2005-2011 Medium-Term Strategic Plan for Information Technology, major accomplishments in the area of information technology were achieved in 2006. The following application systems were developed during the year: (1) Real Time Gross Settlement (RTGS) linkages; (2) Financial Reporting Package (FRP); and (3) Phase 1 of eRediscounting system. The application systems linked with the RTGS which were completed in 2006 were: (1) Intraday Liquidity Facility (ILF); (2) Electronic Cash Withdrawal; and (3) Philippine Dealing and Exchange (PDEX) Fixed Income STP or the transactions from the PDEX.

The ILF is used by the BSP to supply liquidity to banks through the repurchase agreement facility to replenish temporary fund shortages arising from payments of RTGS-based interbank transactions. Following the first pass for User Acceptance Test (UAT) done from 20-22 July 2005, another round of user acceptance testing was completed in 2006. The Electronic Cash Withdrawal System (ECWS) eliminates check transactions with the participating banks. After completing testing with 47 (out of 58) participating commercial and thrift banks on 28 July 2005, a parallel run in January 2006 was completed and the system was implemented on 6 February 2007. The system on PDEX transactions was implemented on 11 September 2006.

Under the FRP, the BSP started adopting the International Accounting Standards (IAS) and the provisions of the PFRS and the PAS effective the annual financial reporting period beginning 1 January 2006, both for purposes of prudential reporting and audited financial statements.

The eRediscounting facility, envisioned to facilitate greater access to credit for borrowers from the countryside, was launched by the BSP on 13 December 2006. The facility seeks to allow banks to convert their receivables into ready cash, putting them in a position to generate more funds to re-lend to different economic sectors, such as the micro, small and medium enterprises.

IT infrastructure developments in 2006 included the installation of the Wireless Local Area Network (LAN) in 18 out of 21 BSP regional office and branches as well as the notice to the winning bidder to proceed with the IT chamber and Data Center renovation on 7 August 2006.

Other projects which have been partially completed include: (1) Integrated Regional Information System (IRIS); (2) enhancements to the Foreign Direct Equity Investment System (FDEIS); (3) Foreign Exchange Portfolio Investment Management System (FXPIMS); (4) use of the Resource Monitoring Center of the TIVOLI system; (5) BSP Regional LAN; and (6) Dual Internet Service Provider (ISP).[34]

Human Resource Management

Activities on human resources improve further employee benefits and enhance superior-employee relations

In 2006, the BSP pursued the implementation of the System Application and Products (SAP) Human Resource (HR) System that integrated the HR Information System to provide real time and accurate data viewing. Programs to enhance systems and methods in recruitment and selection including updating assessment tools, systems and processes were carried out. Likewise, the BSP continued the Job Evaluation and Compensation Project along with the bankwide reorganization.

The BSP shifted to a competency-based HR system where various human resource activities such as recruitment, promotion, training and development, and performance evaluation are anchored on competencies of employees. The ultimate objective of a competency-based HR system is to enhance the productivity of the

[34] These projects include enhancements to BSP's in-house application systems (Items 1 to 3) and infrastructure projects (Items 4 to 6).

BSP personnel and link individual and team performance to the corporate strategy of the BSP. The Bank has started the competency profiling project with the banknote printers as the pilot in September 2005. In 2006, competency profiling was initiated in the Banknotes and Securities Printing Department, the Department of Loans and Credit, the Department of Economic Research, the Office of Supervisory Policy Development and the International Department.

Other HR initiatives included the institutionalization of team-building activities, the BSP anniversary raffle, Christmas food subsidy, conduct of the summer sportsfest, and the launching of the '*Gawad Kalinga*".

The BSP continued to recognize excellence in the performance of duties through the Program Awards and Incentives for Service Excellence (PRAISE) with the grant of the Outstanding Department Award, Outstanding Region Award, Academic Achievement Award, Perfect Attendance and Punctuality Award and Loyalty Awards to deserving employees.

Excellence in Service Delivery

BSP's quality management systems at par with global best practices

The BSP remained committed to instituting a culture of service delivery at par with world class standards in accordance with the medium term objectives of its Service Excellence program for 2005-2011.

The Quality Management System (QMS) projects programmed for certification in 2006 passed the audits conducted by Certification International Philippines, Inc. (CIPI) as a certifying body. The BSP's Corporate Planning Office, the Office of Special Investigation, Cash Department and the Security, Investigation and Transport Department were certified as International Organization for Standardization (ISO) 9001-2000 compliant. This means that the quality management systems in these offices are at par with global best practices of the ISO. Recommendations were also made to improve the effectiveness of the implementation of the Environmental and Occupational Health and Safety Management Systems (EOH&SMS) of the bank. Moreover, the BSP updated its 1981 version of Service Manual that guide employees towards better delivery of service.

Conferences, Seminars and Workshops

Training programs are benchmarked against global practices, and establish professionalism and excellence of BSP officials and staff

The BSP continued to establish professionalism and excellence at all levels by providing training programs benchmarked against global practices. The BSP also enhanced the knowledge and technical skills of officers and staff through their participation in local and foreign development programs/courses and promoted positive values among its personnel as well. Aside from its own employees, the BSP also provided technical training to external clients to enhance organizational capability building for employees of rural banks and thrift banks. In 2006, the BSP moved from managed learning to competency-based learning.

The BSP's In-house training programs comprised the most number of training participants and covered topics relevant to core central banking functions as well as the bank's core disciplines of law, human resource, and information technology. Training courses were conducted to build skills for excellent performance including oral and written communication courses, completed staff work, total quality management, project management, among others. These were supplemented by courses that build the bank's core values as part of the BSP culture. The delivery of training courses in the regions likewise intensified with the launching of computer courses in coordination with the local branches of Informatics.
The BSP also conducted 60 training events for rural banks, thrift banks, savings and loan associations and pawnshop employees, FX dealers and remittance agents, among others. The Basic Rural Banking Course, a mandated training program, was rolled out with an updated course syllabus in 2006 to incorporate Risk Management topics in accordance with the Basle framework as well as microfinance. The Basic Thrift Banking Course likewise underwent revision to incorporate the same concerns.

Participation in training events such as local and foreign trainings/seminars, workshops, conferences and meetings provided BSP officers and staff the opportunities to keep abreast with the latest information, developments, technology and systems, and more importantly, allowed them to network with counterparts and professionals in similar fields, as a continuing source of updates way beyond the training event. Local trainings covered technical skills enhancement training for competencies in IT, accounting, audit, HR, procurement, administrative functions, training, building management and public relations, among others. The BSPI also took advantage of local offerings of international training events for specialized topics. Meanwhile, foreign training centered mostly on central banking topics and were sponsored generally by the IMF Institute (situated in Washington D.C. and Singapore), South East Asian Central Banks (SEACEN) Research and Training Centre, Financial Stability Institute of the Bank for International Settlements, Center for Central Banking Studies of the Bank of England, International Banking and Finance Institute of Banque de France, Deutsche Bundesbank, Federal Reserve Bank System, World Bank Institute, South East Asia New Zealand and Australia (SEANZA), EMEAP, Center for Monetary Studies in Latin America (CEMLA) and other central banks in the region.

In addition to its regular in-house, local and foreign training programs, the BSP was able to support the studies of BSP employees under the following scholarship programs: BSP Educational Scholarship and Training (BEST) Program; Scholarship Program for Deserving Children; Off-Campus MBA, Asia Pacific College; Thesis and Dissertation Writing Scholarship Program and Civil Service Commission for Master's Degree Courses. Bank employees also participated in foreign graduate studies sponsored by the AusAID; the JICE-JDS, Japan; and JICA, Japan.

As part of its international commitment, the BSP coordinated three (3) international/regional training events in 2006, namely: (1) 5-day Asian Development Bank – Federal Reserve System – Asia Pacific Economic Cooperation training entitled "Bank Analysis and Examination School" which was attended by BSP's bank examiners and similar professionals from other regional central banks; (2) Workshop on Risk Management, in cooperation with Deutsche Bundesbank, which brought together risk management experts from their Bank and other banks from Germany to discuss various risk management systems employed by their respective banks; and (3) SEANZA-FSI seminar on Credit Risk which likewise provided a platform for speakers and participants to discuss credit risk-related elements under Basel II, its implementation and issues.

The year 2006 paved the way for competency-based training. The BSP has completed the training and enabled the certification of 10 HRMD HR specialists on

Competency Profiling who will work on the competency model of the core functions in the Bank as a priority. A primary output of the competency profiling would be the Individual Development Plan which would be the template for competency-based training and development interventions.

Other special training projects in 2006 included training on the unified rediscounting and specialized lending system (URSLS), certification programs, and leadership and management skills. The URSLS, a system that computerized credit process and services (discounts, rediscounts, loans and advances), provided the Department of Loans and Credit (DLC) staff with an appreciation of the credit value chain and helped them understand and apply the concepts and techniques on the design and development of credit systems, both from the standpoint of programmers and end-users. The Certification Program covered the conduct of in-house review classes, enrolment in public review classes, facilitation of their registration for the examination and the disbursement of funds for the purpose. Meanwhile, the BSP's Management Skills Enhancement Program (MSEP) is a ladderized training program that addresses the leadership and management skills training of all levels of managers in the Bank. The MSEP program was supplemented with the Executive Development Lecture Series which provided updates for managers on industry trends in management.

Crisis Management

Adoption of comprehensive plan of action allows effective leadership and business continuity management in times of crises

The BSP continued to gear its activities towards effective leadership and direction in crisis and business continuity management. The Monetary Board approved the BSP Business Continuity Plan (BBCP) on 10 February 2006. The BBCP is a comprehensive plan of action that sets out the procedures and establishes the processes and systems necessary to restore the orderly and expeditious operations of BSP, especially those which are mission-critical. A briefing on the BBCP was given to BSP officials and key personnel of mission-critical departments (MCDs) and critical support departments (CSDs) as well as personnel of regional branches. The briefing served as a venue to discuss linkages with the individual departmental business continuity plans and to identify gaps. As a result of two tabletop exercises with the MCDs and CSDs in May 2006, the Basic Model of Communication Process Flow (BMCPF) was adopted.

Related activities on crisis management included the conduct of the first integrated earthquake-fire-business continuity drill, the completion of the BSP Emergency Preparedness and Response Plan on Avian Influenza Pandemic (BSP-EPRP-AIP) and the updating of the Institutional Call Tree.

International Economic Cooperation

BSP participates actively in international meetings that cover monetary and financial issues

The BSP participated actively in international cooperation activities particularly on monetary and financial concerns under the various initiatives and programs of multilateral and regional bodies, as well as foreign financial institutions.

Association of Southeast Asian Nations

Pursuant to the country's commitment under the ASEAN Finance Minister's Process to promote closer economic and financial cooperation in the region, the BSP participated in various ASEAN and ASEAN+3 initiatives on finance cooperation, as follows:

The BSP participated in the ASEAN+3 Finance Ministers Meeting held in Hyderabad, India last 4 May 2006. The ASEAN+3 Finance Ministers approved enhancement of the CMI as a liquidity support mechanism by: (1) increasing the size of the swaps to US$77.0 billion in 2006 from US$39.5 billion; (2) adopting a collective decision-making procedure for swap activation; (3) improving the drawdown mechanism by increasing the size of swaps that could be withdrawn without IMF support program from 10 percent of the agreed total amount of bilateral swap to 20 percent; and (4) establishing the Group of Experts (GOE) to provide independent economic assessment and the Technical Working Group on Economic and Financial Monitoring (ETWG) to enhance regional surveillance capabilities through the development and implementation of national EWS for economic and financial monitoring.

