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**1997-1999 Philippine Economic Downturn:
A Preventable One**

by

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ABSTRACT

The paper tries to trace the downturn in the economy in 1997-1998 and compares it with the crisis experienced in Thailand, Korea and Indonesia. The downturn was not of the magnitude of their crisis and had different causes. GDP fell by a lower rate from 5.2% to -.5%. The decline was of the same magnitude as in the 1990-1991 recession when GDP fell from the average rate of 5.4% in 19986-1990 to .5% in 1991. Supply shocks were the major cause of both recession – in 1990-91 there were the earthquake, Pinatubo, Gulf War and coup attempt, in 1997-1998, there was El Nino that reduced agricultural output by 6.7% that amounted to 2.41 times the drop in GDP. There was a capital upsurge and reversal as happened in the neighbors but the short-term component was not as large. External flows were largely medium-term and long-term. The banks which were major short-term borrowers were able to absorb the currency losses and so remained solvent. There were no massive bank failures as in the other countries. The central bank exacerbated the difficulties of the external borrowers by cutting liquidity. The resulting rise in interest rate added to the losses of the real sector.

The 1997-1999 Philippine Economic Downturn A Preventable One

*Edita A. Tan**

A rich literature has been generated by the economic crisis that hit four of East Asia's highly successful economies - Korea, Thailand, Malaysia and Indonesia. There is a concentration of interest in trying to explain the crisis offering both theoretical underpinnings and political economy analogies. More recent literature has focused on its social impact. International agencies such as the UNDP and the ILO have sponsored studies on its impact on the poor especially through loss of employment and reduction in social services. The paper reviews the various explanations of the Asian four's crisis and examines whether they were applicable to the Philippine recession. The Philippines has suffered a serious economic downturn coincident with its neighbors' crisis but it is not clear that its recession could be viewed as a crisis. Indeed there was a downturn but not of the dimension and causes of the neighbors' crisis.

The Philippine GDP growth declined at a much lower rate than that in the East Asian Four (EA-4) from 5.2% in 1996 to -.5% in 1998. Agriculture contributed 241% of the decline in GDP with its output falling by 6.7 in 1996 to 1997. This was largely a result of the drought wrought by El Niño. The economy suffered from contagion effects reflected in capital outflow that led to currency depreciation of more than 50%. Wrong policy responses by the central bank exacerbated the contagion problem. It is noted that major financial and trade reforms had already been undertaken following the 1983-85 economic crisis and these strengthened the economy's ability to avoid a new crisis. The 1983-85 crisis resulted from the accumulated effects of the economic and political abuses committed by the strong dictatorship of Marcos over the 1970-85 period. GDP fell by 15% in 1983 to 1985. His ouster in February 1986 allowed major reforms, especially in trade and in the financial system. The reforms likely avoided much of the problems that caused the crisis in the EA-4. On the other hand, the Philippines continues to suffer from some serious structural problems such as low saving rate, high average inflation rate, poor infrastructure and poor governance. The economy is recovering but to its old slow growth path. Growth rate is projected to rise from about 2.0% in 1999 to less than 4.0% in 2000. The Medium Term Development Plan sets target growth at 5% to 6% in the last 4 years of the Estrada administration, 2000-2004.

The paper is organized into sections covering successively a review of the more important hypotheses about the crisis; a brief history of the performance of the economy and reforms prior to the current recession; an analysis of the performance of the external sector and the behavior of the capital account; an analysis of financial development and public finance; an analysis of policy responses, and finally the conclusion.

2. Hypotheses on the Asian Crisis

The hypotheses are grouped into the following: a) market failure arguments, currency and exchange rate mismanagement and premature capital account liberalization. Wrong responses that is largely attributed to IMF prescriptions may be treated as a cause on its own or an exacerbating factor.

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2.1. Market Failure in the Financial System

The financial market which is the market for credit of various forms and maturities suffers from three inherent problems of market failure and market imperfections - externalities, asymmetric information between borrowers and lenders and moral hazards. Prudential rules and a competitive environment would mitigate these problems. But bad policies and structures would worsen them.

The financial market plays a critical role in smoothing the functioning of the real sector. An efficient financial market pools funds (saving and excess cash inventories) from surplus spending units for lending to deficit units for investment and other uses. The market develops credit instruments with features that vary in liquidity, size and riskiness, and offers financial services such as portfolio advice, insurance, trade credits and most importantly the means of payment through bank checking accounts, credit cards and other payment mechanisms. We refer to the last service as money supply service. While banks earn income from this service, society as a whole benefits from having this relatively efficient means of payment. This benefit is considered an important externality of banks. Some of the information produced in loan processing, services, insurance and other activities cannot all be internalized by its producers and becomes public good. The offering of varied credit instruments allows for greater portfolio diversification that tends to lower risk and the cost of liquidity. The externalities, especially those related to the maintenance of the payment system, have warranted government intervention which has commonly taken the form of central bank guarantees to prevent bank runs and massive financial collapse. Many governments have taken initiatives in establishing deposit insurance and have a central bank that acts as a bank of last resort to failing banks. In some countries, the idea of being 'too big to fail' has been applied.

The rationale for government intervention to prevent massive bank failure may on the other hand foster moral hazard on the part of bank depositors. Central bank support in case of failure may encourage banks to relax their lending criteria and procedures. The insured depositors need not be too careful in choosing the bank in which to place their funds. At the same time there are inherent moral hazard in banking given the asymmetric information on loan risk that banks and borrowers possess. The borrower necessarily has more information on the prospects of the project for which he is applying for funding than the bank or any creditor at that. That is also true for equities where the issuing corporation has more information about the value of its assets and the expected profitability of its venture than stock buyers. The borrower is faced with the moral hazard of misallocating the borrowed funds since his losses from failure tends to be less than what the creditor bears. Asymmetric information may also lead to adverse selection. The more risky borrowers and equity issuers will have a greater incentive to borrow than the less risky deficit units at any prevailing interest rate which tends to be the market average. Raising the rate for the risky borrowers, will however increase risk since they become less able to meet their debt service. (Stiglitz and Weiss 1981) A good summary of market problems are discussed in Mishkin's money and banking textbook (1995)

Note these problems are inherent to any financial system. Banks are known to minimize the consequences of asymmetric information and the moral hazard of their borrowers by instituting credit evaluation procedures, requiring collateral, monitoring the borrowers' financial conditions during the life of the loan and imposing loan use conditionalities. Good accounting and auditing standards and practices are a critical minimum requirement for implementing prudent credit rules and evaluation. Financial institutions are trust institutions that need to be monitored and supervised in order to preserve the integrity of the payment system, maximize their development impact and protect the interest of their clients.

The financial system of the crisis-hit economies are found to suffer from problems other than the problems of market failure that are inherent in all financial system. The international accounting and auditing standards had not been effectively or extensively implemented in Korea, Thailand and Indonesia so there was no reliable financial information to use for assessing loans and equities and the financial condition of banks (White, 1997). At the same time, credit allocation is partly based on special connections and/or government suasion. Connected banking that takes the form of crony banking in Indonesia, main banking by chaebols in Korea and conglomerated banking in Malaysia and Thailand has impaired the efficiency of credit allocation and the health of the whole financial system. Park (1997) has warned about the weaknesses in the prudential practices of Korean banks. These intrusions in credit allocation have resulted in extremely high non-performing loan rates and the extensive failures in the banking system and other financial institutions in these countries. The capital account liberalization expanded the sources of loanable funds of these institutions which could not but be imprudently allocated given the lax regulatory and supervision environment of the financial system.

2.2. The Currency Problem

Capital account liberalization seriously complicates the management of exchange rate and there are as yet no clear-cut policy tools for doing so. As Krugman would argue, transactions in trade essentially differ from transactions in capital especially considering the environment in which the latter take place. In trade, the parties to the transaction have fairly good information on the goods and services they are buying and selling. A country's trade deficit or surplus would exert palpable pressure on the exchange rate. An open capital market blurs trade signals. If there is capital inflow for one reason or another, interest rate decreases towards the world level and the currency appreciates. Exports are discouraged and imports encouraged. Income increases depending on the balancing impact of reduced exports/ increased imports and increased investment. Capital inflows into short-term loans and portfolio investments will have the same negative impact on exports but questionable impact on investments. Short-term inflows increase overall liquidity and credit for financing investment and other expenditures. The appreciation pressure is temporary in nature since short-term capital flows could readily reverse directions. There is asymmetry in currency risk bearing in capital transactions. Short-term creditors could withdraw funds more quickly than debtors could liquidate their assets. Creditors therefore face lower currency risks than debtors. A currency depreciation may be reasonably anticipated but not its precise timing considering the exchange rate policy of the government. Favorable arbitrage could therefore be arranged by a creditor for say a month maturity with little risk of currency depreciation. But an imprudent borrower who uses short-term funds for medium or longer term investment does not have this advantage and so bears greater currency risk.

The information technology revolution has reduced financial transactions cost to virtually zero. Funds could be invested anywhere at anytime through few computer entries. But the technology is applied unevenly across countries' financial systems. Most less developed economies have not instituted standard financial reporting system and there is highly imperfect information on the financial position of enterprises, financial and non-financial alike, which are engaged in the capital market. The Basle architecture is yet to be built in most emerging economies including the Asian NICs. The capital account opening took place in the EA-4 under these defective financial structure. But confluence of policies and events made the EA-4 economies very attractive to foreign capital. Their well-publicized economic success, high domestic interest rate, low inflation rate and stable nominal exchange rate made short-term

and long-term investments very attractive. Very large increases in short-term loans and portfolio investments from external sources flowed into Thailand, Indonesia and Malaysia. A vicious circle of capital flow, currency appreciation and high interest rate relative to Libor operated around mid 1990s. Much of the short-term flows went to financial institutions that relent them on longer maturities to booming sectors like real estate. In Thailand, the inflow happened at the time when the real estate sector was already overheating and it blew more air into the real estate bubble thus hastening its bursting. Krugman (1998) argued that the very high rate of saving and investment in the East Asian economies implies relatively low marginal rate of return to investment. The capital inflow pushed the marginal rate of return further down. Real estate in Thailand and Chaebol industries in Korea are good examples. On the other hand, they all had relatively small equity market and the surge in portfolio investments meant large demand shifts for equities, hence the equity bubble.

