

**OECD Round Table on Capital Market Reform**  
**Country Report of the Philippines**

Submitted by the Philippine Securities and Exchange Commission

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November 19, 2003, ADB Institute, Tokyo, Japan

## **ECONOMIC OVERVIEW**

### **Year 2002 Performance**

For 2002, growth in GDP of 4.6% was better than 3.2% in 2001 as GNP expanded by 5.2%, higher than the past year's growth of 3.4%. GNP gain came mainly from net factor income flows increasing by 15.5%, more than twice of the 7.2% of the previous year. This was due to increased remittances from overseas workers.

Inflation slowed down to 3.1%, almost half of last year at 6.1%. Moderation in prices was widespread from food, to housing, fuel and utilities partly due to deferred adjustments in regulated prices of power and water.

Interest rates dropped across-the-board with 91-day Treasury bill rate averaging 5.4%, half of that of the 9.9% a year ago. Interest on saving deposits was likewise down to 4.2% from 7.5% of the previous year. Policy rates of Bangko Sentral ng Pilipinas on overnight borrowing came down to 7.00% from 7.925% with lending rate down to 9.25% from 10.175%.

Fiscal deficit by yearend was at P212.7 billion and breached the P130 billion target by 63.6% to the shortfall in revenues of 9.3% and increase expenditures of 3.2%.

The stock market perked up at the start of year stimulated by better GDP growth, lower inflation and interest rates reinforced by prospects of military training and technical assistance from US forces in solving the insurgency problem in the South. The market index posted two consecutive monthly gains and hit an intra-year high of 1,469.07 on 19 February 2002. However, war threats and insurgency problems caused the 30-stock composite index to fall by 12.81% or 149.67 points to 1,018.41, from its previous year's close of 1,168.08. The Index was at its lowest on 19 December 2002, when it breached the 1,000 level at 997.78. The broader All Shares Index also failed to finish higher as it dropped 10.58% or 74.09 points to 608.78 from 682.87. Market capitalization decreased by 2.7% to P2,083.2 billion (US\$39.23 B). There were 310 listed issues and 234 listed companies.

### **First Semester 2003 Performance**

Economic growth for the first semester of 2003 was marginally lower compared to last year. GDP growth was 3.9 percent in the first semester of 2003, as compared to 4.0 percent during the same period last year. Quarter-to-quarter, there was likewise a decline in GDP growth, due to uncontrollable factors such as the El Niño, the Iraq war, and the SARS outbreak.

The slowdown notwithstanding, the Philippines still managed to outperform other Asian countries such as Taiwan (-0.1%), Singapore (-4.2%), and South Korea (1.9%), although the economy still lagged behind China (6.7%), Malaysia (4.4%) and Indonesia (3.8%).

Overall inflation has remained benign, with year-on-year inflation easing to 3.0 percent in August from 3.3 percent in the previous month. The deceleration was traced mainly to lower year-on-year inflation rates for food items, utilities, and services. The August inflation rate was well within the inflation forecast of 2.8-3.1 percent for the month, and brought the average inflation to 3.0 percent for the first eight months of 2003.

The Central Bank has kept policy interest rates at 6.75 percent for the overnight borrowing or reverse repurchase (RRP) rate and 9.0 percent for the overnight lending or repurchase (RP) rate, effective 28 August 2003. The Central Bank policy rates were last adjusted on 2 July 2003 when the rates were cut by 25 basis points.

The January to August 2003 fiscal deficit amounted to PhP 113.6 billion, still PhP 13.9 billion below the period's target of PhP 127.5 billion. Expenditures for the month reached PhP 69.3 billion, PhP 9.7 billion or 16.3% above target and 10% higher than last year's level, as government released more funds to the countryside for pump priming.

Better-than-expected revenue performance in the first seven months has left ample room for higher spending in selected months during the remainder of the year, without sacrificing the full-year target. Total revenues in August 2003 increased slightly by 1.7% year-on-year, although this was still 0.6% lower than target.

## **Second Semester 2003 Projections**

The economy is expected to recover during the remaining half of 2003. GDP is projected to grow by 4.5 percent, led by improved export earnings, the US economic recovery and growth-inducing government policies that have been set in place.

The overall assessment of conditions for future inflation and economic activity suggest a benign inflation environment over the policy horizon. Average annual inflation is expected to fall below the Government's target of 4.5-5.5 percent in 2003 and settle within the range target of 4-5 percent in 2004.