The BSP co-chaired with DOF the 10th Working Committee on ASEAN Financial Services Liberalization under ASEAN Framework Agreement on Services (WC-AFAS) Meeting held on 26-27 October 2006 in Mandaue City, Province of Cebu, Philippines. The Meeting continued the 4th round of negotiations on ASEAN Financial Services Liberalization and adopted a timetable for the negotiations. The working committee agreed to develop a common ASEAN position on issues confronting

ASEAN member countries when negotiating with Dialogue Partners on matters related to forging a free trade agreement (FTA). Towards this end, the WC-AFAS approved in principle the expansion of the mandate of the WC-AFAS to include the facilitation of FTA negotiations with dialogue partners by amending the working committee's Terms of Reference (TOR).

The BSP and BOJ agreed on the renewal of the bilateral swap arrangement (BSA) on 4 May 2006 for a period of three years.[35] Under the newly concluded BSA with BOJ, the one-way swap in the BSA that expired earlier on has been transformed into a two-way swap. In particular, the BSP can swap pesos for US dollars up to US$6 billion while the Ministry of Finance of Japan (MFJ) can swap up to US$500 million equivalent of yen for pesos, based on the applicable exchange rate stipulated under the BSA in the event that an immediate need arises that would require balance of payments or short-term liquidity support. The agreement reflected the measures adopted by the ASEAN+3 Finance Ministers during their meeting in May 2005 in Istanbul, Turkey, to enhance the effectiveness of the CMI as a foreign exchange liquidity support mechanism. The size of the swap that could be withdrawn without an IMF-support program was also increased from 10 percent to 20 percent of the total swap amount.

The BSP concluded the Phase II of the Technical Assistance Project on Bond Market Development in the Philippines, which was implemented by the Daiwa Institute of Research (DIR) in 2005. Under the project, DIR extended technical assistance in the following areas: (a) development of proposals for regulatory authorities to enhance credit rating system; (b) assistance to the PSE in developing a framework for the launching of exchange traded funds; (c) preparation of a roadmap for the introduction of a bond index; and (d) assistance to the FIE in developing a securities lending program covering cash-collateralized securities lending transactions and tripartite securities lending transactions.

In 2006, the BSP participated in other ASEAN and ASEAN+3 Meetings as follows: (1) ASEAN Finance and Central Bank Deputies' Working Group Meeting, 2 March 2006, Siem Reap, Cambodia; (2) Working

[35] The BSA is intended to provide short-term financial assistance in the form of swaps to the participating party that is in need of balance of payment support or short-term liquidity support and shall supplement existing international financing facilities, such as those provided under the IMF and the ASEAN Swap Arrangement (ASA).

Group on the Review of the CMI, 14 March 2006, ADB Headquarters, Manila; (3) Informal ASEAN-6 Central Bank Deputies' Meeting, Indonesia, 17 March 2006 and also in Singapore, 19 September 2006; (4) Meetings of the 14th ASEAN Central Bank Forum (ACBF), ASEAN Finance and Central Bank Deputies Meeting (AFDM), Informal AFDM+3 and 10th ASEAN Finance Ministers' Meeting (AFMM), 1-5 April 2006, Siem Reap, Cambodia; (5) Meetings of the Working Group on the Asian Bond Markets Initiative which was held on the following dates: 16-17 March 2006 at the ADB Headquarters in Manila; 24 September 2006 in Beijing, China and 2 November 2006 in Hangzhou, China; (6) 2nd Seminar on Regional Bond Market Development for Cambodia, Laos, Myanmar and Vietnam (CLMV), 6-7 June 2006, Ho Chi Minh City, Vietnam; (7) 15th ASEAN-Korea Trade Negotiating Committee Meeting, Bandar Seri Begawan, Brunei Darussalam, 31 October-3 November 2006; (8) 3rd ASEAN Finance Ministers' Investor Seminar, 14 September 2006, Hong Kong and 16 September 2006, Singapore; and (9) the Informal AFDM+3, Pyeong Chang, Gangwon-do, Korea, 27-28 November 2006.

South East Asian Central Banks Research and Training Center

As part of its commitment to the SEACEN Centre, the BSP participated in the 4th SEACEN Executive Committee (EXCO) Meeting and Seminar on Capacity Building of Asia Pacific Central Banks on 18-19 February 2006 in Nadi, Fiji. The meeting discussed the program of activities and budget of the SEACEN Centre for OY 2006-2007; deliberated on matters concerning management and supervision of the SEACEN Centre; and made recommendations to the SEACEN Board of Governors on matters and policies of strategic importance to the SEACEN Centre. The BSP also participated in the 41st SEACEN Governors' Conference and the 25th Meeting of the SEACEN Board of Governors on 3-6 March 2006 in Bandar Seri Begawan, Brunei Darussalam to decide and finalize the programs and activities of the SEACEN for OY 2006-2007.

On 15-17 November 2006, the BSP Directors of Research and Training attended the 28th Meeting of SEACEN Directors of Research and Training (DORT) in Siem Reap, Cambodia. The meeting reviewed the progress of research and training activities for OY 2006-

2007 and discussed the proposed program of activities for OY 2007-2008. In conjunction with the DORT Meeting, a Seminar on Macroeconomic Surveillance was conducted for the Directors of Research. The meeting was preceded by a Seminar on Talent Management and Development of Central Banks for Directors of Training and Human Resources.

The SEACEN Expert Group (SEG) on Capital Flows continued to monitor developments in capital flows in the Asian region through the exchange of data on capital flows using a standard set of templates.

Executives' Meeting of East Asia Pacific Central Banks

In support of the EMEAP's primary objective of enhancing regional cooperation among Asia Pacific central banks, the BSP continued to actively participate in the various activities of the organization in 2006.

The BSP participated in the following EMEAP meetings: (1) 11th Governors' Meeting in Canterbury, New Zealand in May 2006, which discussed, among others, macroeconomic management in the perspective of both internal and external imbalances, as well as business continuity planning in the context of economic impacts and central bank precautions caused by pandemic influenza; (2) 3rd Informal Governors' Meeting held on 20 November 2006 in Sydney, Australia in conjunction with the High-Level EMEAP Eurosystem Seminar; (3) 31st Deputies' Meeting in Sydney, Australia in November 2006, where Deputies dealt with issues on asset prices and regional monetary and financial stability, as well as the implications of demographic change for the EMEAP region; and (4) EMEAP Working Group (WG) meetings (i.e., WG on Financial Markets; WG on Banking Supervision; WG on Payments and Settlement Systems; and IT Directors' Forum).

The BSP also took part in various meetings organized under the Task Force on Regional Cooperation among Central Banks in Asia in support of its objective to develop a roadmap on regional cooperation in Asia, as follows: (1) 1st Meeting of the Task Force on Regional Cooperation among Central Banks in Asia held in Kuala Lumpur, Malaysia on 7 April 2006, which discussed, among others, the objectives of enhanced central bank cooperation in Asia and created four working committees on key areas in central banking; (2) 2nd Meeting of the Working Committee on Asian Monetary and Financial

Stability held in Guilin, China on 22 August 2006, where the committee agreed to propose to the Task Force the enhancement of the EMEAP surveillance process and the establishment of a crisis prevention mechanism; and (3) 2nd Meeting of the Task Force on Regional Cooperation among Central Banks in Asia held in Kuala Lumpur, Malaysia on 28 August 2006, which agreed to propose to the EMEAP Governors the enhancement of the EMEAP surveillance process and the establishment of a crisis prevention mechanism.

South East Asia New Zealand and Australia

SEANZA was formed to promote cooperation among central banks by providing intensive and systematic training courses for central bank staffs, as well as to provide an avenue for information exchange on issues and problems of common interest among member economies. Training courses are held biennially with a rotating system of host members.

The BSP participated in the 26th SEANZA Central Banking Course held in Langkawi Island, Malaysia on 20-24 November 2006, and the Governors' Symposium and Meeting also in Langkawi Island on 25 November 2006. During the symposium, the SEANZA Governors discussed macroeconomic management in an environment of aggregate supply shocks.

Asia Pacific Economic Cooperation (APEC)

The BSP participated in the 13th APEC Finance and Central Bank Deputies' Meeting, 5-6 September 2006 and APEC Finance Ministers' Meeting, 7-8 September 2006, held in Hanoi, Vietnam. The meetings focused on the following themes: (1) public finance efficiency and sustainability towards stable and efficient revenue sources; and (2) financial sector reforms to attract capital flows. Also discussed in the meetings were the progress of various APEC activities such as the review of the APEC Finance Ministers' Process (FMP), developments on the APEC Policy Initiatives, and macroeconomic developments in the Asia-Pacific region.

In preparation for the 2008 APEC Finance Ministers' Meeting (FMM), the BSP also participated in the 23rd Senior Finance Officials' Meeting (SFOM-1), formerly known as the APEC Finance Ministers' Technical Working Group (TWG) Meeting, in New South Wales, Australia on 11 December 2006. The 23rd SFOM-1 covered the following themes for the 2008 FMM: (1) Transparency and Sustainability in the Public Balance Sheet; and (2) Deepening and Integrating Capital Markets.

Bank for International Settlements

The BSP took part in high-level meetings held under the auspices of the BIS, having been a member of the international organization since 2003. These meetings provide a venue for the review of current economic and financial developments and the exchange of views on issues that are of particular interest to central banks, such as Basel II, financial stability and prudential policy, and financial market development.

On 20 November 2006, the BSP participated in BIS high-level meetings in Sydney, Australia. These meetings included: (1) the Global Economy Meeting, which reviewed recent economic and financial market developments; (2) the Meeting of Governors on the development and integration of cross-border integration of financial markets; and (3) a Special Meeting of Governors, which focused on the implications of the rise of the emerging market economies for the International Monetary System. In early December 2006, the BSP took part in the Deputy Governors' Meeting, which was held in Basel, Switzerland.

In addition, the BSP participated actively in the Asian Consultative Council (ACC) since joining it in 2003. The BIS created the ACC in 2001 as a vehicle for communication between its Asian member central banks and the BIS on matters of concern to the Asian central banking community. On 12 February 2006, the BSP participated in a retreat for ACC members in Shanghai, China. The BSP also took part in the Meeting of the ACC on 24 June 2006 in Basel, Switzerland, where representatives discussed (1) the BIS Asian research program; (2) banking services and the Asian Bond Fund 2; and (3) economic analysis and meetings to foster central bank cooperation.

International Monetary Fund

The BSP, as the representative of the Government of the Philippines in the IMF Board of Governors, maintained close dialogue with the IMF within the framework of post program monitoring (PPM) and the annual Article IV Review Consultations. Under Article IV of the IMF's

Articles of Agreement, the IMF holds annual bilateral discussions with members. An IMF staff team visits the country to collect economic and financial information and discuss developments and policies with country officials. A staff report is prepared and forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director summarizes the views of the Executive Directors and this summary is transmitted to the country's authorities. On the other hand, the PPM provides for frequent consultations between the IMF and the members whose arrangements have expired but who continue to have outstanding Fund credit. Policies that have bearing on external viability are the particular focus in these consultations. Two IMF review missions were conducted in 2006. The PPM review was held on 21 July-2 August 2006 while the annual Article IV consultations/PPM review was conducted on 6-17 November 2006.

The BSP prepaid in full its outstanding obligations to the IMF amounting to SDR146.3 million (about US$219.9 million) on 29 December 2006. The BSP paid the IMF ahead of the scheduled maturities of these obligations which extend to 2008. The prepayment triggered the country's early exit from its PPM arrangement with the IMF, which was originally scheduled to end in April 2007. The prepayment served as a watershed event in the Philippines' relationship with the IMF, since it ended the country's use of IMF resources after nearly four and a half decades. The pre-payment of the IMF debt is expected to send a clear signal to the international community that the structural reform process and macroeconomic prudence in the Philippines have firmly taken root to allow reduced engagement with the IMF. The established close policy dialogue with the IMF will continue under the Article IV framework, which all member countries go through on a regular basis.