2.3. The Trade Sector

According to Lim (1999), the East Asian economies had relied on the export sector to stimulate and sustain their industrialization efforts until the mid-1990s. This sector expanded the market for their goods and earned the foreign exchange required to finance their capital and intermediate goods imports. Export growth was double-digit for these countries until the first half of the 1990s. Subsequently the export sector weakened partly because of the competition fostered by industrializing cheap-labor countries (China, India, Bangladesh), the lack of technological capacity for competing in new products/processes, increasing labor cost and the overvalued currency. Thailand and Malaysia were unable to sustain their foreign exchange earning capacity and foreign capital replaced exports as the important source of foreign exchange. The policy of pegging the exchange rate to the US dollar did not help encourage exports but instead encouraged foreign borrowing. Fabella (1999) pointed another fact that during the early stages of development, credit allocation favored the export sector and other priority areas. With capital account liberalization, the starved non-tradable sectors like real estate, drew much of the loanable funds. The overvalued exchange rate also made this sector relatively attractive.

2.4. Policy Responses to the Crisis

There is a growing consensus that the IMF policy prescriptions were inappropriate (Stiglitz 1998, 1999, Corden 1998, Hall Hill 1999). Moreover, the measures were not fair in both economic and political sense. (McKinnon, 1998, Stiglitz 1998, 1999) The immediate prescription of the IMF was to deflate the economy as a means of strengthening the exchange rate via high interest rate and low import demand. Restrictive monetary and fiscal policies were prescribed. The capital flow reversal combined with the restrictive monetary policy drastically reduced liquidity and put a strong pressure on domestic interest rate. The policy intensified uncertainty and pessimism. Business losses due to currency depreciation and high interest rates led to an over-shooting of non-performing loans. Banks suffered losses from the currency depreciation and the NPLs. An appropriate short-run policy should have been to counter the loss of confidence the deflationary impact of the currency capital outflow by easing the liquidity and interest rate pressure.

The IMF imposed the elements of the now popularized financial architecture on the crisis-hit economies as a conditionality for its syndicated extended facility (with ADB, World Bank and bilaterals) possibly because it had failed to get them instituted during normal time. The Basle-IMF architecture consists of international accounting and auditing standards, prudential rules including those on insolvency and financial disclosure and effective

supervision and monitoring of financial institutions. Note that these are measures that are essentially long-term in nature. They take time to implement. For instance, establishing good accounting and auditing practice will involve instruction of formal and informal nature (accountancy is a degree program in many countries), institution of the accounting and auditing profession and legalizing the use of audited statements. The practice of the standards has to spread to financial institutions and the business sector. Prudential rules on the other hand have to be legislated or written up, the courts have to be acquainted with them and the affected parties educated about them. The central banks and other supervisory bodies need also to be educated and trained in monitoring and supervision.

There is great unevenness in the IMF stance. The architecture is imposed on the crisis-hit economy but the majority of LDCs need it just as badly. The transition economies, for instance, have not yet learned the capitalist accounting system. Additionally McKinnon (1998) pointed out that the US being the supplier of world liquidity and earning seigniorage from the privilege should act as a world central bank and take on the responsibility of mitigating currency crises by extending liquidity assistance. US assistance is essential since the IMF resources are inadequate. Fears are expressed that should another region suffer a similar crisis, the IMF would not have the resources to help it. The measures imposed were unfair in another sense. The borrowers were asked to bear all the risk of the loans. The crisis may not have occurred if the short-term creditors were made to share in the risk by rolling-over the credit. This would have reduced the capital flow reversal, reduced the rate of currency depreciation, the business losses and therefore the downturn. A mild recession instead of a crisis would have occurred. Korea's fast recovery might be partly due to its success in rolling – over its short-term loans.

3. Philippine Economic Development before the Crisis

The country's economic performance over the last three decades has been very much inferior to that of all its East Asian neighbors. GDP grew at much slower rate and exhibited wider fluctuations. (Table 1) The economy was subjected to more serious interventions and for a longer time than in the other East Asian neighbors. (Note 1) The exchange rate was fixed at P2/\$1 in the first 60 years of the last century, the import substituting policy was followed until 1990, financial repression with effective interest rate ceilings and a complex system of subsidized credit was in effect until 1985. The privatization of numerous public corporations has not been completed. The economy was subjective to an abusive dictator for 20 years (1965-1985) where direct and indirect thievery of resources was practiced. It ended in an economic crisis where GDP declined by 7.5% per year in 1984 and 1985.

The major reforms were undertaken only after the dictatorial government was toppled. The new government of Cory Aquino (1986) faced the daunting task of reestablishing a democratic government, servicing a very large external debt, dismantling crony monopolies, privatizing inefficient public corporations, initiating financial and trade reforms and financing the deficits.

Excepting for the Social Security System all the government financial institutions¹ which became the vehicle for funneling funds to crony businesses were found insolvent in

¹The government financial institutions consisted of The Philippine national Bank (PNB) and the Philippine Veteran's Bank (PVB) are commercial banks; The Development Bank of the Philippines (DBP), the Land Bank of the Philippines and The Amanah Bank are specialized banks; and the Government Service Insurance System (GSIS) and the Social Security System (SSS).

1986. The government had to decide whether to close down the Philippine National Bank (PNB) and the Development Bank of the Philippines (DBP) or reduce their size to the level of their performing assets. The latter was chosen. There was no pressure to close the Government Service Insurance System (GSIS) since it could rely on a stable flow of social security contributions. The Philippine Veterans Bank was closed down while the Amanah Bank which operates on Muslim banking principles never developed into a viable bank. Some 180 of the highly subsidized rural banks became bankrupt and closed down. A few private development banks had also to close down. The aggregate impact of the asset value adjustments and bank closure is reflected in the large downsizing of the GFIs. Their share in the total assets of the financial system fell from 25% to 8.7% in 1985 to 1987. It fell further to 7.5% in 1996.

Under pressure from the WB and the IMF, Marcos abolished the interest rate ceilings on long term loans and time deposits in 1981. The remaining ceilings were removed in 1982. The policy change did not have much impact since the credit interventions through subsidized lending and rediscounting continued through the end of the Marcos era. The first important financial reform by the Aquino government in 1986 was to remove the easy/cheap rediscounting facility. Banks including the GFIs now have to obtain the bulk of their loanable funds from the market. Other important measures to liberalize the financial system included the relaxation of domestic bank entry and bank branching in 1992-1995. The capital account was liberalized in 1992, foreign banks were allowed entry in 1993 and the CB became independent of the executive in 1995. The last measure was in consonance with the 1986 Constitution which provided for the establishment of an independent central bank. The new Bangko Sentral ng Pilipinas (BSP) includes only two cabinet members in its 7-member Monetary Board.

Drastic reforms had to be implemented in the trade sector. The Aquino government inherited both high and highly differentiated tariff protection and non-tariff barriers that largely protected import-substitute industries. The protection was also used to favor Marcos crony businesses. The effective rate of protection for the manufacturing industry fell from 70% to 28.3% between 1985 to 1988. The NTBs on some 1,800 items which affected 32% of imports were abolished. Tariff rates were reduced to 10% between 1992 and 1998, and then again to 5% by 2003. Exports are provided tax incentives and export facility.

Until the 1980, tax effort (tax revenue to GDP ratio) averaged only about 12%. Tax revenue came from import duties, income taxes and indirect taxes plus other taxes. They have about equal shares in the tax revenue. Income tax has a progressive schedule though it is poorly implemented and does not significantly contribute to tax progressiveness. The indirect taxes were, until 1995, largely excise taxes on a few items such as tobacco and alcohol. They have been replaced by value added tax. The ineffectiveness of tax collection explains much of the low tax effort though this has been rising and is now at about 18%. Manasan (1998) found that the rate of evasion was about 60% for income and indirect taxes. Corruption is perceived to be prevalent in the Bureau of Customs thus lowering its tax effort. The celebrated government loss of the tax case amounting to 10% of tax revenue against Fortune Tobacco which is owned by a close friend of President Estrada adds to the evidence of prevalent tax evasion.

Government expenditures have not been directed at accelerating economic growth. (Table 2) The share of capital outlay for infrastructure has been very small as compared to the country's East Asian neighbors, averaging 15.7% in the 1986-89 and 16.6% or about 3.0% of GDP in the 1990s. Debt service which absorbed 39.0%, of the budget in 1986-89 crowded out all expenditures including infrastructure. Debt service has declined since then

and is now only 14.4%. The largest allocation has been to social services, mainly education which averaged more than 20% through the years. The government has succeeded in enrolling close to about 95% of its young children but the education sector is faulted for producing mainly poor quality education. Advanced science and technology has been badly neglected.²

4. The Downturn and its Cause

The economy suffered three downturns over the last two decades. The 1997-1999 economic downturn was much less serious and has different causes than the 1989-1991 recession and the 1983-85 crisis: GDP decline from 3.2% to -7.5 in 1980-83 to 1983-84 and to -7.5 in 1984-85 and from 5.2% to -.5% in 1997 to 1998. A succession of destructive events led to the 1990-1991 recession. A near-successful military coup in December 1989 created uncertainty in the political and economic system and discouraged business investment, stopping short the recovery from the 1983-85 economic crisis. In mid-1990, a strong earthquake badly damaged Baguio, the summer capital and third largest city and its surrounding agricultural area. In 1991, Mount Pinatubo had one of the century's strongest volcanic eruption. It destroyed much of Pampanga, one of the more progressive provinces and hastened the departure of the American military from the Clark Air Base following the termination of the base agreement with the US. The Gulf war added to the problems when oil price shot up for a few months in 1991. All these shifted aggregate supply to the left resulting in an inflationary downturn. The current downturn may also be seen as a large leftward supply shift due partly from contagion and all its repercussions and partly from the drought wrought by the El Niño phenomenon. El Niño did not hit all of Asia but mainly North Korea, Indonesia and the Philippines. This section examines in greater details the causes of the 1997-1998 downturn, specifically the macro fundamentals, the external sector and capital flows and the performance of the financial system and the quality of its architecture, and the behavior of the fiscal sector. An outstanding feature of the country's experience is the relative strength of the financial system.