Government remains confident that it will meet its full-year fiscal deficit target of 4.7% of GDP for 2003. To complete the demutualization of the exchange, the Philippine Stock Exchange intends to list its shares by the end of the year.

## **MARKET REFORMS**

### **1. Promotion of Good Corporate Governance**

Since 2001, the Philippine SEC has spearheaded the adoption of reforms to promote good corporate governance. Towards this end, we prepared and issued the following rules and guidelines in 2002:

- Memorandum Circular No. 2 s.2002, promulgating the Code of Corporate Governance aimed to raise investor confidence, develop capital market and help achieve high sustained growth for corporate sector and the economy.
- Memorandum Circular No. 5 Series 2002, requiring the accreditation and specifying reportorial requirements of external auditors of public companies.
- Memorandum Circular No. 10 Series 2002, amending SRC Rule 68 to incorporate the new IAS and the Statements of Financial Accounting Standards (SFAS), which govern the financial disclosures of publicly-held corporations, bringing them in line with IAS.
- Memorandum Circular 14 Series 2002, specifying the guidelines for accreditation of institutional training providers on Corporate Governance, to ensure seminars/trainings for directors of corporations covered under the Code are given institutional training providers that are duly recognized and accredited by the SEC.
- SEC Memorandum Circular No. 15 Series 2002, creating the Accreditation Committee, responsible for accrediting qualified institutional training providers on corporate governance and for monitoring proper conduct of the same.
- SEC Memorandum Circular No. 16, Series 2002, providing the guidelines on the nomination and election of independent directors. The Memorandum Circular sets out the definition of independence, the required number of independent directors, and the duties of the Nomination Committee in the process of screening the candidates.
- Memorandum Circular No. 5 and 5A, Series 2003, requiring the submission of self rating form on corporate governance.
- Memorandum Circular No. 8, Series 2003, clarifying the rule on rotation of external auditors or engagement partners every 5 years.
- Memorandum Circular No. 9 and 10, Series 2003, adopting 32 Philippine Standards on Auditing to harmonize Philippine auditing standards with the International Standards on Auditing.

The Code was made applicable to corporations whose securities are registered or listed, corporation which are grantees of permits/licenses and secondary franchise from the Commission and public companies. All these covered entities were required to adopt their Manual on Corporate Governance. In addition, as in 2002, financial statements of listed companies submitted in 2003 will be reviewed with the assistance of the business school of the state university.

## 2. Implementation of the International Accounting Standards (IAS)

In keeping with the Commission's effort to establish reliable and globally acceptable financial reporting structures that will promote full disclosure and transparency, we

harmonized the Philippine accounting and auditing standards with international accounting and auditing standards practices. Among others, we did the following:

- Amended the Securities Regulation Code (SRC) Rule 68 to incorporate the New International Accounting Standards (IAS) and the Statements of Financial Accounting Standards (SFAS) which were then adopted by the Accounting Standards Council and the SEC. We expect that by year 2005, all the IAS rules are incorporated in the Philippine GAAP.
  - For effective implementation of the above principles, we conducted a series of workshops on International Accounting Standards (IAS) for the staff of the various operations department.
3. Approved the following PSE amended rules submitted by the new management to SEC:
- Electronic Disclosure System
  - Amended Listing Rules
  - Amended Disclosure Rules
  - Additional Listing Rules
  - Distribution of Initial Public Offering – discounts to small investors
4. Adopted the “Omnibus Rules and Regulations for Investment Houses and Universal Bank Registered as Underwriters in Securities.” – The Rules rationalized the existing regulatory framework pertaining to entities engaged in the investment houses and universal banks registered as underwriters of securities in view of the significant changes in the securities regulation landscape. Salient Features: 1) New Registration/Requirements for HI/US; 2) Integrated Code of Corporate Governance and Anti-Money Laundering; 3) Required compliance with IAS.
5. Anti Money Laundering Act.
- To combat money laundering, the Commission issued SEC Circular No. 1, s. 2002 mandating regulated intermediaries to submit to the Commission their Statements of Policies, Procedures and Manual detailing their implementation and compliance with the Act.
6. Special Purpose Vehicle
- A new law to enable banks and financial institutions to unload non-performing loans and assets at a discount and with fiscal incentives was passed by Congress. Principal implementor of the law is the SEC.