Asia-Pacific Group (APG) on Money Laundering

The APG on Money Laundering is an organization in the Asia Pacific region participating in the fight against money laundering and terrorist financing. It conducts mutual evaluation of its members to ensure that their efforts come up to Financial Action Task Force standards and holds workshops to keep track of trends in dealing with money laundering. The Philippines is a founding member of the APG and attends its meetings regularly.

The Philippines' Anti-Money Laundering Council hosted the 9th Annual Meeting of the APG on Money Laundering held in Manila on 3-7 July 2006. The event was attended by over 250 delegates from legal, financial and law enforcement sectors in the region. The five-day meeting provided a platform for high-level discussions, cooperation and evaluation of the progress made by APG members in implementing internationally recognized standards designed to combat and deter money laundering and the financing of terrorism.

Center for Monetary Studies in Latin America

The BSP hosted the meetings of the IMF/IBRD Governors of Latin America, Spain and the Philippines and the meeting of Central Bank Governors of Latin America and Spain as well as the CEMLA Board of Governors meeting on 13 September 2006 at the Philippine International Convention Center, Pasay City. During these meetings, Governors from Latin America, Spain and the Philippines, as well as representatives from the IMF and WB, discussed current developments in the Asian region, global and regional economic outlook, and other administrative/ governance matters in the CEMLA.

General Agreement on Trade in Services (GATS) under the World Trade Organization (WTO)

The Ministerial Declaration of the 6th Session of the WTO Ministerial Conference held in Hong Kong on 13-18 December 2005 introduced the plurilateral approach to negotiating concessions under the GATS. [36]

The BSP provided inputs to the services cluster meetings which were held in Geneva, Switzerland from 27 March 2006 to 7 April 2006 during which major issues on the plurilateral requests in 14 or more sectors were discussed plurilaterally and bilaterally. The BSP attended the services cluster meeting on financial services which were held on 6 April 2006 as well as the bilateral meetings with the US, Japan and the European Communities on 6-7 April 2006. Subsequent bilateral meetings with Australia and the EU were held in Manila in June 2006. The meetings focused on technical discussions on the substance of the requests, including the implications of

[36] The plurilateral approach is taken when any member or group of members make collective requests to other members in any sector. The Philippines is one of the members which received plurilateral request on banking services. The request is collective financial services request of Australia, Canada, the European Communities, Ecuador, Hong Kong China, Japan, the Republic of Korea, Norway, the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu, and the United States.

the cross-border liberalization of trade in financial services, the ability of domestic regulators to protect consumers and maintain quality standards, definitional and classification issues, existing economic needs test and transparency.

Intersessional Meetings on the Japan-Philippine Economic Partnership Agreement (JPEPA)

The JPEPA seeks to strengthen economic collaboration between Japan and the Philippines by increasing flows of goods, persons, investments and services. The accord provides protection of intellectual property rights, improvement of the business environment and cooperation in various fields.

The BSP participated in the Intersessional Meetings with the Japanese delegation on various dates in 2006 on the JPEPA. The text of the JPEPA, particularly the Chapter on Trade in Services was finalized and the commitments by both the Japanese and the Philippine governments including those on banking services were confirmed. The concurrence of the Philippine Senate is required to enforce the provisions/commitments of the Philippine Government to the Government of Japan under the JPEPA.

PART THREE: FINANCIAL CONDITION OF THE BSP

BSP Balance Sheet

BSP's net worth increases in 2006

Based on preliminary and unaudited financial statements, the resources of the BSP as of end-December 2006 reached ₱1.571 trillion, while its liabilities amounted to ₱1.305 trillion (Table 15). This increased the BSP's net worth by ₱18.6 billion to ₱266.8 billion, 7.5 percent higher than the year-ago level.

The ₱278.6 billion or 21.6 percent growth in assets during the period was traced mainly to the ₱147.5 billion increase in domestic securities on account of the BSP's net purchases of Treasury bills in the course of BSP's liquidity management operations. Banks unloaded their holdings of maturing Treasury bills due to the establishment of the reserve deposit account as compliance with the liquidity reserve requirement. The increase in assets was likewise driven by the continued buildup in international reserves which rose by ₱145.2 billion during the review period. The rise in international reserves, which can be attributed mainly to higher foreign exchange inflows, was reflected in the ₱129.0 billion increase in deposits with foreign banks. The increases in domestic securities and international reserves were, however, partially tempered by the declines registered in the foreign exchange receivable (₱14.2 billion) and other assets (₱2.2 billion) accounts.

During the same period, BSP liabilities expanded by ₱260.0 billion or 24.9 percent compared to the same level a year-ago. The expansion came mostly from higher balances in the reserve deposits of banks and other financial institutions amounting to ₱331.9 billion, partly reflective of banks' shift to the reserve deposit account as compliance to the liquidity reserve requirement. The increase in liabilities was also due to the ₱105.8 billion upsurge in BSP debt instruments owing to the rise in BSP's reverse repurchase borrowings for the year. The increase was, however, offset partly by the decline in foreign loans payable as the BSP prepaid some of its foreign obligations.

BSP Net Income

BSP's total revenues increase at a faster pace than expenses

Based on preliminary and unaudited data, the BSP's operations generated a net gain of ₱3.7 billion in 2006, lower than the ₱4.8 billion profit recorded during the previous year (Table 16).

Total revenues amounted to ₱55.8 billion or 22.4 percent higher than the ₱45.6 billion reported in the previous year. The rise in revenues principally resulted from higher interest income by ₱9.7 billion or 23.7 percent due largely to the ₱11.8 billion interest earned from international reserves on account of increased level of foreign investments and deposits to foreign banks during the review period.

Total expenses reached ₱52.0 billion, or 7.7 percent higher than that recorded during the previous period. This was due to higher interest expense of 18.6 percent or ₱6.4 billion as BSP borrowings under the reverse repurchase facility almost doubled during the period. The increase in expenses was offset slightly by the decline in other expenses and the cost of minting and printing currency during the period.

Meanwhile, taxes and licenses remitted to the government amounted to ₱1.18 billion in 2006.

List of Statistical Tables

1 GROSS NATIONAL PRODUCT BY INDUSTRIAL ORIGIN

for periods indicated
in million pesos, at constant 1985 prices

				Percent Change		
	2004	2005	2006	2004	2005	2006
Agriculture, Fishery and Forestry	226,612	230,762	240,158	5.3	1.8	4.1
Industrial Sector	380,542	399,076	418,209	4.7	4.9	4.8
Mining and Quarrying	18,325	20,032	18,835	2.6	9.3	-6.0
Manufacturing	276,747	292,238	307,932	5.1	5.6	5.4
Construction	48,718	49,142	51,381	3.4	0.9	4.6
Electricity, Gas and Water	36,753	37,663	40,060	4.2	2.5	6.4
Services	545,019	579,635	616,049	7.6	6.4	6.3
Transportation,Communication & Storage	97,605	104,650	111,681	11.2	7.2	6.7
Trade	192,691	203,552	214,744	6.8	5.6	5.5
Finance	56,919	64,664	70,811	9.9	13.6	9.5
Other Dwellings & R. Estate	53,654	56,528	59,801	5.3	5.4	5.8
Private Services	92,913	98,043	104,755	10.1	5.5	6.8
Government Services	51,237	52,198	54,257	0.5	1.9	3.9
Gross Domestic Product	**1,152,174**	**1,209,473**	**1,274,415**	**6.2**	**5.0**	**5.4**
Net Factor Income From Abroad	98,014	111,208	128,312	13.5	13.5	15.4
Gross National Product	**1,250,188**	**1,320,681**	**1,402,727**	**6.7**	**5.6**	**6.2**

Totals may not add due to rounding.
All figures are estimates as of January 2007.
Source: NSCB

1a GROSS NATIONAL PRODUCT BY EXPENDITURE SHARES

for periods indicated
in million pesos, at constant 1985 prices

				Percent Change		
	2004	2005	2006	2004	2005	2006
Personal Consumption Expenditures	903,131	947,747	999,576	5.8	4.9	5.5
Government Consumption Expenditures	75,455	78,487	82,964	1.4	4.0	5.7
Gross Domestic Capital Formation	234,065	219,926	224,583	7.2	-6.0	2.1
Fixed Capital Formation	224,176	215,399	216,593	1.3	-3.9	0.6
Construction	94,402	93,550	96,196	-0.8	-0.9	2.8
Durable Equipment	113,359	105,298	103,849	3.2	-7.1	-1.4
Breeding Stock & Orchard Development	16,415	16,551	16,547	0.9	0.8	0.0
Changes in Stocks	9,889	4,527	7,991	…	…	…
Exports	537,173	559,541	627,231	14.4	4.2	12.1
Less: Imports	628,911	643,807	660,224	5.8	2.4	2.5
Statistical Discrepancy	31,260	47,579	285	…	…	…
Gross Domestic Product	**1,152,174**	**1,209,473**	**1,274,415**	**6.2**	**5.0**	**5.4**
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Totals may not add up due to rounding.
All figures are estimates as of January 2007.
Source: NSCB

2 SELECTED LABOR, EMPLOYMENT AND WAGE INDICATORS

for the periods indicated

	2004	2005	2006	Percent Change 2005	Percent Change 2006
Employment Status [1]					
Labor Force (In Thousands)	35,862	36,458	35,785	1.7	
Employed	31,613	32,313	32,961	2.2	2.0
Unemployed	4,249	4,145	2,825	-2.4	
Employment Rate (%)	88.2	88.6	92.1		
Unemployment Rate (%)	11.8	11	7.9		
Overseas Employment (Deployed)	933,588	988,383	1,092,055 [p]	5.9	10.5
Land-Based	704,586	740,632	831,318 [p]	5.1	12.2
Sea-Based	229,002	247,751	260,737 [p]	8.2	5.2
Strikes					
Number of new strikes declared	25	26	12 [p]	4.0	-54.0
Number of workers involved (In Thousands)	11.0	8.5	1.4 [p]	-22.7	-84.0
Legislated Wage Rates [2]					
In Nominal Terms					
Non-Agricultural					
National Capital Region (NCR)	300	325	350	8.3	7.7
Regions Outside NCR (ONCR)	129-255	140-265	200-287	n.a.	n.a.
Agricultural					
NCR	263	288	313	9.5	8.7
ONCR					
Plantation	131-230	160-240	190-262	n.a.	n.a.
Non-Plantation	131-210	151-220	170-242	n.a.	n.a.
In Real Terms (at 1994 prices) [3]					
Non-Agricultural					
National Capital Region (NCR)	237	239	246	0.8	2.1
Regions Outside NCR (ONCR)	103-204	105-199	145-208	n.a.	n.a.
Agricultural					
National Capital Region (NCR)	208	213	219	2.4	2.9
Regions Outside NCR (ONCR)					
Plantation	105-184	120-181	145-189	n.a.	n.a.
Non-Plantation	105-168	114-166	123-175	n.a.	n.a.

[1] Explanations on the employment status data are as follows: a) all figures comprise the average of four quarterly data for the year; b) 2004-2005 figures are based on the old definition of unemployment; and c) 2006 figures are based on the new definition of unemployment per NSCB Resolution No. 15 dated October 20, 2004.

[2] Includes basic minimum wage and Cost of Living Allowance (COLA). Data are as of December for all years.

[3] Real wages are at 2000 prices.