4.1. Growth and Macro Fundamentals in the 1990's

As explained earlier El Niño reduced agricultural output by 6.7% in 1997-1998 contributing 2.41 times to the GDP decline.³ The Asian contagion and bad policies damaged the industrial sector which experienced a dive in growth rate from 6.1% to -1.9%. Construction suffered a very large drop from 16.2% to -8.5%. But export growth accelerated in this period to 1999. The trend in export growth contrasts with the crisis-hit economies which experienced export slowdown starting in 1994-1995. The uptrend may be attributed to the trade liberalization which reduced the biases against exports (Tecson 1998), and possibly compensated for the declining competitiveness in the garment industry, a major export industry. Exports are increasingly being concentrated in electronics which now comprise about 60% of the total. This high concentration makes the country's export sector vulnerable to the keen worldwide competition and rapid technological changes in this industry. Manufacturing has shown a very modest performance despite the growth of exports.

²In the Asiaweek rating of the Asia Pacific Region's best universities, the most prestigious University of the Philippines ranked 46 out of 62 in 1997 and 26 in 1998.

³ $[(18\% \text{ to GDP share} \times -6.7 \text{ growth}) + -0.5\% \text{ GDP growth rate}]$

Saving rate has been low as compared to all the East Asian neighbors. It averaged about 21% in 1986–1990 but began to fall in 1990. There was excess saving over investment in 1986–1989 which went to debt service but since then the investment/GDP ratio exceeded the saving/GDP ratio by about 8 percentage points on average from 1990 to 1998. This means a high dependence of investment on foreign financing. The current account deficits/GDP ratio (CA/GDP) showed an upward trend rising from –0.7% to 5.1% from 1990 to 1997. The recession drastically brought down imports and led to a surplus in the current account in 1998 up to the first half of this year. There was an upward movement of the real effective exchange rate from 69.2% to 91.4% from 1990 to 1996 which perhaps stimulated exports, albeit not to the maximum considering that the REER index was still less than unity in the 1990s relative to 1980. The REER declined as an aftermath of the Asian crisis as the currency depreciated at a slower rate than its trading partners. (Table 2) The public sector appears not to have contributed to the current problems since the trend in the cash budget operation was towards a surplus from 1994 onward.

Inflation rate fluctuated widely since 1986 (also in the 1970s to 1985). Supply shocks from oil price inflation, currency depreciation and natural calamities affecting food supply explain much of the upward swings in the price level. The 1989–1991 calamities and political disturbances shifted to the left the aggregate supply curves, thus the inflationary downturn in this period. The supply shifts in 1997–1998 due to El Niño, currency depreciation and high interest rate also resulted in stagflation. Attempts to control inflation through monetary and fiscal policies have had only moderating effects because supply shocks occurred before the anti inflation cycle could be completed. The relatively poor performance of the agricultural sector since the 1980s and its sensitivity to climatic changes tend to set the inflation level at much higher rate than in the neighboring economies.

4.2. Movement in the Capital Account

The Philippines is known not to be a 'miracle' country and so failed to attract as much capital as the EA-4. (Growth had been much slower and more unstable and the infrastructure, especially communications was inadequate.) Still it experienced capital surges in 1995 to 1997. (Table 4) The balance of payments (BOP) accounts show net capital flows of less than \$2 B until 1992 but increased to \$2.8B in 1993, then to \$4.5B in 1994, and \$4.4B in 1995; it more than doubled to \$11.1B in 1996, but dove down to \$6.6B in 1997 and further to \$0.9B in 1998. The net flow consisted largely of medium and long term loans and direct investments, again in contrast to Thailand's largely short-term flows. Both these accounts had positive net flows throughout the critical period of 1996 to 1999. There were less fluctuations in the MT and LT loans which were largely from ODA sources. (Table 5) The investment flows consisted of FDI which had net inflows throughout the 1997–1999 period and the more unstable portfolio flows. Net portfolio investment which was first reported in 1996 was \$2.1 Billion in 1996, –0.406B in 1997, \$0.206B in 1998 and \$0.604B in 1999. Expectedly there were net outflows in ST loans and commercial banks (KB) net foreign assets. Large drops in net flows took place in these two accounts for the whole period turning from positive in 1996 to 1997 to negative in 1998 and 1999. There were always negative net flows for bonds and securities transaction reflecting resident investments abroad and repayment of government bond issues. The outflows could be inferred as inflow - net flow. Very large outflows took place for bond transactions. Possibly renegotiation of MT and LT loans led to lower loan payments beginning in 1997 where outflows show a declining trend despite the rising MT and LT debts.

External debts show a more favorable picture. (Table 5) Medium-term and long-term

outstanding liabilities comprise the bulk of the country's external debt averaging about 85% in the early 1990s, falling to 82.8% in 1996, then to 81.4% in 1997 when much short-term loans were coming in. The reversal of short-term flows pushed back the share of medium-term and long-term loans to 86%. About 25% went to the private non-bank sector and 16% to commercial banks or a total of 41% to private. About half of the loans came from multilateral and bilateral sources which were largely to MT and LT. Some 35% of the remaining MT and LT loans came from private sources possibly for private investment in infrastructure through build-operate-transfer (BOT) and similar schemes. These schemes were being encouraged by the government through some risk sharing arrangements.

Only about 15% of the loans were short-term, half of which were for trade credits, a non-speculative type of loan. Short-term loans as a ratio to gross international reserves was relatively low in 1996 or 61.5% but rose to 95.5% in 1997 when the large inflows took place. The ratio in fact improved from very high levels in the early 1990s. (Table 6)

The debt service burden has been brought down from a very high level - 43% of exports in 1990 to 22% in 1997, and 17.2% in 1998. Debt service relative to current account income is much lower considering that net factor income was generally positive because of the large income from overseas workers. However, overseas workers appear to be quite sensitive to the risk and return of domestic assets relative to those of foreign assets. Foreign income can be readily placed in foreign assets located in the place of work or anywhere by electronics banking. Remittances declined from \$5.7 Billion to \$4.9 Billion though the net deployment of workers rose from 747,696 to 755,684 in 1997 to 1998. There is now a fairly permanent stock of workers abroad with only small numbers of new migrants leaving the country each year. As the foreign exchange market stabilized, remittances started to rise again increasing by close to 50% between the first semester 1998 and the first semester 1999. The movement of overseas workers' saving is partly reflected in the foreign currency deposit liabilities of banks.

4.3 *The Financial Sector*

The reforms undertaken during the Aquino and the Ramos administrations have substantially strengthened the banking system and allowed it to withstand the contagion effects of the Asian crisis. The abandonment of credit intervention and the liberalization of the capital account and bank entry have fostered competition and market discipline. The reforms also encouraged investment in the banking industry and other financial institutions. The number of banks and other types of financial institutions and their branch offices increased significantly, the level of intermediation grew substantially, the intermediation margin narrowed and a greater variety of instruments and services increased. The banking system manifested a fair degree of stability with rather few insolvencies occurring. Only one small bank suffered insolvency in 1998-1999.

The assets of financial institutions/GNP ratio rose from 53.2% in 1987 to 134.1% in 1997 but declined to 123.6% in 1998. (Table 7) M_3 /GNP⁴ ratio also had an upward trend from 24.5% to 42.2% over 1986 to 1997, then fell to 41.0% in 1998. The financial assets/GNP ratio grew faster than M_3 /GNP ratio reflecting the increased variety of financial instruments being offered by the proliferating intermediaries. The financial system consists of a very large number of institutions or more than 8000 companies in 1996. Commercial banks (KB) form the most important segment of the financial system and contributed 82% to

⁴The definition of M_3 is less inclusive than in the US as it consists of only of M_1 and the different types of deposits: saving time, marginal and deposit substitutes.

the system's assets in 1997 and 73% in 1998. There were 49 KBs in 1997 of which 21 were classified as expanded commercial bank (EKB) with larger capital requirement and the authority to make proportionately large investments in equities. Their asset share was 67% of the total. Included among the EKBs are three government banks. Foreign bank branches number 22 from only 4 before the relaxation of foreign bank entry in 1995. The other KBs are very much smaller and their assets averaged only P7B as compared to P70B for the EKBs. The other financial institutions are even smaller. They shared only 18% of the system's assets and had an average size of only P56 Million.

The health of the financial system rests on the health of the commercial banks considering their high relative importance. Examined here are their sources and uses of funds and non-performing loan to total loan ratio or NPL. Table 8 shows significant improvements in saving mobilization as indicated by the proportion of loanable funds tapped from deposits by both the KBs and the rural banks. The share of their bills and other liabilities which include rediscounting and other borrowings from the central bank gradually declined through 1995. In the Marcos era (before 1986), banks especially rural banks relied heavily on this source since it was given cheaply and they could not attract as much deposits because of the interest rate repression. The share of deposit liabilities were very much higher among the KBs than among the government banks and the rural banks; in 1986 the deposits share were, respectively, 62.3%, 44.0% and 49.2% in 1995-1996, the shares were 69%, 21% and 77%. The share of deposits in KBs fell in 1996 and 1997 because of the increased reliance on short-term foreign loans. The three government banks greatly increased their borrowings in 1995 possibly partly from foreign sources also. Rural banks are too small and little known to be able to issue bills or borrow from abroad.