[p] Preliminary

n.a. - Not Applicable

Sources: BLES, NSO

3 CONSUMER PRICE INDEX IN THE PHILIPPINES, METRO MANILA AND ALL AREAS OUTSIDE METRO MANILA

for periods indicated
2000=100

Commodity Group	Philippines				Metro Manila				All Areas Outside Metro Manila			
			Percent Change				Percent Change				Percent Change	
	2005	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005	2006
All Items	**129.8**	**137.9**	**7.6**	**6.2**	**131.5**	**140.7**	**8.6**	**7.0**	**129.1**	**136.8**	**7.2**	**6.0**
Food, Beverages & Tobacco	123.8	130.6	6.4	5.5	120.8	127.6	4.8	5.6	124.7	131.6	7.0	5.5
Non-Food	135.8	145.3	8.7	7.0	138.7	149.5	11.0	7.8	134.3	142.9	7.5	6.4
Clothing	118.4	122.0	3.5	3.0	123.4	126.7	2.9	2.7	116.6	120.4	3.6	3.3
Housing & Repairs	126.9	131.9	4.5	3.9	125.5	131.7	6.4	4.9	128.0	132.0	3.2	3.1
Fuel,Light & Water	156.2	176.4	18.1	12.9	182.5	206.0	28.4	12.9	144.7	163.5	13.0	13.0
Services	148.5	161.7	11.8	8.9	148.8	164.4	12.6	10.5	148.4	160.2	11.4	8.0
Miscellaneous	117.1	120.6	3.2	3.0	116.8	120.1	3.0	2.8	117.2	120.7	3.3	3.0

Source: NSO

4 CASH OPERATIONS OF THE NATIONAL GOVERNMENT

for periods indicated
in million pesos

	Actual 2005	Actual 2006 r	Program 2006	Actual vs. Program (%)	Percent Change (%)
Revenues	**816,159**	**979,638**	**974,122**	**0.6**	**20.0**
Tax Revenues	705,615	859,857	879,780	-2.3	21.9
Bureau of Internal Revenue	542,697	652,734	675,353	-3.3	20.3
Bureau of Customs	154,566	198,161	195,976	1.1	28.2
Other Offices	8,352	8,962	8,451	6.0	7.3
Non-tax Revenues	110,544	119,781	94,342	27.0	8.4
of w/c: Bureau of the Treasury	70,597	74,446	51,860	43.6	5.5
Expenditures	**962,937**	**1,044,429**	**1,099,002**	**-5.0**	**8.5**
of which:					
Allotments to Local Government Units	160,550	174,713	134,068	30.3	8.8
Interest Payments	299,807	310,108	339,998	-8.8	3.4
Equity and Net Lending	1,897	3,692	9,491	-61.1	94.6
Surplus/Deficit (-)	**-146,778**	**-64,791**	**-124,880**	**-48.1**	**-55.9**
Financing	**235,992**	**110,121**	**149,970**	**-26.6**	**-53.3**
External Borrowings (Net)	92,665	120,754	102,357	18.0	30.3
Domestic Borrowings (Net)	143,327	-10,633	47,613	-122.3	-107.4
Total Change in Cash: Deposit/Withdrawal (-)	22,329	6,063	1,429	324.3	-72.8
Budgetary	89,214	45,330	25,090	80.7	-49.2
Non-Budgetary [1]	-66,885	-39,267	-23,661	66.0	-41.3

[1] Refers to accounts not included in the NG budget, e.g., sale, purchase or redemption of government securities, but included in the cash operations report to show the complete relations in the movements of the cash accounts.
Source: BTr

5 DEPOSITORY CORPORATIONS SURVEY[p]

as of periods indicated
in million pesos

Item	LEVELS			FLOWS		GROWTH RATE (%)	
	Dec-05	Nov-06	Dec-06	Dec06-Dec05	Dec06-Nov06	Dec06-Dec05	Dec06-Nov06
1. NET FOREIGN ASSETS	**911,651**	**1,346,800**	**1,368,517**	**456,866**	**21,717**	**50.11**	**1.61**
A. Bangko Sentral ng Pilipinas	**846,112**	**1,071,877**	**1,076,898**	**230,786**	**5,021**	**27.28**	**0.47**
Net International Reserves	**937,032**	**1,114,782**	**1,127,726**	**190,694**	**12,944**	**20.35**	**1.16**
Foreign Assets	981,465	1,127,095	1,128,401	146,936	1,306	14.97	0.12
Foreign Liabilities	44,433	12,313	675	-43,758	-11,638	-98.48	-94.52
Medium & Long-Term Foreign Liabilities	**90,920**	**42,905**	**50,828**	**-40,092**	**7,923**	**-44.10**	**18.47**
B. Other Depository Corporations (Deposit Money Banks)	**65,539**	**274,923**	**291,619**	**226,080**	**16,696**	344.95	6.07
Foreign Assets	675,756	774,645	794,953	119,198	20,308	17.64	2.62
Foreign Liabilities	610,217	499,723	503,335	-106,882	3,612	-17.52	0.72
2. NET DOMESTIC ASSETS	**2,298,242**	**2,306,229**	**2,403,867**	**105,624**	**97,638**	**4.60**	**4.23**
A. Net Claims on Residents (Net Domestic Credits)	**2,803,128**	**2,948,434**	**2,986,370**	**183,241**	**37,936**	**6.54**	**1.29**
Net Claims on the Public Sector (Public Sector)	**960,081**	**1,010,687**	**1,024,794**	**64,713**	**14,107**	**6.74**	**1.40**
National Government	718,986	751,860	758,518	39,533	6,659	5.50	0.89
Credits	912,800	977,504	982,702	69,902	5,198	7.66	0.53
CB BOL	215	220	0	-215	-220	-100.00	-100.00
Foreign exchange Receivables	18,312	4,210	4,084	-14,228	-126	-77.70	-2.99
T-IMF accounts	-60,393	-59,556	-58,438	1,955	1,118	3.24	1.88
Deposits	-151,948	-170,518	-169,830	-17,882	688	-11.77	0.40
Local Government and Other Public Entities	241,095	258,827	266,275	25,180	7,448	10.44	2.88
Claims on Other Sectors (Private Sector)	**1,843,048**	**1,937,747**	**1,961,576**	**118,528**	**23,829**	**6.43**	**1.23**
Other Financial Corporations	159,683	145,630	146,968	-12,715	1,338	-7.96	0.92
Others	1,683,365	1,792,117	1,814,608	131,243	22,491	7.80	1.26
B. Net Other Items	**-504,886**	**-642,205**	**-582,503**	**-77,617**	**59,703**	**-15.37**	**9.30**
3. LIQUIDITY AGGREGATES (TOTAL LIQUIDITY)	**3,209,894**	**3,653,029**	**3,772,384**	**562,490**	**119,355**	**17.52**	**3.27**
A. M4	**3,125,769**	**3,556,695**	**3,687,516**	**561,747**	**130,821**	**17.97**	**3.68**
Broad-Money Liabilities (M3)	**2,338,053**	**2,709,379**	**2,838,384**	**500,331**	**129,005**	**21.40**	**4.76**
Currency Outside Depository Corporations and Transferable Deposits (Narrow Money)	616,780	694,552	768,774	151,994	74,221	24.64	10.69
Other Deposits (Quasi-Money)	1,697,671	1,973,401	2,025,752	328,081	52,351	19.33	2.65
Securities Other Than Shares Included in Broad Money (Deposit Substitutes)	23,602	41,426	43,859	20,257	2,433	85.83	5.87
Transferable & Other Deposits in Foreign Currency (FCDU Deposits-Res)	**787,716**	**847,316**	**849,132**	**61,416**	**1,816**	**7.80**	**0.21**
B. Liabilities Excluded from Broad-Money (Other Liabilities)	**84,125**	**96,334**	**84,868**	**743**	**-11,466**	**0.88**	**-11.90**
Bills Payable	79,456	90,684	79,485	29	-11,199	0.04	-12.35
Marginal Deposits	1,406	2,245	2,213	808	-32	57.44	-1.41
Restricted Deposits	3,263	3,405	3,170	-93	-235	-2.86	-6.90
Deposits with Other Depository Corporations Under Liquidation	1,794	1,902	1,902	108	0	6.00	0.00
Import Deposits	1,469	1,503	1,268	-201	-235	-13.68	-15.64
Narrow Money	**616,780**	**694,552**	**768,774**	**151,994**	**74,221**	**24.64**	**10.69**
Currency Outside Depository Corporations (Currency in Circulation)	267,874	261,043	307,205	39,331	46,162	14.68	17.68
Transferable Deposits (Demand Deposits)	348,906	433,509	461,568	112,663	28,059	32.29	6.47
Other Deposits (Quasi-Money)	**1,697,671**	**1,973,401**	**2,025,752**	**328,081**	**52,351**	**19.33**	**2.65**
Savings Deposits	1,276,381	1,478,392	1,471,786	195,406	-6,606	15.31	-0.45
Time Deposits	421,290	495,009	553,965	132,675	58,957	31.49	11.91

[p] *Preliminary*
Source: BSP

6 SELECTED DOMESTIC INTEREST RATES

for the periods indicated
in percent per annum

	Nominal Interest Rates			Real Interest Rates [7]		
	2004	2005	2006	2004	2005	2006
Bank Borrowing Rates						
Interbank Call Loans	7.0473	7.3448	7.8077	1.0473	-0.2552	1.6077
Savings Deposits [1]	4.2620	3.7550	3.5460	-1.7380	-3.8450	-2.6540
Time Deposits, All Maturities [1]	6.4270	5.2580	4.9420	0.4270	-2.3420	-1.2580
Manila Reference Rates, All Maturities [2]	8.1250	7.0625	6.7500	2.1250	-0.5375	0.5500
Bank Lending Rates						
All Maturities[3]	10.0680	10.1470	9.7140	4.0680	2.5470	3.5140
High[4]	12.0764	11.0606	10.1542	6.0764	3.4606	3.9542
Low[5]	10.0677	9.0531	8.2964	4.0677	1.4531	2.0964
Bangko Sentral Rates						
R/P (Overnight) [6]	9.0000	9.3125	9.7500	3.0000	1.7125	3.5500
R/P (Term) [6]	9.0838	9.2307	9.8125	3.0838	1.6307	3.6125
RR/P (Overnight) [6]	6.7500	7.0404	7.5000	0.7500	-0.5596	1.3000
RR/P (Term) [6]	6.8429	7.0698	7.5904	0.8429	-0.5302	1.3904
Rediscounting	6.6400	6.6260	5.3990	0.6400	-0.9740	-0.8010
Government Securities Rates						
Treasury Bills (All Maturities)	8.1270	7.5280	6.1960	2.1270	-0.0720	-0.0040
91-Days	7.3400	6.3580	5.3510	1.3400	-1.2420	-0.8490
182-Days	8.3210	7.6710	6.1490	2.3210	0.0710	-0.0510
364-Days	9.2180	8.6830	6.9550	3.2180	1.0830	0.7550