The banks' portfolio underwent substantial changes. More than 90% of loans went to the private sector. (Table 7) The share of medium-term and long-term loans increased from 22.85 average level in 1988-1992 to 27.7% in 1997 and then to 33.7% in 1997. The rise in maturities likely resulted from the growing loans to real estate. The new loans (loans granted account) to real estate absorbed 6.1% in 1996 and 7.6% in 1997 from just over 2% in the preceding decade. Other assets in the banking portfolio such as investment in securities and consumption loans did not change significantly. No data on car loans are reported though these became very visible in the late 1990s and could have caused some problems.

There was an acceleration in the growth rate of gross domestic credits in deposit money banks (DMB) starting in 1993. (Table 7) Growth rose from an average rate of 21.4% in the preceding five years (1988-1992) to an average rate of 31.4% in the next two years (1993-1994), and then to an average rate of 42.4% in 1994 to 1997. The growth of domestic credit was partly financed from external sources as seen in the rapid acceleration of the growth rate of foreign liabilities. Their growth rate rose from 23.4% to 29.5% and to 60.9% for the same period. The bank's foreign liabilities were not fully hedged since the foreign liabilities always exceeded foreign assets. (Table 9) The 1997-1998 downturn, like the 1983-85 crisis, was preceded by very high ratios of foreign liabilities to foreign assets. The ratio peaked at 478% in 1982 then it gradually declined to 108% in 1988 but rose monotonically until it peaked at 323% in 1996. The capital flow reversal brought it down quite rapidly to 205% in 1997 and 184% in 1998. The reliance on foreign sources of domestic credit is reflected in the ratio of net foreign assets (liabilities) to gross domestic credit. There were modest movements in the money multipliers.

The bank restructuring and reforms appear to have improved the quality of bank loans

until the Asian crisis hit the system. The NPL ratio shows a declining trend from 1990 to 1996 for the whole financial system and for the commercial banks (KB). (Table 10) The high NPL of 7.9% in 1990 was inherited from the financial repression period. The KBs had 7.2% NPL ratio, the thrift banks the same level, but the highly subsidized rural banks 28.5%. The KBs were able to reduce their NPL ratio which fell to 2.8% and the rural banks to 14.1% by 1996. The improvement in rural banks is partly explained by the closure of some 180 insolvent banks which contributed a large share of the group's NPLs. The NPL ratio of the whole financial system increased to 11% following the 1997-1998 downturn. The KBs which form a very large segment of the system contributed about 85% to the total NPLs. The KBs' NPL ratio rose first from 2.8% to 4.7% in 1996 to 1997 and then to 10.3% in 1998 and 14.4% in the first quarter of 1999. The large or expanded KBs and the foreign bank branches suffered lower NPL problem than the smaller KBs. The government banks show lower NPL ratios than the private banks though there could be significant underreporting of their NPLs. The media reported a very high NPL ratio of 26 to 29% for the Philippine National Bank and bankruptcies of some large borrowers of the Land Bank of the Philippines. These banks are reported to have made connected loans.

On the whole, the banking system survived the crisis in 1983-85 and the current downturn with minimal bank failures and no bank runs. There is a core group of large banks that have established prudent practices and a solid reputation. Only one small KB is officially declared insolvent in 1998. The cause was not the currency crisis but violations of the DOSRI rule (loans to directors, officers and affiliated individuals). In the 1983-85 crisis more banks closed down - 3 KBs and some 180 rural banks; 3 GFI's became insolvent but the failures did not lead to a bank run. The rural banks might be the weakest segment of the banking sector though they form a very small segment of the banking industry, about 5% of its assets. They are small unit banks with an average capital of P56Million (\$1.38Million at PP40.1/\$1 exchange rate) and likely operate below efficient scale.

While the banking system has exhibited resilience and sound practices, there remain some structural problems that negatively affect its overall efficiency. Too many banks have been allowed to be established as part of the supply-leading strategy of the 1950s to 1970s. There now exist 8,000 deposit money banks. The policy that allowed foreign entry has attracted 22 foreign bank branches from the original 4 in 1994. The 10 largest banks dominate the banking system contributing 67% of its total assets. The banks, in turn, dominate the financial system with asset share of 73%. The securities market has not developed fast enough because of weak architecture. A bill is pending in Congress for instituting stricter monitoring and supervision standards. A scandal about connected insider trading is getting much media reporting and flight from the equity market.⁵ There is an undeveloped government securities market. The government issues mainly large denominated securities in P100,000 lots which only the very wealthy can afford to hold. The recent issue of P5,000 denominated bonds has had little impact in the market since the volume was too small to reach the small savers. Competition is hampered by this structure and possibly contributes to the persistently large intermediation margin (lending rate - saving deposit rate) that averaged 7.0 percentage points in 1995-1998. The margin is much higher than in the country's more advanced neighbors. (Table 6)

4.4. Policy Responses

⁵The term connected is used here to mean all forms of politically influenced activities. A gaming company manipulated its stocks that pushed its price from P2.70 to P104 then to P3.0 in one month's trading. The media alleged close friendship between the President and the speculators.

Until the end of 1997 the BSP felt confident that its international reserves would be able to fend off attacks on the currency.⁶ But by then the exchange rate had already risen from P26/\$1 to P32/\$1. Some economists welcomed the depreciation as favorable to exports. The problem in Thailand was initially seen to be limited to its boundaries. The spread to Korea and then to Indonesia at the end of 1997 fanned speculative attack on the peso and the exchange rate continuously rose by the day reaching P43/\$1 in January 1998.

The BSP's initial response took two forms - "intensified dollar sales and several upward adjustments of its key overnight interest rates" (p.9 BSP July 1999) The dollar sale was abandoned in July 1997 as the BSP wisely realized it could not effectively move against the assault on the currency. But it continued with the credit crunch by increasing the reserve requirements. The following measures were adopted:

1. The BSP provided non-deliverable forward facility as a hedging facility to cover the risk of eligible borrowers with existing unhedged foreign liabilities in foreign currency deposits. Under the scheme only the net difference between the contracted forward rate and the market rate was to be settled and paid in pesos. The BSP however also tightened prudential rules on foreign exchange transactions. Banks had to obtain prior BSP clearance for their sales of non-deliverable contracts to non-residents. Restraints on banks' overbought/oversold foreign exchange position from 20% to 5% of unimpaired capital and from \$100,000 to \$25,000 of over the counter sale of foreign exchange.
2. The BSP overnight borrowing rate was raised from 15% in end of June 1997 to 37% in mid July 1997. Its lending rate was likewise raised from 17% to 34% in the same period. In the following month, its lending facility was temporarily closed "to have a firm grip on liquidity".
3. Liquidity reserves, a new form of reserve requirement, was imposed in July 1997, first at 2% and later raised to 8% in August 1997. The reserves could be in government securities.
4. When the NPL rate increased, loan loss provisions were imposed first at 1% in October 1998, then at 1.5% in April 1999 and at 2.% in October 1999.
5. The Bankers Association of the Philippines (BAP) agreed among themselves with encouragement from the BSP to transact foreign exchange within a band, initially within 2-4% and later within 4-6%. The band was effective from October 1997 to March 1998.

The deflationary monetary policy did reduce the growth rate of credit from 47.5% in 1995 to 1996 to 28.9% in 1996-1997. The lending rate which averaged 14.5% and 13.5% in 1996 and in the first half of 1997 rose to 19.1% in the second half. The rate reached high levels of 26.8% in November and December of 1997. The drastic rise in interest rate and in the NPL of banks alarmed the BSP and led it to reverse its policy (not without IMF approval). The regular reserve requirement was lowered by 3 percentage points in March 1998, then by another 2 percentage points in May 1998 "to help bring down the cost of money and make more funds available for lending". The BSP lending rate was brought down in January 1998 and the rediscount window was reopened.

⁶From a conversation with a Monetary Board member in November 1997.

Meanwhile, prudential regulations were imposed including the following: (1) portfolio ceiling on real estate loan at 20% of the total, (2) lower loanable value of real estate collateral, (3) a 30% liquid cover on all foreign exchange liabilities and foreign currency deposits, (4) raised the qualification of bank managers, (5) redefined the criteria for past due loans by reducing the number of installments in arrears to 6 monthly or 2-3 quarterly, and (6) loan loss provisions for NPL loans at 1% in October 1998, 1.5% in April 1999 and 2.0% in October 1999, and (7) increased the minimum capital requirement of the different bank categories from P3.5B to P4.5B for expanded KB and P1.525B to P2.0B for the non-expanded KB. The BSP encourages mergers as a way of raising bank capital.