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

7 CROSS RATES OF THE PESO

period averages
pesos per unit of foreign currency

		US Dollar	Japanese Yen	Pound Sterling	Hongkong Dollar	Swiss Franc	Canadian Dollar	Singapore Dollar	Australian Dollar	Bahrain Dollar	Saudi Rial	Brunei Dollar	Indo Rupiah	Thai Baht	UAE Dirham	EURO
2005	**Ave**	**55.08548**	**0.50150**	**100.29745**	**7.08300**	**44.31237**	**45.49880**	**33.10900**	**41.99212**	**146.13508**	**14.68915**	**33.00977**	**0.00569**	**1.36967**	**14.99922**	**68.61015**
	Jan	55.76619	0.54038	104.88907	7.15564	47.37927	45.62889	34.04580	42.72412	147.92747	14.87080	33.94219	0.00606	1.43927	15.18540	73.28122
	Feb	54.81284	0.52262	103.29402	7.02932	45.93482	44.27091	33.44760	42.75121	145.42815	14.61979	33.34588	0.00594	1.42489	14.92814	71.25201
	Mar	54.44015	0.51801	103.92207	6.98077	46.45392	44.70775	33.42956	42.79620	144.42339	14.51851	33.32722	0.00583	1.41282	14.82415	71.94285
	Apr	54.49176	0.50799	103.29714	6.98731	45.59894	44.16691	32.99696	42.11570	144.54560	14.53082	32.89734	0.00570	1.37891	14.83687	70.55984
	May	54.34110	0.50987	100.86202	6.97516	44.69042	43.31095	32.92982	41.62997	144.14739	14.49081	32.83034	0.00575	1.36596	14.79589	69.06753
	Jun	55.17905	0.50800	100.40711	7.09631	43.63394	44.47222	33.00421	42.29196	146.37020	14.71444	32.90579	0.00575	1.34946	15.02406	67.13860
	Jul	56.00620	0.50066	98.29648	7.20361	43.33751	45.75750	33.26509	42.09269	148.56445	14.93425	33.16660	0.00571	1.34359	15.24965	67.49799
	Aug	55.95230	0.50546	100.29492	7.20011	44.26844	46.37877	33.68981	42.62752	148.42133	14.92029	33.58867	0.00562	1.35959	15.23467	68.78173
	Sep	56.15618	0.50575	101.62847	7.23410	44.45100	47.63906	33.41585	42.92330	148.96240	14.97371	33.31672	0.00548	1.36795	15.29100	68.85835
	Oct	55.70770	0.48598	98.28910	7.18219	43.25834	47.35858	32.95589	42.02677	147.79071	14.85219	32.85871	0.00551	1.36153	15.16871	67.01703
	Nov	54.56058	0.46107	94.69867	7.03668	41.65346	46.14286	32.12983	40.08609	144.78599	14.54829	32.03548	0.00546	1.32745	14.85515	64.35228
	Dec	53.61175	0.45216	93.69029	6.91475	41.08839	46.15124	31.99754	39.83990	142.25392	14.29586	31.90236	0.00545	1.30457	14.59696	63.57243
2006	**Ave**	**51.31428**	**0.44140**	**94.51121**	**6.60599**	**40.97388**	**45.26090**	**32.30198**	**38.63557**	**136.13459**	**13.68362**	**32.20060**	**0.00560**	**1.35418**	**13.97217**	**64.44729**
	Jan	52.61714	0.45555	92.83238	6.78616	41.12047	45.43830	32.19990	39.39212	139.59863	14.03076	32.10165	0.00556	1.32585	14.32604	63.70416
	Feb	51.81680	0.43931	90.64592	6.67796	39.75112	45.11136	31.81505	38.45452	137.48611	13.81750	31.71768	0.00560	1.31810	14.10808	61.94653
	Mar	51.21891	0.43694	89.40371	6.60120	39.25749	44.33600	31.59423	37.28089	135.90700	13.65753	31.49709	0.00560	1.31486	13.94711	61.59132
	Apr	51.35972	0.43915	90.72940	6.62161	40.01474	44.83122	32.07531	37.74727	136.25932	13.69432	31.97546	0.00575	1.35091	13.98411	63.04799
	May	52.12727	0.46645	97.43320	6.72283	42.77615	46.97690	33.07905	39.82809	138.30025	13.90150	32.97444	0.00580	1.37329	14.19405	66.56275
	Jun	53.15667	0.46391	98.04205	6.84723	43.16393	47.74079	33.41841	39.31151	141.02945	14.17393	33.31370	0.00569	1.38607	14.47351	67.33258
	Jul	52.39760	0.45315	96.59268	6.74102	42.41585	46.49466	33.09112	39.34043	138.99414	13.97185	32.98696	0.00574	1.37938	14.26667	66.52478
	Aug	51.36177	0.44343	97.19137	6.60510	41.69515	45.86764	32.59987	39.20465	136.24733	13.69562	32.49674	0.00565	1.36560	13.98431	65.78101
	Sep	50.40121	0.43038	95.15593	6.47758	40.55505	45.17738	31.94148	38.13837	133.69862	13.43925	31.84060	0.00552	1.34684	13.72305	64.22967
	Oct	50.00381	0.42154	93.76421	6.42224	39.70285	44.33937	31.66911	37.60666	132.64953	13.33685	31.56913	0.00547	1.33926	13.61619	63.11807
	Nov	49.84343	0.42481	95.20129	6.40482	40.30600	43.87730	32.03080	38.46862	132.22005	13.29114	31.92820	0.00547	1.36408	13.57189	64.18182
	Dec	49.46700	0.42221	97.14233	6.36415	40.92771	42.93991	32.10941	38.85367	131.22460	13.19315	32.00554	0.00543	1.38588	13.47103	65.34681

Source: BSP

7a EFFECTIVE EXCHANGE RATE INDICES OF THE PESO

average for periods indicated
December 1980 = 100

	NOMINAL			REAL		
	Major Trading Partners [1]	Competing Countries		Major Trading Partners [1]	Competing Countries	
		Broad [2]	Narrow [3]		Broad [2]	Narrow [3]
2005	**12.30**	**26.83**	**48.60**	**62.69**	**101.43**	**149.52**
Jan	11.84	26.03	46.50	59.24	97.35	142.80
Feb	12.08	26.43	47.27	60.27	97.99	144.48
Mar	12.12	26.63	47.96	60.49	99.09	146.41
Apr	12.19	26.89	48.65	61.02	100.00	147.34
May	12.29	26.86	48.58	61.85	100.56	149.90
Jun	12.24	26.69	48.46	62.36	101.99	152.13
Jul	12.29	26.60	48.38	63.43	102.58	152.45
Aug	12.18	26.61	48.60	63.05	102.90	153.68
Sep	12.11	26.84	49.18	62.02	102.76	153.82
Oct	12.40	27.02	49.19	63.66	101.36	147.80
Nov	12.82	27.54	50.08	66.77	105.24	150.91
Dec	13.02	27.76	50.39	68.11	105.40	152.53
2006	**13.31**	**27.73**	**49.64**	**70.33**	**107.20**	**150.66**
Jan	13.14	27.64	50.01	68.46	105.25	149.94
Feb	13.45	27.79	49.99	70.54	106.15	150.05
Mar	13.60	27.97	50.06	71.48	107.25	150.26
Apr	13.49	27.50	48.95	70.68	104.75	145.24
May	12.92	26.96	48.15	67.57	103.21	145.62
Jun	12.79	26.95	48.53	67.43	105.04	149.15
Jul	13.00	27.12	48.55	69.38	106.59	149.86
Aug	13.16	27.65	49.36	70.30	109.15	153.60
Sep	13.46	28.19	50.36	71.29	110.03	154.70
Oct	13.63	28.47	50.86	72.48	109.87	154.34
Nov	13.56	28.31	50.59	72.37	110.44	153.38
Dec	13.54	28.25	50.32	71.98	108.73	151.84

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

8 OUTSTANDING DEPOSITS OF THE BANKING SYSTEM

As of end - December 2005 - 2006
In million pesos

Institutions	2005				2006				Percent Change			
	TOTAL	Demand	Savings	Time	TOTAL	Demand	Savings	Time	TOTAL	Demand	Savings	Time
TOTAL	2,933,457.7	387,642.6	1,571,072.2	974,742.9	3,436,891.0 [p]	490,824.9	1,791,942.0	1,154,124.1	17.16	26.62	14.06	18.40
Commercial Banks [1]	2,591,829.0	368,490.0	1,311,343.0	911,996.0	3,028,092.0	467,474.0	1,480,092.0	1,080,526.0	16.83	26.86	12.87	18.48
Thrift Banks	260,524.9	17,331.9	205,418.1	37,774.9	319,141.8 [a]	21,371.8	252,067.9	45,702.1	22.50	23.31	22.71	20.99
Savings Banks	205,732.6	14,943.7	165,010.8	25,778.1	257,181.5 [p]	18,684.0	206,275.9	32,221.6	25.01	25.03	25.01	25.00
Private Development Banks	44,948.0	2,092.8	32,328.6	10,526.6	49,991.9 [p]	2,327.4	35,957.7	11,706.8	11.22	11.21	11.23	11.21
Stock Savings and Loan Associations	9,708.8	295.4	7,943.2	1,470.2	11,797.9 [p]	360.4	9,663.8	1,773.7	21.52	22.00	21.66	20.64
Microfinance Banks	135.5	0.0	135.5	0.0	170.5 [p]	0.0	170.5	0.0	25.83	0.00	25.83	0.00
Rural Banks	81,103.8	1,820.7	54,311.1	24,972.0	89,657.2 [b]	1,979.1	59,782.1	27,896.0	10.55	8.70	10.07	11.71

[1] *Includes DBP and AAIIBP*
[p] *preliminary*
[a] *As of November 2006*
[b] *As of September 2006*
Source: BSP

9 TOTAL RESOURCES OF THE PHILIPPINE FINANCIAL SYSTEM [1]

as of period indicated
in million pesos

Institutions	2005	2006	Percent Change
Total	**5,619,470 [p]**	**6,126,524 [p]**	**9.0**
Banks	4,464,091	4,943,367 [p]	10.7
Commercial Banks	3,985,980	4,392,589	10.2
Thrift Banks	357,828	420,341 [p]	17.5
Savings Banks	269,227	315,763 [a]	17.3
Private Development Banks	71,099	75,267 [a]	5.9
Stock Savings and Loan Associations	16,942	28,727 [a]	69.6
Micro Finance Banks	560	584 [a]	4.3
Rural Banks	120,283	130,437 [a]	8.4
Non-Bank Financial Institutions [2]	1,155,379 [p]	1,183,157 [a]	2.4

[1] *Excluding the Bangko Sentral ng Pilipinas*
[2] *Includes Investment Houses, Finance Companies, Investment Companies, Securities Dealers/Brokers, Pawnshops, Lending Investors, Non-Stock Savings and Loan Assn., Mutual Building and Loan Assn., Venture Capital Corp., Credit Card Companies and others; also includes Private and Government Insurance Companies (i.e., SSS and GSIS).*
[p] *Preliminary*
[a] *As of end-September 2006*
Source: BSP

9a NUMBER OF FINANCIAL INSTITUTIONS[1]

as of period indicated

Institutions	2005	2006	Percent Change
Total	**20,107**	**20,953**	**4.2**
Head Offices	7,082	7,264	2.6
Branches/Agencies	13,025	13,689	5.1
Banks	7,670	7,710	0.5
Head Offices	879	862	-1.9
Branches/Agencies	6,791	6,848	0.8
Commercial Banks	4,318	4,313	-0.1
Head Offices	41	39	-4.9
Branches/Agencies	4,277	4,274	-0.1
Thrift Banks	1,293	1,322	2.2
Head Offices	84	84	0.0
Branches/Agencies	1,209	1,238	2.4
Savings and Mortgage Banks	817	844	3.3
Head Offices	32	33	3.1
Branches/Agencies	785	811	3.3
Private Development Banks	298	300	0.7
Head Offices	22	21	-4.5
Branches/Agencies	276	279	1.1
Stock Savings and Loan Associations	162	165	1.9
Head Offices	26	26	0.0
Branches/Agencies	136	139	2.2
MicroFinance Banks	16	13	-18.8
Head Offices	4	4	0.0
Branches/Agencies	12	9	-25.0
Rural Banks	2,059	2,075	0.8
Head Offices	754	739	-2.0
Branches/Agencies	1,305	1,336	2.4
Non-Bank Financial Institutions[2]	12,437	13,243	6.5
Head Offices	6,203	6,402	3.2
Branches/Agencies	6,234	6,841	9.7

[1] Excluding the Bangko Sentral ng Pilipinas
[2] Includes Investment Houses, Finance Companies, Investment Companies, Securities Dealers/Brokers, Pawnshops, Lending Investors, Non-Stock Savings and Loan Assn., Mutual Building and Loan Assn., Venture Capital Corp., Credit Card Companies and others; also includes Private and Government Insurance Companies (i.e., SSS and GSIS).
Source: BSP

10 STOCK MARKET TRANSACTIONS [1]

for the periods indicated
Volume in million shares
Value in million pesos

	2005		2006		Percent Change 2006	
	Volume	Value	Volume	Value	Volume	Value
T o t a l	**317,641.0**	**383,520.0**	**601,090.7**	**572,634.3**	**89.2**	**49.3**
Financial	3,036.4	73,623.0	4,960.1	108,577.1	63.4	47.5
Industrial	10,419.6	81,959.5	29,285.2	113,138.5	181.1	38.0
Holding Firms	47,316.8	59,428.0	61,223.2	71,013.1	29.4	19.5
Property	31,112.0	50,736.2	50,125.2	90,429.4	61.1	78.2
Services	32,079.0	98,720.6	92,565.3	154,649.3	188.6	56.7
Mining & Oil	193,651.2	18,945.6	362,922.2	34,775.7	87.4	83.6
SME	26.0	107.1	9.5	51.2	-63.5	-52.2
Composite Index (Average)	**1,983.1**		**2,412.3**			**21.6**

[1] *Starting January 2006, new classification by sector was implemented. Data for 2005 is already based on the new sectoral classification.*
Source: PSE

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

	Jan - Dec 2005	Jan - Dec 2006	Percent Change
Current Account	**1,984**	**5,022**	**153.1**
Goods and Services	-9,113	-7,624	16.3
Export	44,788	51,561	15.1
Import	53,901	59,185	9.8
Goods	-7,773	-6,955	10.5
Credit: Exports	40,263	46,158	14.6
Debit: Imports	48,036	53,113	10.6
Services	-1,340	-669	50.1
Credit: Exports	4,525	5,403	19.4
Debit: Imports	5,865	6,072	3.5
Income	-294	-543	-84.7
Credit: Receipts	3,937	4,390	11.5
Debit: Disbursements	4,231	4,933	16.6
Current Transfers	11,391	13,189	15.8
Credit: Receipts	11,711	13,512	15.4
Debit: Disbursements	320	323	0.9
Capital and Financial Account	**2,229**	**-1,722**	**-177.3**
Capital Account	40	136	240.0
Credit: Receipts	58	180	210.3
Debit: Disbursements	18	44	144.4
Financial Account	2,189	-1,858	-184.9
Direct Investment	1,665	2,242	34.7
Debit: Assets, Residents' Investments Abroad	189	103	-45.5
Credit: Liabilities, Non-Residents' Investments in the Phil.	1,854	2,345	26.5
Portfolio Investment	3,475	2,744	-21.0
Debit: Assets, Residents' Investments Abroad	146	461	215.8
Credit: Liabilities, Non-Residents' Investments in the Phil.	3,621	3,205	-11.5
Financial Derivatives	-43	-138	-220.9
Debit: Assets, Residents' Investments Abroad	-98	-159	-62.2
Credit: Liabilities, Non-Residents' Investments in the Phil.	-141	-297	-110.6
Other Investment	-2,908	-6,706	-130.6
Debit: Assets, Residents' Investments Abroad	4,791	4,705	-1.8
Credit: Liabilities, Non-Residents' Investments in the Phil.	1,883	-2,001	-206.3
Net Unclassified Items	-1,803	469	126.0
Overall BOP Position	**2,410**	**3,769**	**56.4**
Debit: Change in Reserve Assets	1,621	2,934	81.0
Credit: Change in Reserve Liabilities	-789	-835	-5.8
Use of Fund Credits	-321	-402	-25.2
Short-term	-468	-433	7.5

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

11a EXPORTS BY MAJOR COMMODITY GROUP

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

Commodities	January-December						Growth Rates (%)		
	2005			2006 p			2006		
	Volume	Price	Value	Volume	Price	Value	Volume	Price	Value
Coconut Products			**821**			**757**			**-7.8**
Copra	0	0	0	0	0	0	0.0	0.0	0.0
Coconut Oil	1152	570	657	1064	544	579	-7.6	-4.7	-11.9
Desiccated Coconut	126	1013	127	136	1019	139	8.5	0.6	9.2
Copra Meal/Cake	430	65	28	432	71	31	0.3	8.4	8.7
Others			8			9			7.3
Sugar and Products			**81**			**98**			**20.6**
Centrifugal & Refined	223	295	66	217	385	83	-2.6	30.3	26.9
Molasses	185	75	14	116	102	12	-37.2	36.5	-14.3
Others			2			3			57.1
Fruits and Vegetables			**660**			**718**			**8.8**
Canned Pineapple	208	526	110	186	580	108	-10.9	10.2	-1.8
Pineapple Juice	70	231	16	71	316	22	1.6	36.4	38.6
Pineapple Concentrates	48	734	35	166	223	37	244.8	-69.6	4.8
Bananas	2024	179	363	2304	175	404	13.8	-2.1	11.5
Mangoes	31	852	27	26	917	24	-16.2	7.7	-9.7
Others			110			123			11.8
Other Agro-Based Products			**442**			**474**			**7.3**
Fish, Fresh or Preserved	67	3560	240	73	3558	258	7.9	-0.1	7.8
Of which: Shrimps & Prawns	12	7359	92	13	7484	97	4.6	1.7	6.4
Coffee, Raw, not Roasted	0	0	--	0	0	..	0.0	0.0	0.0
Abaca Fibers	15	811	12	14	895	13	-2.0	10.3	8.1
Tobacco,Unmanufactured	17	1722	30	17	1887	33	-0.1	9.6	9.5
Natural Rubber	41	889	37	34	1370	46	-17.7	54.2	26.9
Ramie Fibers, Raw or Processed	..	935	--	..	917	..	0.0	-1.9	0.0
Seaweeds, Dried	21	1329	28	19	1305	25	-9.1	-1.8	-10.7
Rice	0	576	0	..	974	0	0.0	69.0	0.0
Others			95			98			3.3
Forest Products [1]			**33**			**28**			**-16.5**
Logs	..	61	0	..	71	..	0.0	16.3	0.0
Lumber	130	66	9	183	72	13	40.7	8.4	52.6
Plywood	40	450	18	19	489	9	-51.4	8.7	-47.2
Veneer Sheets/Corestocks	7	539	4	7	613	4	-1.9	13.7	11.6
Others			3			1			-78.0
Mineral Products			**819**			**2058**			**151.2**
Copper Concentrates	55	670	37	62	1366	84	11.8	104.0	128.1
Copper Metal	114	3177	361	177	6711	1187	55.6	111.2	228.8
Gold 2/	150	332	50	1308	174	227	772.0	-47.7	356.1
Iron Ore Agglomerates	4130	27	110	5199	29	153	25.9	10.5	39.1
Chromium Ore	58	81	5	74	64	5	26.9	-21.4	-0.2
Nickel			--			0			0.0
Others			257			402			56.4
Petroleum Products			**586**			**856**			**46.2**
Manufactures			**36945**			**41081**			**11.2**
Electronic Products			27287			29588			8.4
Other Electonics			1200			1556			29.6
Garments			2309			2626			13.7
Textile Yarns/Fabrics			247			220			-11.2
Footwear			26			24			-5.4
Travel Goods and Handbags			20			30			48.4
Wood Manufactures			138			550			298.7
Furnitures & Fixtures			304			276			-9.2
Chemicals			546			751			37.5
Non-Metallic Mineral Manufactures			171			182			6.7
Machinery & Transport Equipment			1836			1716			-6.6
Processed Food and Beverages			519			583			12.3
Iron & Steel			94			240			153.8
Baby Carr., Toys, Games & Sporting Goods			131			150			15.0
Basketwork, Wickerwork, & Other Articles of Plaiting Materials			58			53			-8.6
Misc. Manufactured Articles, n.e.s.			283			319			12.6
Others			1634			2049			25.4
Special Transactions			**793**			**853**			**7.6**
TOTAL EXPORTS, as per NSO Foreign Trade Statistics			**41255**			**47037**			**14.0**
Coverage and Conceptual Adjustments			-992			-879			11.4
TOTAL EXPORTS, BPM5			**40263**			**46158**			**14.6**

[1] Volume in 000 cubic meters; unit price in US$/cu.m.
[2] Volume in 000 troy ounces; unit price in US$/oz t.
.. Less than one thousand metric tons
-- Less than one million US$
p Preliminary
Source: NSO

11b IMPORTS BY MAJOR COMMODITY GROUP

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

Commodities	January - December						Growth Rates (%)		
	2005 [a]			2006 [p]			2006		
	Volume	Price	Value	Volume	Price	Value	Volume	Price	Value
Capital Goods			**8928**			**9078**			**1.7**
Power Generating & Specialized Machines			2148			2216			3.2
Office & EDP Machines			3307			3235			-2.2
Telecommunication Eqpt. & Elect. Mach.			1939			1898			-2.1
Land Transport Eqpt. excl. Passenger Cars & Motorized Cycle			618			696			12.6
Aircraft, Ships & Boats			467			566			21.2
Prof. Sci. & Cont. Inst.; Photo-graphic Eqpt. & Optical Goods			449			467			4.0
Raw Materials & Intermediate Goods			**28832**			**31752**			**10.1**
Unprocessed Raw Materials			1482			1643			10.9
Wheat	2050	155	318	2744	170	467	33.9	9.7	46.9
Corn	71	296	21	306	160	49	331.0	-45.9	133.3
Unmilled cereals excl. rice & corn			1.00			2			0.0
Crude materials, inedible			962			963			0.1
Pulp & waste paper			64			65			1.6
Cotton	33	1055	35	25	1200	30	-24.2	13.7	-14.3
Syn. fibers	47	1748	83	41	1829	75	-12.8	4.6	-9.6
Metalliferous ores			438			415			-5.3
Others			342			378			10.5
Tobacco, unmanufactured			180			162			-10.0
Semi-Processed Raw Materials			27350			30109			10.1
Feeding stuffs for animals	1751	243	426	1729	237	409	-1.3	-2.5	-4.0
Animal & vegetable oils & fats			143			152			6.3
Chemical			3297			3631			10.1
Chemical compounds			825			908			10.1
Medicinal & pharmaceutical chemicals			459			529			15.3
Urea	570	165	94	498	215	107	-12.6	30.3	13.8
Fertilizer excl. urea	744	146	109	955	145	138	28.4	-0.7	26.6
Artificial resins			855			945			10.5
Others			955			1004			5.1
Manufactured goods			3799			3915			3.1
Paper & paper products	594	667	396	1784	257	458	200.3	-61.5	15.7
Textile yarn, fabrics & made-up articles			788			888			12.7
Non-metallic mineral mftures.			186			194			4.3
Iron & steel	2677	516	1381	3108	369	1148	16.1	-28.5	-16.9
Non-ferrous metals			470			604			28.5
Metal products			329			376			14.3
Others			249			247			-0.8
Embroideries			1366			1300			-4.8
Mat/Acc for the mftr. of elect. eqpt.			18228			20658			13.3
Iron ore, not agglomerated	4777	19	91	2268	19	44	-52.5	0.0	-51.6
Mineral Fuels & Lubricant			**6281**			**8121**			**29.3**
Coal, Coke	4403	40	176	5701	43	243	29.5	7.5	38.1
Petroleum Crude [1]	78.33	48.29	3783	80.15	63.93	5124	2.3	32.4	35.4
Others [1]	38.69	60.02	2322	38.53	71.48	2754	-0.4	19.1	18.6
Consumer Goods			**3427**			**3741**			**9.2**
Durable			1410			1640			16.3
Passenger cars & motorized cycle			601			751			25.0
Home appliances			215			217			0.9
Misc. manufactures			594			672			13.1
Non-Durable			2017			2101			4.2
Food & live animals chiefly for food			1876			1934			3.1
Dairy products	268	1542	414	294	1507	443	9.7	-2.3	7.0
Fish & fish preparation	125	489	61	123	472	58	-1.6	-3.5	-4.9
Rice	1822	274	499	1715	272	467	-5.9	-0.7	-6.4
Fruits & vegetables			114			161			41.2
Others			788			805			2.2
Beverages & tobacco mfture.			61			79			29.5
Articles of apparel, access.			80			88			10.0
Special Transactions			**1060**			**782**			**-26.2**
Articles temporarily imported & exported			500			344			-31.2
Others			560			438			-21.8
TOTAL IMPORTS [2]			**48528**			**53474**			**10.2**
Conceptual and Coverage Adjustments [3]			-492			-361			26.6
TOTAL IMPORTS, BPM5			**48036**			**53113**			**10.6**