The deflationary actions of the Bangko Sentral in 1997 exacerbated the uncertainties and pessimism. The large increases in interest rate and the large depreciation of the currency wrought a tripple whammy to the banking sector. The higher reserve requirements and the loan provisioning directly increased the intermediation cost and reduced credit supply. The banks' unhedged foreign liabilities amounted to about 22% of domestic credit at end of 1996. The currency depreciation of about 54% (40/26 - 1.0) implies an approximate loss of 11% on these credits. The tight monetary policy and the rise in NPL arising from the recession reduced the banks intermediation volume. Some large banks reported drastic falls in their profit rates. The real sector suffered on two counts. Those who borrowed foreign exchange suffered currency losses and had to pay high interest rates to service their debts. All had to suffer a liquidity crunch and pay high interest rate. The real estate sector and the consumer durable sector were more sensitive to interest rate and so experienced larger output declines. (Table 1)

5. Some Conclusions

The Philippines suffered a serious economic crisis in 1983-1985 of a similar nature that Indonesia experiences now. Their problem had a political origin where the leaders of their dictatorial governments appropriated and misallocated economic resources. The financial system became a channel for economic capture. This sector is vulnerable to abuses since transactions are not physically observable. Misallocation in real resources are not immediately observed and is allowed to cumulate to some substantial dimension before the public becomes aware of the problem. A dictatorship can therefore last for years before it is toppled. External assistance from multilateral agencies helped sustain the Philippines and Indonesian dictators. The Philippines received large increases in ODA from the World Bank and other international agencies after Martial Law was declared in 1972. The Suharto government has also been one of the five largest recipients of ODAs in the world and in Asia 1980s and 1990s. Both the Philippines and Indonesia had large external debt overhang and extensive bank insolvencies when their dictators were removed. Insolvencies in the financial system occurred largely in the GFIs and small rural banks. Fortunately, there was a large enough core of financially strong private commercial banks which had developed a solid tradition of prudent banking. Their presence prevented bank runs and allowed fast recovery. It also enabled the sector to attract foreign equity without much delay. Indonesia faces a longer struggle with its bank restructuring. It developed its financial institutions later than the Philippines and its (Indonesia's) banking system is dominated by government banks which may take time to privatize.

The economy began recovering in 1999 as GDP growth reversed from -5% to 2.7%. The growth rate for 1999-2000 is expected to be at about 4%. The manufacturing sector

experienced a positive growth of 6% this year, from negative growth in 1998 and 1999. The weather has been favorable so that agriculture is expected to produce above average growth of 3%. The export sector boasts of accelerating growth rate from 16% in 1998 to 19% in the last quarter of 1999. Barring political and other extraneous upheavals the economy is expected to course through its old low growth path of 5–6% considering the weak growth fundamentals that have characterized it. There are no new policies and strategies to propel it to a higher growth path. No measures are being taken for raising the saving rate, for intensifying population control, for increasing tax effort, for increasing investments in infrastructure, for raising agricultural productivity, for stimulating tourism, for diversifying manufacturing production, and for strengthening technological capability through advanced ST education and research. The President's promise to pursue poverty alleviation and agricultural growth has not been concretized into operational strategies and measures. Even the rhetoric has been sparse. There are evident signs of a significant deterioration in the quality of governance which creates uncertainties about the direction of policy and how it is to be implemented. The recovery is slower than in the 1983–1985 crisis possibly because of the uncertainties emanating from a deterioration of governance. Both domestic and foreign investments have been rising, albeit too slowly. A recent survey of the 300 of the 700 biggest corporation gave the government a generally poor rating pointing to its lack of direction and the return of cronyism. A survey of foreign investors gave a similar result. In his recent visit, World Bank President Wolfenson warned the administration it cannot solve poverty at its low target growth given the high population rate of 2.3%. (Business World, February 28, 2000)

The three main hypotheses of the causes of the Asian crisis do not strongly apply to the Philippines downturn. The capital account liberalization took place after essential prudential regulations and practices in the banking system have been established. There is much improvement in the BSP data collection detailing the flow of funds from both domestic and foreign sources. More data on foreign transactions are being collected now than before. Goldman and Sachs (1998) in fact gave the country's banking sector fairly high ratings. The banking system was able to absorb their large currency losses and NPLs. Not one major bank became insolvent. The one small bank that failed did so because of violations of BSP rule on DOSRI (loans to directors and related individuals). A 20% ceiling on real estate loans/total loans ratio was imposed in 1996 though the banks' ratio was below this. The capital/asset ratio of banks has always exceeded the Basel standard. The currency depreciation likely prevented the decline in exports and compensated for the slack demand from the region especially Japan.

There were some differences in the problems that led to the crisis in Korea, Thailand, Indonesia and Malaysia. In Korea the concentration of economic power in the chaebols appears to be central to the weaknesses that developed in the financial system and in the allocation of investment funds across industries and companies. The Korean case has its equivalence in Indonesia's crony capitalism. Economic power is more dispersed in Thailand and Malaysia. Thailand had a weaker financial architecture than Malaysia. The role of capital flow also differs significantly across the EA-4. Thailand falls more closely to the stereotype case of short-term capital upsurge that went to create real estate and stock market speculation and over-heating. There were much less short-term flows into Indonesia and Korea than into Thailand. Korea's short-term flows largely went to banks which allowed easier roll-overs. Indonesia's short-term loans went to firms and could not be readily renegotiated. Politics had much to do with the uncertainties and inefficiencies in Indonesia.

The moral hazard in the banking sector are of different nature. Indonesia still has a

dominant government banking system which is subject to greater government interventions. Thailand's financial system has always been largely private and their insolvency is the bankers' own doing permitted by poor prudential environment and over-optimism. Korea's banks are dominantly private but are under the control of the chaebols. According to Park (1997), bank loan officers merely rubber stamp the loan applications that have already been negotiated between the chaebols and the bank heads.

All the EA-4 and the Philippines maintained overvalued currency prior to the crisis. This worsened the loss of competitiveness of Thai exports whose growth began declining since 1994. Thailand had the highest current account deficits among the EA-4, 8% in 1997. Indonesia's export earnings were more subject to oil price movement though oil's share in total export had long declined. Indonesia had the lowest CA/GDP ratio. Korea maintained technological capacity to export higher-tech products. But the inefficiencies in the chaebol-controlled economy offset the advantages from its advanced R&D and high quality manpower.

The IMF imposes the conditionality that the EA-4 adopt and implement the prescribed financial architecture, meaning international standards of accounting and auditing, disclosure rules, prudential regulations and effective supervision. The connected banking syndrome has to be broken down. In Indonesia this would require the privatization of banks, in Korea, the break-up of the chaebols, and in Thailand, more effective prudential rules and supervision.

The theory on market failure problems inherent in the banking industry (and other financial sectors) needs to be put in the context of banks' long-run objectives. Central banks do provide some implicit guarantees and last recourse facility to prevent bank runs and the failure of the payment system. In the US the Fed have in a few cases also decided to prevent big banks from failing. The banks, in turn, institute mechanisms for reducing moral hazards on the part of their clients. Adverse selection is minimized by good accounting and auditing practices and monitoring. There are unsystematic risk that can be minimized by diversification and prudential procedures. The literature on the market problems implicitly argues that central bank guarantees encourage banks to be imprudent. It does not look at the cost of failure to a bank. A bank is established for a long horizon. As a trust institution, its viability depends on its goodwill which is created by constant good performance over a long time period. Insolvency destroys goodwill so that even if a bank is bailed out by the central bank, it loses goodwill, its most valuable asset. Throughout the world, there are the historical banks like the Hongkong Shanghai Bank, Chase Manhattan Bank, Union Bank of Switzerland, etc. In the Philippines, the oldest most respected bank, the Bank of the Philippine Islands, has survived through the Marcos era and the current difficulties. The ten largest banks here which include the Far East Bank, the Metropolitan Bank, the Rizal Commercial and Industrial Bank, the Philippine Commercial and Industrial Bank and the Allied Bank have remained stable.

The moral hazard problem that is seen to emanate from central bank and other guarantees appears to be exaggerated. From the individual bank viewpoint, they provide a good insurance for temporary problems but they are immaterial as far as the bank's long-run objectives are concerned. The inherent problems of market failure are seen not to be the cause of financial failures. The problems are traceable to direct interventions and abuses in an environment of political-economic concentration.

Appendix Note:

As a colony of the US, the country suffered more economic destruction during WWII. The damage from the heavy bombing (by America) wrought the heaviest destruction of physical capital and human toll in all of the Asia-Pacific region. America imposed fixed exchange rate at P2/\$1 and heavy preferential trading agreement as a conditionality for its reconstruction assistance to the Philippines. Extensive import controls and conservative monetary policy had to be adopted in order to maintain this exchange rate level. The control package favored import of "essential" goods that in effect provided heavy protection for import substitutes that were largely consumer goods. The import-substitution policy continued until the end of the 1960s although the measures changed from quantitative controls to high and differentiated tariff rates. The currency was devalued for the first time in 1960-63 with the nominal exchange rate doubling to around P4/\$1. Gradual trade and industrialization reforms were undertaken intermittently since the 1970s. Tariff rates were reduced for the first time in the early 1970s, then again in the 1980s and the 1990s. But the Marcos government (1965-1985) imposed non-trade barriers on about 1800 items which affected 32.0% of imports. The barriers were used to favor selected crony businesses. Government intervention in the financial market was extensive throughout the first four decades of the post independence period, 1946 to 1986. Interest rate ceilings were set and subsidized credit were provided to priority sectors by government financial institutions (GFI) and subsidized thrift banks. The government followed the world fashion of supply-leading financial development as it established GFIs and subsidized the creation of private banks. It operated the Philippine National Bank, the largest commercial bank until its restructuring in 1996, the Development Bank of the Philippines and two other smaller banks (The Philippine Veterans Bank and the Amanah Bank.), the Government Social Insurance System (for civil servants) and the Social Security System (for private employees). The Central Bank of the Philippines (now called the Bangko Sentral ng Pilipinas or BSP) was established in 1948. Its initial task was to defend the currency, manage the import control scheme and provide subsidized capital and loanable funds to the GFIs and the private development banks and rural banks. These are small unit thrift banks. The Monetary Board of the CB was dominated by cabinet secretaries and was therefore not independent.

The nominal interest rate ceilings originated from the anti-usury law of 1900's. Deposit ceilings were also imposed through 1980. At the same time, CB granted easy and cheap rediscounting facilities for all banks and preferential ones for the government banks and the subsidized thrift banks. The loan rate ceilings meant low real rates which oftentimes turned negative in times of high inflation. The real deposit rates were almost always negative during the 1960s through the 1980s. The policy had the predictable result of repressing intermediation activities and the development of the financial system. Banks could not attract as much deposits as they could. The rediscounting facility of the CB was a good substitute source of loanable funds for some banks though the rediscounting volume was restricted by the dictates of general monetary policy. The presence of GFIs and the availability of subsidized credit also permitted inefficient loan allocation. The GFIs are not subject to the discipline of the market since the institutions and their employees enjoyed implicit guarantees of bail-outs and tenure. The subsidized credit created excess demand and encouraged rent-seeking borrowing.

The inefficiencies and disintermediation resulting from the financial repression policy are evident. The financial system failed to deepen as reflected in the stagnant and low M3/GNP ratio. From 1960 to the mid 1980s, the ratio remained at around 25%. Inefficient credit allocation resulted in the bankruptcy of almost all GFIs in 1986. The PNB and the DBP had worked as milking cows of the Marcos family and cronies. The term 'behest' loans or those demanded by Marcos were 'front-ended'. The term means that a borrower applies

for a loan for purposes other than the reason given to the bank. Borrowing was merely a method for stealing money from the GFIs. The GFIs were largely funded by the Central Bank. They barely tapped deposits and other intermediation channels. At the end of the Marcos era (Feb. 1986) an audit of the GFIs showed that 85% of the DBP assets were bad, 65% of the PNB and 50% of the Government Social Insurance System (GSIS).

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**FIGURE 1: Annual Growth Rate of GDP,
Sectors, Exports**

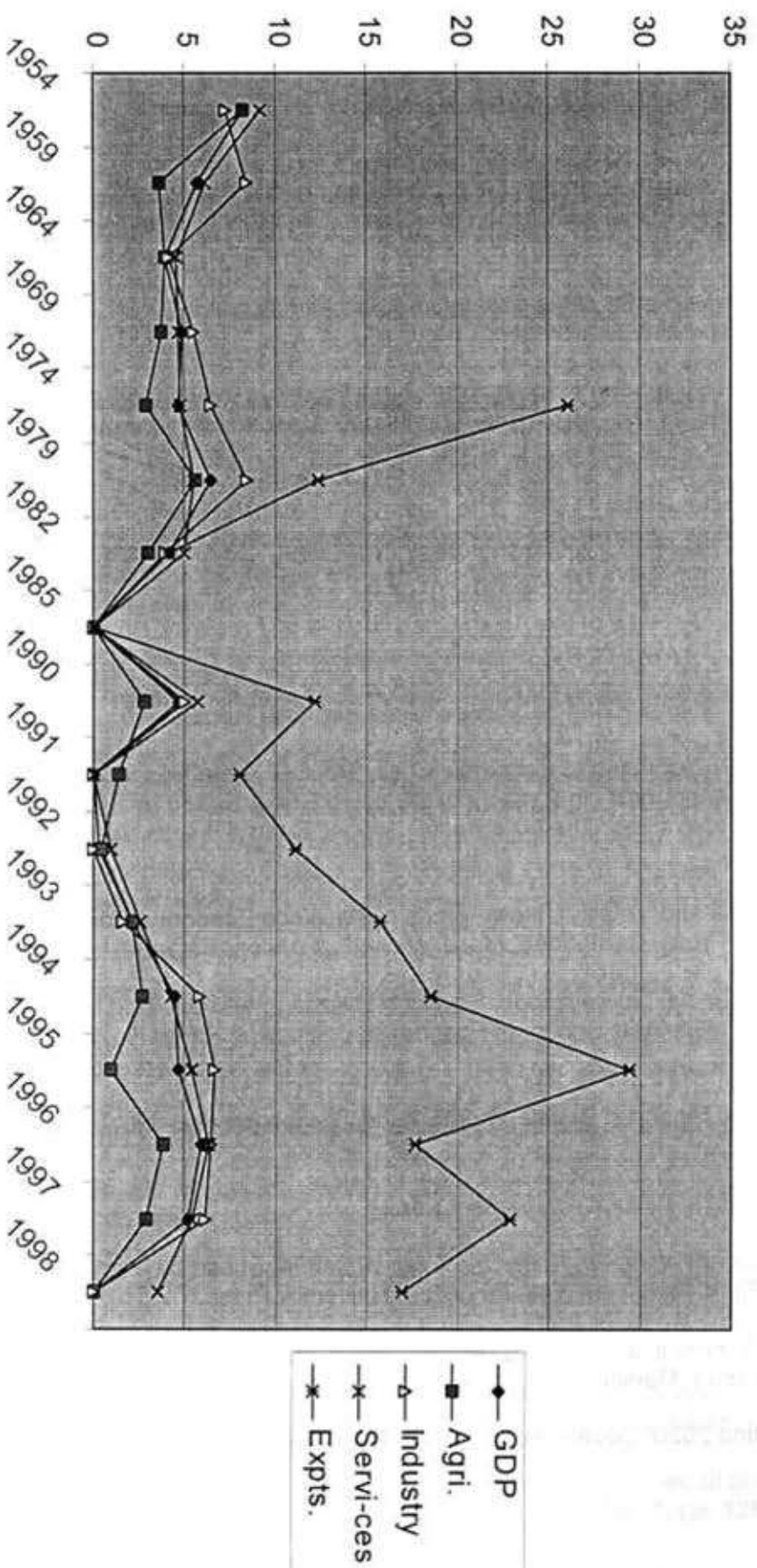
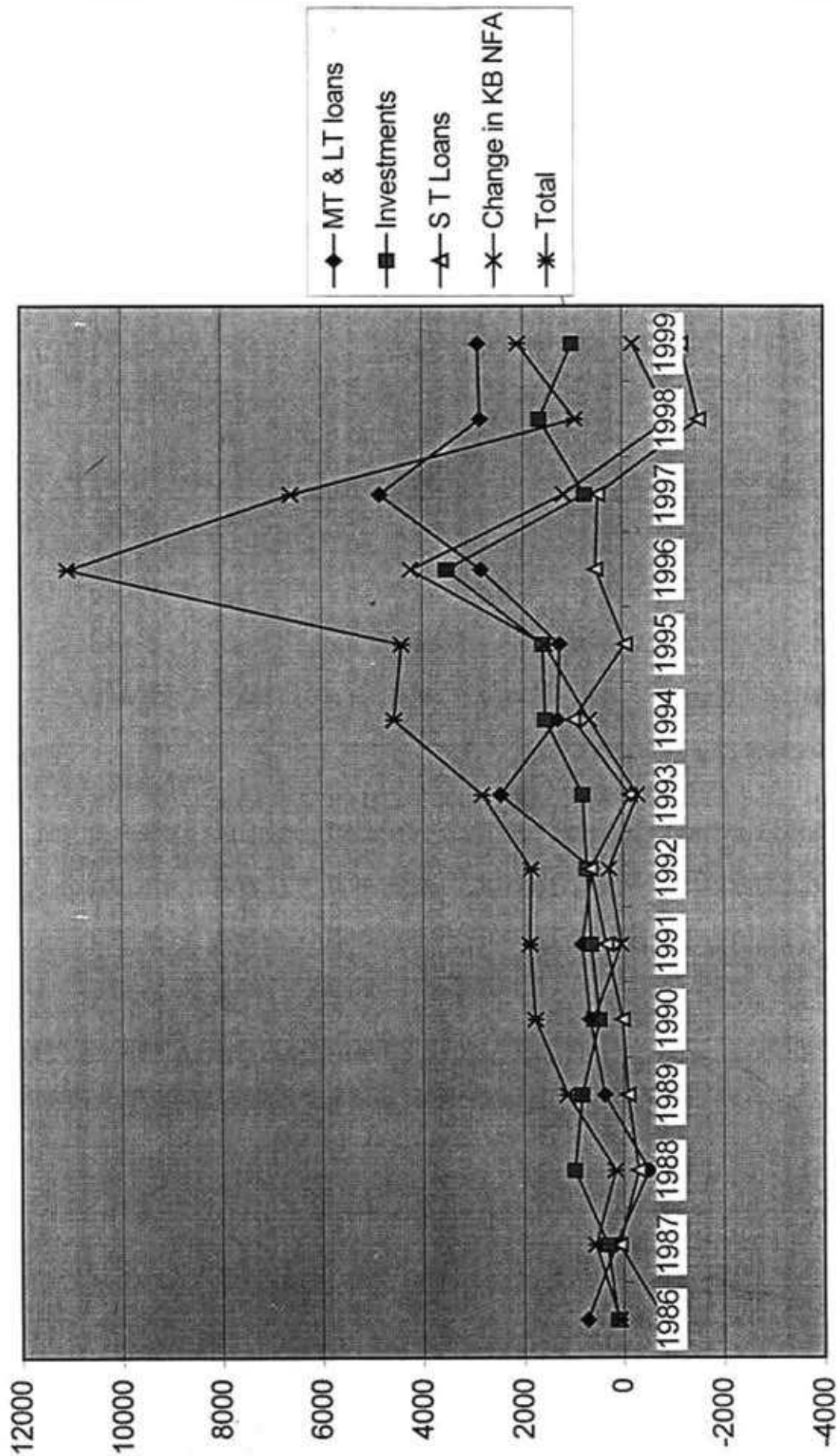