[1] Volume in million barrels; unit price in U.S.$/barrel
- - Less than one million US dollars
. . Less than one thousand metric tons
[2] Include valuation adjustments to NSO data
[3] Include deductions for aircrafts acquired under operational lease agreement
[a] Based on the final adjustments made by NSO that was released on March 24, 2006
[p] Preliminary
Note: Valuation adjustments include:
a.) Adjustments to NSO's raw material imports for electronics exports' for 2006.
b.) Adjustments to NSO's raw material imports for garments for 2005 and 2006.

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

12 GROSS INTERNATIONAL RESERVES OF THE BANGKO SENTRAL NG PILIPINAS

end of period
in million US dollars

		GIR	Reserve Position in the Fund	Gold	SDRs	Foreign Investments	Foreign Exchange	Import Cover [1]	Short-Term External Debt Cover (in percent) Original Maturity	Residual Maturity [2]
		(1=2 to 6)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
2004	Jan	16,281.35	129.40	3,236.07	9.17	12,326.43	580.28	3.83	263.49	132.05
	Feb	15,931.47	129.30	3,100.40	2.19	12,268.69	430.89	3.73	256.79	136.22
	Mar	16,534.15	129.33	3,317.01	2.19	12,568.27	517.35	3.85	220.75	127.57
	Apr	16,604.10	126.83	3,050.15	7.23	13,201.13	218.76	3.83	229.34	134.33
	May	16,745.23	128.31	3,137.45	1.34	13,287.48	190.65	3.87	234.53	136.07
	Jun	16,378.05	128.09	3,170.77	1.34	12,833.60	244.25	3.74	246.88	140.18
	Jul	16,152.30	127.45	3,216.25	7.89	12,538.05	262.66	3.67	243.48	137.64
	Aug	16,200.50	127.71	3,312.78	0.99	12,398.40	360.62	3.65	244.20	136.86
	Sep	16,140.04	128.44	3,400.98	1.00	12,336.79	272.83	3.60	282.22	148.72
	Oct	16,117.90	130.97	3,263.78	7.76	12,374.96	340.43	3.55	292.04	149.12
	Nov	16,071.41	134.29	3,239.53	0.99	12,399.77	296.83	3.52	291.20	149.64
	Dec	16,227.91	135.33	3,112.07	1.00	12,742.09	237.42	3.55	321.60	156.94
2005	Jan	15,745.60	132.94	2,866.31	8.58	12,288.55	449.22	3.44	312.04	154.55
	Feb	16,530.40	133.94	2,882.82	2.30	13,023.90	487.44	3.62	348.30	166.29
	Mar	16,525.61	132.10	2,699.35	2.27	13,325.75	366.14	3.63	299.87	157.25
	Apr	16,718.76	132.12	2,643.73	6.04	13,581.05	355.82	3.65	303.37	153.20
	May	17,281.03	128.96	2,495.72	0.31	14,304.62	351.42	3.76	313.57	155.40
	Jun	17,723.13	127.35	2,582.32	0.30	14,604.07	409.09	3.82	290.59	149.66
	Jul	17,668.79	127.02	2,592.36	6.11	14,387.96	555.34	3.81	289.70	149.96
	Aug	17,943.65	127.72	2,533.55	0.56	14,860.59	421.23	3.82	299.06	152.05
	Sep	18,542.31	126.81	2,568.75	0.56	15,386.53	459.66	3.91	296.77	147.64
	Oct	18,097.87	126.25	2,462.16	4.88	15,031.76	472.82	3.81	289.66	140.14
	Nov	18,058.62	124.59	2,554.83	0.11	14,958.89	420.20	3.79	289.03	136.61
	Dec	18,494.35	125.04	2,568.38	0.84	15,397.53	402.56	3.82	289.20	131.56
2006	Jan	20,401.77	126.45	2,658.62	5.19	17,117.26	494.25	4.19	325.39	149.20
	Feb	20,481.81	125.54	2,612.17	0.36	17,242.78	500.96	4.17	326.66	149.97
	Mar	20,645.34	126.05	2,797.31	0.36	17,208.85	512.77	4.15	335.81	152.11
	Apr	20,852.48	129.19	3,042.94	5.53	17,203.83	470.99	4.17	339.18	156.86
	May	20,949.91	130.72	2,849.39	0.89	17,503.48	465.43	4.14	340.76	161.69
	Jun	21,123.47	129.42	2,903.60	0.88	17,647.94	441.63	4.15	364.32	170.71
	Jul	21,274.11	129.90	2,940.65	5.33	17,910.27	287.96	4.14	373.36	176.43
	Aug	21,540.69	130.31	2,868.37	0.55	18,214.70	326.76	4.12	388.26	187.73
	Sep	21,593.36	129.25	2,746.44	0.55	18,265.57	451.55	4.14	380.23	191.57
	Oct	22,309.58	130.03	2,869.16	6.49	18,819.30	484.60	4.27	392.84	202.28
	Nov	22,649.27	132.27	2,991.66	2.34	19,321.35	201.65	4.34	398.82	213.57
	Dec	22,966.72	131.70	2,941.30	2.33	19,611.41	279.98	4.40	404.41	234.93

[1] *Number of months of average imports of goods and payment of services and income that can be financed by reserves.*
[2] *Refers to adequacy of reserves to cover outstanding short-term external debt based on original maturity plus principal payments on medium- and long-term loans of the public and private sectors falling due in the next 12 months.*
Source: BSP

13 TOTAL EXTERNAL DEBT [1]

as of dates indicated
in million US dollars

	September 30, 2005				December 31, 2005				September 30, 2006			
	Short-term		Medium		Short-term		Medium		Short-term		Medium	
	Trade	Non-Trade	& Long-Term	Total	Trade	Non-Trade	& Long-Term	Total	Trade	Non-Trade	& Long-Term	Total
Grand Total	**2,243**	**4,005**	**49,232 [a]**	**55,480**	**2,178**	**4,216**	**47,791 [a]**	**54,186**	**3,271**	**2,407**	**48,382 [a]**	**54,061**
Public Sector	3	807	36,873	37,683	268	573	35,661	36,502	252	240	37,109	37,601
Banks	3	807	4,120	4,930	268	573	4,074	4,914	252	240	3,401	3,893
Bangko Sentral ng Pilipinas	–	394	1,400	1,794	–	416	1,450	1,866	–	–	867	867
Others	3	413	2,720	3,137	268	157	2,623	3,048	252	240	2,534	3,026
Non-Banks	–	–	32,753	32,753	–	–	31,588	31,588	–	–	33,708	33,708
CB-BOL	–	–	59	59	–	–	56	56	–	–	47	47
NG and Others	–	–	32,694	32,694	–	–	31,531	31,531	–	–	33,661	33,661
Private Sector	2,240	3,198	12,359	17,797	1,911	3,644	12,130	17,684	3,019	2,168	11,273	16,460
Banks	250	2,966	1,910	5,126	585	3,387	2,199	6,171	907	1,895	2,808 [b]	5,610
Foreign Bank Branches	35	638	1,167	1,840 [c]	376	1,048	1,441	2,864 [c]	735	775	1,999	3,509 [c]
Domestic Banks	215	2,328	743	3,286	210	2,339	759	3,307	172	1,120	809	2,101 [d]
Non-Banks	1,989	233	10,449 [e]	12,671	1,325	257	9,931 [e]	11,513	2,112	272	8,465 [e]	10,850

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

a Includes cumulative foreign exchange revaluation on US dollar-denominated multi-currency loans from Asian Development Bank and World Bank amounting to US$77 million and US$25 million, respectively as of 30 September and 31 December 2005, and US$30 million as of 30 September 2006.

b Includes accounts restructured under CB Circular No.1179 amounting to US$43 million as of 30 September 2006.

c Excludes "Due to Head Office/Branches Abroad" accounts of branches and offshore banking units of foreign banks operating in the Philippines which as of 30 September 2005 amounted to US$2,508 million and US$3,042 million and US$2,521 million as pf 31 December 2005 and 30 September 2006, respectively.

d Includes US$10 million liabilities of private development bank and rural banks as of 30 September 2006.

e Excludes obligations under various capital lease agreements of US$ 1,232 million and US$1,215 million as of 30 September and 31 December 2005 respectively, and US$1,133 million as of 30 September 2006. Also, excludes loans without BSP approval/registration amounting to US$2,398 million and US$3,133 million as of 30 September and 31 December 2005, respectively and US$3,096 million as of 30 September 2006.

Source: BSP

14 SELECTED FOREIGN DEBT SERVICE INDICATORS

for periods indicated
in million US dollars

	2005					2006 p				
	Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3	Q4	Total
Debt Service Burden (DSB) [1]	2127	1438	2282	1777	**7,624**	1,954	1,722	1,859	2,367	**7,902**
Principal	1344	901	1472	1191	**4,908**	1,007	1,090	954	1,591	**4,642**
Interest	783	537	810	586	**2,716**	947	632	905	776	**3,260**
Export Shipments (XS)	9,361	9,687	10,469	10,746	**40,263**	10,693	11,608	12,187	11,670	**46,158**
Exports of Goods and Receipts from Services and Income (XGSI) [2]	13,063	13,682	14,742	15,033	**56,520**	15,344	16,474	16,999	17,138	**65,955**
Current Account Receipts (CAR) [3]	14,000	14,682	15,752	16,002	**60,436**	16,145	17,345	17,879	18,094	**69,463**
Gross National Product (GNP)	24,090	26,062	25,802	30,763	**106,676**	28,874	30,539	31,349	37,290	**127,832**
Ratios (%) :										
DSB to XS	22.72	14.84	21.80	16.54	**18.94**	18.27	14.83	15.25	20.28	**17.12**
DSB to XGSI	16.28	10.51	15.48	11.82	**13.49**	12.73	10.45	10.94	13.81	**11.98**
DSB to CAR	15.19	9.79	14.49	11.10	**12.61**	12.10	9.93	10.40	13.08	**11.38**
DSB to GNP	8.83	5.52	8.84	5.78	**7.15**	6.77	5.64	5.93	6.35	**6.18**

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

[2] Includes cash remittances of overseas Filipino workers that were coursed through and reported by commercial banks which are reflected under Compensation of Employees in the income account and workers' remittances in the Current Transfers account.