FIGURE 2: Capital Accounts Net Flows



**Table 1 Performance Indicators of the
Real Sector 1970-1997**

	GNP	GDP	Agri.	Industry	Mfg.	Const.	Servi- ces	Expts.
<i>A. Average Annual Growth Rate of GNP, GDP, Sectors, Exports</i>								
1950-54	8.3	8.3	8.3	7.3	13.7	-3.7	9.2	
1955-59	6.0	5.7	3.6	8.5	9.9	4.7	6.1	
1960-64	4.8	3.9	3.9	4.1	4.1	6.6	4.5	
1965-69	5.0	4.9	3.7	5.5	6.1	1.4	4.6	
1970-74	6.2	4.7	2.9	6.5	6.8	5.2	4.8	26.0
1974-79	6.5	6.4	5.6	8.5	4.4	19.9	5.5	12.4
1980-82	3.7	4.1	3.0	3.9	2.6	5.9	5.0	4.1
1983-85	-8.2	-4.2	-0.2	-8.6	-6.1	-19.6	-1.0	-2.2
1986-90	5.4	4.7	2.7	5.0	5.1	7.8	5.7	12.2
1991	0.5	-0.6	1.4	-2.7	-0.4	-15.7	-0.2	8.0
1992	1.6	0.3	0.4	-0.5	-1.7	2.8	1.0	11.1
1993	2.1	2.1	2.1	1.6	0.7	5.7	2.5	15.8
1994	5.2	4.4	2.6	5.8	5.0	8.9	4.2	18.5
1995	4.9	4.7	0.9	6.7	6.8	6.5	5.4	29.4
1996	7.2	5.9	3.8	6.4	5.6	10.9	6.3	17.7
1997	5.2	5.2	2.9	6.1	4.2	16.2	5.4	22.8
1998	0.08	-0.5	-6.7	-1.9	-1.1	-8.5	3.5	16.9
<i>B. Sectoral Shares in GDP</i>								
1950			38.3	21.9	12.5	7.7	39.3	
1960			39.8	22.0	17.4	4.0	43.3	
1970			28.9	29.5	23.2	5.8	41.6	
1980			23.5	40.5	27.6	9.4	36.0	25.3
1985			24.6	35.0	25.2	5.1	40.4	24.0
1990			21.9	34.5	24.8	6.0	43.6	30.2
1995			21.6	32.1	23.0	5.6	46.3	42.9
1998			18.5	33.8	23.8	5.6	43.1	44.9

Source: National Statistical Coordinating Board (NSCB), Philippine Statistical Yearbook, 1998, 1990, 1980.
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**Table 2 Indicators of Economic Fundamentals
1986-1999**

Year	S/GDP	I/GDP	CA/GDP	National Government Deficits/GDP	Index of REER 1980=100	Inflation rate
1986	19.0	15.2	3.1	-5.1		0.8
1987	21.0	17.5	-1.4	-2.4		3.8
1988	21.1	18.7	-1.0	-2.9		8.8
1989	21.3	21.6	-6.7	-1.6		12.2
1990	18.7	24.2	-5.8	-0.7	69.2	13.2
1991	16.6	20.2	-1.9	-1.6	68.2	18.8
1992	14.1	21.3	-1.6	-3.1	76.4	8.6
1993	13.8	24.0	-5.5	-1.4	74.7	7.0
1994	14.9	24.1	-4.5	1.1	79.6	8.3
1995	14.5	22.5	-4.3	0.8	84.3	8.0
1996	15.2	24.8	-4.6	0.8	91.4	9.1
1997	15.3	26.3	-5.1	0.6	88.5	5.9
1998	12.4	22.1	1.9	0.6	69.5	9.8
1999	12.1	22.4	4.9	-	75.9 ¹	7.4 ²

¹June 1999

²Sept. 1999 to Sept. 1998

Source: NSCB, Philippine Statistical Yearbook 1998, BSP Selected Philippine Economic Indicators, 1997, Oct. 1999.

**Table 3 National Government Cash Budget Current,
1986-98 (Billion Pesos)**

Year	Revenue	Surplus (Deficits)	Debt Service % share	Other Current Expenditures % share	Capital Outlay % share	Equity and Net L % share
1986	79.2	-31.3	35.2	41.8	23.0	-
1987	103.2	-16.7	45.2	36.9	13.0	4.80
1988	112.9	-23.2	42.6	43.6	10.9	2.80
1989	142.1	-14.6	32.8	50.5	15.8	0.80
1990	179.5	-7.9	41.6	42.6	15.0	0.80
1991	220.8	-19.8	41.1	40.0	16.9	2.00
1992	223.3	-42.3	38.1	48.0	13.1	0.80
1993	260.3	-20.6	36.4	48.4	14.3	0.90
1994	335.3	18.1	24.2	55.8	20.3	0.30
1995	370.0	15.5	19.6	55.3	24.8	0.30
1996	417.2	17.5	19.1	68.4	12.2	0.30
1997	485.1	14.7	16.0	69.5	14.3	0.20
1998	540.9	16.0	14.4	71.1	13.6	0.09

Source: NSCB, Philippine Statistical Yearbook 1998.

TABLE 4 Capital Accounts Flows and
Gross International Reserves (GIR) (US\$ MN.)

Year	NET FLOWS								INFLOW					GIR End Of Period
	MT & LT Loans	Bonds and Secu- rities	Invest- ments	FDI	Port- Folio	S T Loans	Change in KB NFA	Total	Loans MT & LT	Bonds And Secu- rities	Investments Total	Port- Folio		
1986	732		114			-824		81	2605		186		2506	
87	159		326			80		565	2598		439		2014	
88	(519)		986			-303		164	2412		1077		2111	
89	381		843			-89		1135	2797		961		2375	
1990	674		480			19	603	1776	4575		498		2048	
91	835		654			349	40	1878	3622		681		4525	
92	633		737			660	289	1850	7432		931		5338	
93	2455		812			-148	-299	2820	5205		2135		5922	
94	1313		1558			1002	674	4547	4369		2492		7121	
95	1276		1609			-56	1574	4403	3927		2944		7762	
96	2841	-37	3517	520	2101	540	4214	11075	6540	4148	3621	1520	11745	
97	4824	-676	762	1249	-406	495	1188	6593	7724	3072	843	1249	8767	
98	2850	-1082	1672	2016	206	-1521	-963	956	5791	3308	2016	1752	10806	
99 ¹	2898	-439	1022	1244	604	-1163	-214	2104	4562	2594	1244	649	14575	

Note: MT, LT, ST are medium term, long term and short term loans; KB are commercial banks; NFA is net foreign assets.
¹1999 data is for Jan. to July.

Source: BSP, Statistical Bulletin, 1997, BSP Selected Philippine Economic Indicators, October 1999, December 1997.

Table 5 Distribution of External Debt Outstanding by Maturity,
by Borrower Type, and by Source

Year	Foreign Exchange Outstanding Liabilities percent of Total							Non-bank			MLT & BLT
	Total US\$ Bn.	MT & LT (%)	ST Non-Trade (%)	ST Trade (%)	To BSP	To KB	To Public	To Private			
1990	28.5	84.6	1.0	14.4	19.2	8.1	57.4	13.3	51.0		
91	29.6	83.9	0.8	15.3	17.8	7.1	61.6	13.5	53.5		
92	30.9	83.0	1.0	16.0	7.4	6.1	70.3	16.1	59.8		
93	34.3	85.3	4.5	10.2	3.8	3.3	72.8	15.4	62.2		
94	37.1	86.0	4.9	9.2	2.3	5.9	68.9	18.5	57.5		
95	39.4	86.6	6.7	6.8	3.1	10.8	67.7	18.4	61.0		
96	41.9	82.8	7.4	9.8	3.3	17.2	54.7	21.8	52.7		
97	45.4	81.4	9.6	8.9	5.5	18.0	49.0	27.5	48.3		
98	47.8	85.0	9.7	5.3	7.2	16.3	49.8	25.3	52.3		
99Mar.	48.6	86.0	9.1	4.9	6.4	15.9	51.2	25.2	50.9		
US\$ Bn.											
1997Dec	45.4	37.0	4.4	4.0	2.5	8.2	22.3	0.5			
1998Mar	45.7	36.8	4.9	4.0	3.3	7.8	22.1	0.5			
June	45.8	37.6	4.8	3.3	3.9	7.5	21.8	0.5			
Sept	46.4	38.4	5.0	3.0	3.7	7.7	22.4	0.4			
Dec	47.8	40.6	4.6	2.6	3.4	7.8	24.5	0.3			
1999Mar	48.6	41.8	4.4	2.4	3.1	7.8	25.5	0.3			

Note: ST = short-term, MT = medium-term, LT = long-term

MLT = multilateral institutions, BLT = bilateral sources

FCD = foreign currency deposits

Source: Bangko Sentral ng Pilipinas, Selected Philippine Economic Indicators, December 1998, October 1999.

TABLE 6 Exchange Rate, Debt Service Ratio, Interest Rates,
Stock Price Changes 1990-1999

Year	Nominal ER P/US\$ Average	Index of REER 1980 = 100	Debt Service as % of			ST debt/ GIR (%)	Interest Rate					Annual %Δ
			Exports of Goods	Current Acct. Income	GNP		TB 91 days	Lending Rate Average	Lending Rate High	Saving Deposit	Libor Three Months	
1990	24.3	69.2	43.3	25.8	8.1	220.0		24.3			8.2	-12.3
91	27.5	68.2	32.0	18.5	6.2	106.6		23.5			6.0	4.8
92	25.5	76.4	30.0	16.3	5.5	100.0		19.4			3.8	17.4
93	27.1	74.7	28.4	16.5	5.8	84.7	12.3	14.6		8.3	3.3	18.6
94	26.4	79.6	31.1	16.7	6.4	73.2	13.6	15.0		8.0	4.7	25.2
95	25.7	84.3	28.8	15.3	6.6	67.9	11.3	14.6		8.0	6.1	-10.9
96	26.2	91.4	24.5	12.3	5.8	61.5	12.4	14.8		8.0	5.5	-2.6
97	29.5	88.5	22.2	11.3	6.5	95.5	13.1	16.2	19.7	9.1	5.7	-12.9
98	40.9	69.5	17.2	11.5	7.4	66.6	15.3	18.4	19.5	11.0	5.6	-33.5
99	38.5	75.9	18.9	13.1	-	52.7	10.4	12.3	16.6	7.9	5.2	37.6

(Continuation)

Nominal Exchange Rate and Nominal Interest Rates, 1998-1999 (Monthly)

Year/month	Nominal Exchange Rate P/US\$ Ave.	INTEREST RATE				
		TB 91 days	Lending Rate Average	Lending Rate High	Saving Deposit	Libor 3 months
1998 1	42.7	19.1	21.1	26.8	13.7	5.7
2	40.4	17.8	20.0	26.1	12.5	5.6
3	39.0	16.6	20.1	23.3	12.1	5.7
4	38.4	15.2	18.1	22.0	12.1	5.7
5	39.3	14.4	17.1	21.2	10.3	5.7
6	40.4	14.0	16.1	19.8	10.1	5.7
7	41.8	14.7	16.1	20.4	10.3	5.7
8	43.0	14.1	15.2	19.9	10.2	5.7
9	43.8	13.8	14.6	19.7	10.1	5.5
10	42.9	13.5	14.5	19.8	9.9	5.3
11	39.9	13.5	13.5	19.7	10.0	5.3
12	39.0	13.4	14.8	19.7	10.0	5.2
1999 1	38.4	13.2	14.9	19.5	9.3	5.0
2	38.8	12.7	12.4	19.0	8.9	5.0
3	38.9	12.1	14.0	18.5	8.9	5.0
4	38.2	10.9	12.1	17.2	8.3	5.0
5	37.8	10.0	12.7	16.2	7.6	5.0
6	37.9	9.3	11.5	15.6	7.1	5.2
7	38.3	8.4	10.4	14.9	6.8	5.3
8	39.3	8.4	10.3	14.7	6.6	5.4
9	40.2	8.6	-	14.1	-	5.4

Source: Central Bank of the Philippines (Bangko Sentral ng Pilipinas) Statistical Bulletin, 1990, 1997, Selected Philippine Economic Indicators, June 1998, October 1999.

Table 7 Selected Financial Development Indicators (%) 1986-1998

A. Multiplier and Financial Rates

Year	M ₁ Multiplier	M ₂ Multiplier	Annual growth of domestic credit	Assets of FI GNP	M ₃ GNP	M ₄ GNP	No. of Bank Offices
1986	1.77	5.98	-15.8		24.5	-	3614
7	2.10	6.55	11.0	53.2	24.5	-	3547
8	2.12	7.16	22.7	53.5	25.7	-	3562
9	1.80	5.93	26.4	58.7	28.5	-	3588
1990	1.77	5.99	24.4	74.6	28.0	29.6	3638
1	1.56	5.36	13.6	73.4	27.7	28.8	3791
2	1.52	5.23	19.9	79.1	28.0	29.2	4296
3	1.46	5.23	32.5	90.6	32.0	33.2	4657
4	1.50	5.99	30.3	94.8	35.0	36.2	5096
5	1.55	6.39	37.2	104.6	38.9	40.2	5564
6	1.62	6.41	47.5	116.6	39.0	40.4	6332
7	1.65	6.62	28.9	134.1	42.2	63.3	7182
8				123.6	41.0	60.7	7696
9							7653 ¹

¹June 1999

Table 7 Selected Financial Development Indicators (%) 1986-1998

(Continuation)

B. Development of Financial Institutions

Year	Asset Share in the Financial System (%)						
	KB	EKB	Foreign KB	Gov't KB	FS	KB	EKB
1986							
7	73.3	38.1	13.9	6.8	13.7	8.7	10.2
8	74.9	43.1	11.9	6.0	14.4	9.2	10.3
9	75.8	48.6	9.5	5.0	14.1	8.7	9.1
1990	76.6	52.1	9.9	6.0	14.0	8.8	9.4
1	73.6	52.8	8.3	7.6	15.0	10.2	11.2
2	71.0	52.7	7.0	10.0	15.0	11.3	12.0
3	68.1	52.2	6.7	12.9	14.3	11.1	11.6
4	69.4	56.5	6.2	11.2	14.7	11.4	11.7
5	70.9	57.2	6.4	9.7	15.2	12.5	12.9
6	82.5	67.3	8.7	-	14.1	11.8	12.6
7	74.1	-	-	-			
8	73.2	-	-	-			
9	73.3 ²	-	-	-			

² July 1999

Note: FI = financial institutions

KB = commercial banks

EKB = expanded large KB

DMB = deposit money banks

Table 8 Sources and Uses of Funds in Banks,
1986-1997

Year	Commercial Banks				Government Banks				Rural Banks			
	Deposits Total Liab.	Bills and Other Liab. Total Liab.	Chattel Mortgage Total Assets	Real Estate loans Total Asset	Deposits Total Liab.	Bills and Other Liab. Total Liab.	Chattel Mortgage Total Assets		Deposits Total Liab.	Bills and Other Liab. Total Liab.	Chattel Mortgage Total Assets	
1986	62.8	35.3	1.9		44.0	55.4	7.9		49.2	49.8	3.9	
7	62.4	36.0	1.6		37.9	61.4	4.5		55.7	43.0	3.7	
8	66.4	31.6	1.3		53.8	44.9	3.7		58.7	40.5	3.5	
9	67.7	30.6	0.9		49.8	48.7	3.3		61.2	37.0	3.2	
1990	65.0	33.6	0.8		50.4	47.5	2.5		63.3	34.4	3.0	
1	69.4	29.3	0.8		48.8	49.7	1.8		66.7	31.3	2.8	
2	71.1	28.2	0.8		47.6	50.1	1.4		70.5	28.2	2.7	
3	73.5	24.8	1.1		36.7	62.8	1.1		73.5	25.2	2.7	
4	74.8	24.0	1.0		21.3	78.1	1.1		76.1	22.3	2.6	
5	75.0	23.7	0.8		21.1	78.2	1.1		76.7	21.8	2.2	
6	68.5	29.3	0.6		-	-	-		75.6	23.5	2.2	
7	66.6	32.6	0.8		-	-	-		-	-	-	
March 1997				11.9								
Dec. 1997				13.7								
June 1998				12.1								
Dec. 1998				13.1								

Source: Bangko Sentral ng Pilipinas (BSP) Statistical Bulletin, 1997, 1990; Selected Philippine Economic Indicators, Oct. 1999, Dec. 1997.

Table 9 Foreign Assets and Liabilities of Deposit Money Banks, 1980-1998

Year	Foreign Assets and Liabilities of DMB				Distribution of Gross Domestic Credit of DMB (%)		Net Foreign assets Gross Domestic Credit (%)
	Net (% Δ)	Assets (% Δ)	Liabilities (% Δ)	Liabilities Assets (%)	Loans to Private	ST Loans Total Loans	
1980				216	78.7	78.2	21.7
81	-9.6	11.7	0.3	194	80.8	73.4	16.7
82	25.0	21.0	23.2	198	79.5	69.0	18.0
83	77.0	19.0	47.1	244	78.2	66.8	24.3
84	21.9	50.3	33.7	217	71.0	60.6	29.0
85	-25.0	-4.8	-15.7	192	68.8	65.9	23.5
86	-63.9	7.8	-26.6	131	62.5	69.2	10.0
87	-35.0	25.0	11.0	116	70.0	71.5	5.9
88	-40.0	26.4	17.1	108	68.1	70.9	2.9
89	73.4	14.0	18.2	112	66.6	74.6	4.0
1990	140.6	35.2	46.1	121	69.6	80.0	7.7
91	49.1	-8.4	1.4	134	66.1	78.3	10.0
92	91.3	15.1	34.2	156	68.7	77.6	16.0
93	39.0	16.8	24.8	166	72.5	72.3	15.8
94	43.8	11.2	24.2	186	71.7	-	18.5
95	63.2	13.4	36.4	223	75.5	-	22.1
96	130.8	28.2	85.4	323	78.2	66.3	34.5
97	-47.4	10.8	-29.5	205	77.7	70.0	14.1
98	-23.3	-4.1	-14.0	184			
99	-2.4	-7.3	-5.5	184			

¹ commercial banks only

Source: BSP Statistical Bulletin, 1997, 1990, 1988, BSP Selected Philippine Economic Indicators, October 1999.

Table 10 Nonperforming Loans of Financial System and Banks

Year	Loan Loss Provision	Non Performing Loans/Total Loans								
		FS	KB	TB	RB	KB	EKB	NEKB	Gov't	FX
A. NPL of Financial System 1990-1999										
1990	4.4	7.9	7.2	7.2	28.5					
1	3.8	7.3	6.6	7.6	26.3					
2	3.3	6.8	6.1	7.9	24.4					
3	2.5	5.2	4.7	6.0	21.3					
4	2.0	4.7	3.9	8.4	18.2					
5	1.7	4.0	3.2	7.9	16.1					
6	1.4	3.5	2.8	7.7	14.1		2.4	3.7	4.3	3.3
7	2.3	5.4	4.7	10.7	15.4		4.2	7.2	6.1	4.4
8	4.0	11.0	10.3	16.3	18.0		10.4	13.6	10.1	7.9
March 9			14.4				15.2	18.5	13.3	5.4
B. Percentage in Total NPL										
1998	(P bill)	188.7	160.0	21.3	7.4	160.0	112.4	16.5	18.8	12.2
	%	100.0	84.8	11.3	3.9	100.0	70.2	10.3	11.8	7.6
C. Percentage share in Total Financial Assets										
		100.0	82.1	7.8	2.0	82.1	67.3	6.1	—	8.7

Note:

KB = commercial banks, EKB = expanded (large) KB, NEKB = non-expanded KB

TB = Thrift banks, Government banks and FX = foreign banks and branches.

Sources:

BSP Selected Philippine Economic Indicator (SPEI) April 1999, October 1999.

BSP Fact of Financial System, 1996, 1995.