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

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Source: BSP

15 BALANCE SHEET OF THE BANGKO SENTRAL NG PILIPINAS

As of the periods indicated
In million pesos

	2005 Dec	2006 [u] Dec	Percent Change (%)
Assets	**1,292,767.4**	**1,571,363.0**	**21.6**
International Reserves	974,712.2	1,119,943.0	14.9
Foreign Exchange Receivable	18,309.8	4,076.4	-77.7
Domestic Securities	74,903.2	222,453.0	197.0
Loans and Advances	116,150.4	118,114.6	1.7
Bank Premises and Other Fixed Assets	11,784.1	12,116.0	2.8
Other Assets	96,907.8	94,660.0	-2.3
Liabilities	**1,044,627.6**	**1,304,600.6**	**24.9**
Currency Issue	336,557.5	384,491.6	14.2
Deposits	317,886.7	571,197.8	79.7
Reserve Deposits of Banks & Other FIs	120,536.9	331,937.8	175.4
Special Deposit Accounts	60.1	51,755.0	86,011.3
Other Deposits of Banks & Other FIs	10,513.6	2,626.0	-75.0
Treasurer of the Philippines [1]	87,843.3	108,546.2	23.6
Other Foreign Currency Deposits	14,942.4	13,582.0	-9.1
Foreign Financial Institutions	82,514.6	55,066.9	-33.3
Other Deposits [2]	1,475.8	7,683.8	420.6
Foreign Loans Payable	147,394.1	51,693.0	-64.9
Net Bonds Payable	46,310.9	39,620.1	-14.4
Allocation of SDRs	8,885.6	8,660.8	-2.5
Derivative Instruments	13.6	3,887.0	28,572.1
Net Revaluation of International Reserves	57,611.3	9,097.0	-84.2
BSP Debt Instruments	122,872.1	228,694.3	86.1
Other Liabilities	7,095.9	7,259.0	2.3
Net Worth	**248,139.8**	**266,762.3**	**7.5**
Capital	10,000.0	10,000.0	0.0
Surplus/Reserves	238,139.9	256,762.3	7.8

Note: Breakdown may not add up to totals due to rounding.
[1] Includes foreign currency deposits.
[2] Mostly GOCC deposits.
[u] Based on the unaudited BSP balance sheet as of end-December 2006 prepared by the Financial Accounting Department of the BSP.
Source: BSP

16 INCOME POSITION OF THE BANGKO SENTRAL NG PILIPINAS
For the periods indicated
In billion pesos

	2005	2006 [u]	Percent Change (%)
Revenues	**45.6**	**55.8**	**22.4**
Interest Income	41.0	50.7	23.7
International Reserves	27.8	39.6	42.4
Domestic Securities	7.3	6.9	-5.5
Loans and Advances	4.2	3.7	-11.9
Others	1.7	0.5	-70.6
Miscellaneous Income	4.4	4.9	11.4
Net income from Branches	0.2	0.2	0.0
Expenses	**48.3**	**52.0**	**7.7**
Interest Expenses	34.5	40.9	18.6
Legal Reserve Deposits of Banks	3.1	4.8	54.8
Special Deposit Accounts	0.0	2.2	
National Government Deposits	8.2	7.6	-7.3
BSP Debt Instruments	8.5	15.0	76.5
Loans Payable	14.5	11.1	-23.4
Other Foreign Currency Deposits	0.2	0.2	0.0
Other Liabilities	0.0	0.0	
Cost of Minting	1.7	1.4	-17.6
Other Expenses	12.1	9.8	-19.0
Net Income Before Gain/(Loss) on FXR Fluctuations	**-2.7**	**3.8**	**240.7**
Gain/Loss(-) on FXR Fluctuations	11.8	0.0	-100.0
Provision for Income Tax	1.1	0.0	-100.0
Net Income	**8.0**	**3.8**	**-52.5**
Capital Reserves	3.2	0.1	-96.9
Net Income Available for Distribution	**4.8**	**3.7**	**-22.9**

Note: *Breakdown may not add up to totals due to rounding.*
[u] *Based on the unaudited BSP income statement as of end-December 2006 prepared by the Financial Accounting Department of the BSP.*
Source: BSP

17 CONDENSED STATEMENT OF CONDITION OF THE BANGKO SENTRAL NG PILIPINAS

As at 31 December Assets	2006 PHP000	2005 PHP000
Foreign currency financial assets		
Deposits with foreign banks	**354,628,763**	225,657,287
Other cash balances	**369,308**	310,004
Investment securities-available for sale	**620,573,837**	612,407,705
Gold	**144,256,111**	136,292,315
International Monetary Fund special drawing rights	**114,954**	44,871
Gross international reserves	**1,119,942,973**	974,712,182
Loans and advances	**774,670**	509,865
Non-IR foreign currency on hand	**89**	0
Other foreign currency receivables	**8,240,670**	24,281,052
Total foreign currency financial assets	**1,128,958,402**	999,503,099
Local currency financial assets		
Investment securities-available for sale	**222,453,035**	74,903,188
Loans and advances	**117,339,941**	115,640,515
Due from administrator of funds	**33,739,299**	29,194,881
Other receivables	**24,571,298**	28,089,139
Total local currency financial assets	**398,103,573**	247,827,723
Total financial assets	**1,527,061,975**	1,247,330,822
Other assets		
Bank premises, furniture, fixtures and equipment	**12,115,966**	11,784,140
Acquired assets	**11,354,869**	11,796,693
Inventories	**14,565,181**	18,691,368
Deferred tax assets	**6,095,170**	1,808,951
Miscellaneous assets	**169,812**	1,355,469
Total other assets	**44,300,998**	45,436,621
Total assets	**1,571,362,973**	1,292,767,443

17 CONDENSED STATEMENT OF CONDITION OF THE BANGKO SENTRAL NG PILIPINAS
(continuation)

As at 31 December Liabilities and Capital	2006 PHP000	2005 PHP000
Foreign currency financial liabilities		
Short-term deposits	**41,301,012**	19,808,094
Loans payable	**51,693,046**	147,401,248
Bonds payable	**39,620,078**	46,310,887
Allocation of International Monetary Fund special drawing rights	**8,660,848**	8,885,560
Derivative instruments	**3,886,961**	13,557
Other liabilities	**1,342,079**	3,376,926
Total foreign currency financial liabilities	**146,504,024**	225,796,272
Local currency financial liabilities		
Government deposits	**80,824,292**	82,967,697
Deposits of banks and quasi banks	**342,250,539**	132,529,031
Deposits of the International Monetary Fund and other FIs	**55,066,923**	82,514,610
Securities sold under agreements to repurchase	**280,449,352**	122,932,210
Total local currency financial liabilities	**758,591,106**	420,943,548
Total financial liabilities	**905,095,130**	646,739,820
Other liabilities		
Currency in circulation	**384,491,616**	336,557,506
Retirement benefit obligations	**1,618,311**	1,311,051
Miscellaneous liabilities	**3,411,112**	2,407,898
Dividends payable	**887,472**	0
Revaluation of foreign currency accounts	**9,097,004**	57,611,313
Total other liabilities	**399,505,515**	397,887,767
Total liabilities	**1,304,600,645**	1,044,627,587
Capital accounts		
Capital	**10,000,000**	10,000,000
Surplus	**49,913,230**	36,309,990
Capital reserves	**206,849,098**	201,829,866
Total capital accounts	**266,762,328**	248,139,856
Total liabilities and capital accounts	**1,571,362,973**	1,292,767,443

18 CONDENSED STATEMENT OF INCOME AND EXPENSES OF THE BANGKO SENTRAL NG PILIPINAS[1]
with Budget Information

Years ended December 31	2006 Budget PHP000	2006 Actual PHP000	2005 Actual PHP000
Operating Income:			
Income from foreign currency financial assets			
Interest income	34,223,794	40,119,469	29,428,281
Fees & miscellaneous foreign currency income	1,523,998	1,709,627	2,051,780
Total income from foreign currency financial assets	35,747,792	41,829,096	31,480,061
Expenses on foreign currency financial liabilities			
Interest expense	(15,345,826)	(13,345,600)	(15,484,630)
Other foreign currency expenses	(1,058,896)	(361,112)	(805,400)
Total expenses on foreign currency liabilities	(16,404,722)	(13,706,712)	(16,290,030)
Foreign currency income	19,343,070	28,122,384	15,190,031
Income from local currency financial assets			
Interest income	12,171,477	10,580,974	11,483,955
Total income from local currency financial assets	12,171,477	10,580,974	11,483,955
Expenses on local currency financial liabilities			
Interest expense	(32,420,374)	(27,508,582)	(18,975,455)
Final tax on interest income/discounts	(1,053,418)	(945,874)	(1,187,653)
Total expenses on local currency financial assets	(33,473,792)	(28,454,456)	(20,163,108)
Local currency income/(loss)	(21,302,315)	(17,873,482)	(8,679,153)
Total operating income	(1,959,244)	10,248,902	6,510,878
Currency printing and minting cost	(2,206,106)	(1,387,717)	(1,744,021)
Operating expenses:			
Personnel services, development and training	(6,203,665)	(5,517,799)	(6,322,223)
Traveling	(343,540)	(259,735)	(235,938)
Taxes and licenses	(115,952)	(222,735)	(111,610)
Currency and gold operations	(107,810)	(92,370)	(79,799)
Prior period expense	0	319,115	0
Other services	(2,343,772)	(1,437,155)	(1,428,687)
Depreciation	(641,598)	(476,349)	(437,836)
Fidelity insurance	(68,267)	(68,016)	(64,341)
Light, fuel & water	(238,809)	(213,784)	(227,735)
Repairs & maintenance	(366,936)	(228,855)	(141,801)
Communication services	(155,704)	(106,013)	(120,336)
Supplies	(68,828)	(48,371)	(68,442)
Others[2]	(803,630)	(295,767)	(368,197)
Total operating expenses	(9,114,738)	(7,210,679)	(8,178,257)
Net operating loss before impairments	(13,280,089)	1,650,506	(3,411,400)

[1] *The statement presentation was restated for comparability with the budget format.*
[2] *Includes provisions for contingencies which when utilized are classified under the appropriate budget item.*

18 CONDENSED STATEMENT OF INCOME AND EXPENSES OF THE BANGKO SENTRAL NG PILIPINAS[1]

with Budget Information

(continuation)

Years ended December 31	2006 Budget PHP000	2006 Actual PHP000	2005 Actual PHP000
Impairment losses on loans and advances[3]	**(876,543)**	**(665,968)**	(977,131)
Market Decline of Acquired Assets[4]	**(707,251)**	**(569,947)**	(914,203)
Net operating income/(loss) after impairment	**(14,863,883)**	**414,591**	(5,302,734)
Other operating income	**3,066,804**	**3,105,134**	2,594,746
Prior period income	**0**	**276,628**	0
Net realized gains on FX rates and price fluctuations	**11,959,908**	**0**	11,847,817
Profit before income tax	**162,829**	**3,796,353**	9,139,829
Income tax paid	**0**	**(11,765)**	(1,105,383)
Profit for the year	**162,829**	**3,784,588**	8,034,446
Reserve for fidelity losses		**0**	(2,536,997)
Reserve for medical benefit fund		**0**	(192,500)
Reserve for directors/officers liability fund		**(100,000)**	(500,000)
Profit for distribution		**3,684,588**	4,804,949

[3] *Represents additions to the contra-asset account allowance for probable losses.*
[4] *Represents the difference between the book value and appraised value of acquired assets; accumulated in the contra-asset account allowance for market decline of acquired assets*