



2008 BUDGET BRIEFER

CONGRESSIONAL PLANNING AND BUDGET DEPARTMENT

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THE MACROECONOMIC PERSPECTIVE:

The Continuing Imperative for Fiscal Performance and Reform¹

...adhere to a sustainable fiscal policy and a clear set of strategic sectoral priorities...through...a prudent and efficient annual General Appropriations Act...that would contribute to addressing national development requirements judiciously.

*Perspectives from the Secretariat in Support of Legislative
Agenda Setting for the 14th Congress, July 2007*

MACROECONOMIC TARGETS AND THE FISCAL PROGRAM

Over the years, the CPBD's *Analysis of the President's Budget* has always underscored that macroeconomic targets or assumptions are critical underpinnings for the sustainability of the overall fiscal program of the national government. The attainment of the macroeconomic targets is very crucial in the realization of the fiscal targets, which in turn could support national development objectives. As such, the national expenditure program, as a vital instrument for development, could help enable the benefits of economic growth to redound to the Filipino people.

With the economy starting to reap gains from past reforms and the continued support of countless overseas Filipinos, the growth momentum over the medium-term must be sustained by continuing to address structural weaknesses and bottlenecks. Breaking down economic barriers would expedite the pursuit of a more robust and sustainable growth path.

Higher economic growth naturally leads to expectations of more revenues to support development expenditures. However, rapid growth of the economy in 2007 has not translated so far into a higher tax take. Tax effort or the ratio between the government's tax and duty collection vis-à-vis gross domestic product (GDP) dropped to 13.8% in the first half of 2007 compared with 14.7% in the same period last year. Furthermore, tax buoyancy—which measures the responsiveness of the tax collection effort with respect to GDP growth—weakened substantially to 0.335 in the first half of 2007 from 2.21 in the same period last year.

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In view thereof, it has become all the more imperative to focus on fiscal performance and reforms in the consideration of the proposed 2008 obligation budget of P1,227 billion.

Note that although the Development Budget Coordinating Committee (DBCC) revised upward the low-end economic growth assumption from 5.7% to 6.1% for 2007, documents related to the Budget of Expenditures and Sources of Financing (BESF) indicate that the tax revenue target that was assumed for the same fiscal year (2007) is lower by P54.6 billion.

TABLE I
VARIANCE IN 2007 ASSUMPTIONS/TARGETS

OFFICIAL TARGETS/ ASSUMPTIONS	BESF 2007	BESF 2008	Variance B – A
Real GDP Growth Rate (%)			
2006	5.5	5.4	(0.1)
2007	5.7	6.1	0.4
Nominal GDP (P billion)			
2005	5,418.8	5,437.9	19.1
2006	6,028.2	6,032.6	4.4
2007	6,712.7	6,609.7	(103.0)
Tax Effort (Tax/GDP)			
2006	14.6	14.3	(0.4)
2007	15.3	14.7	(0.6)
Tax Revenues (P billion)			
2006	881.6	859.9	(21.7)
2007	1,028.2	973.6	(54.6)
BIR Effort (BIR/GDP)			
2006	11.2	10.8	(0.4)
2007	11.7	11.2	(0.5)
BIR Revenues (P billion)			
2006	675.4	652.7	(22.7)
2007	784.1	741.3	(42.8)
Revenue Effort (Tot Rev/GDP)			
2006	16.2	16.2	0.0
2007	16.7	16.9	0.2
Total Revenues (P billion)			
2006	974.1	979.6	5.5
2007	1,118.8	1,118.8	(0.0)

An improvement in real economic growth is usually accompanied by expectations of higher tax revenue. Sensitivity indicators provided by the Department of Finance in 2007 indeed show that a one percentage point increase in real GDP growth would lead to an increase of P7.6 billion in revenues. However, adverse effects of other upbeat macroeconomic indicators—such as the decline in T-bill rates, lower inflation, and appreciation of the peso—tend to negate the positive impact of economic growth on potential revenues.

Using the DOF sensitivity indicators, the CPBD estimates that the approximate impact of the aforementioned economic variables (sans imports, since official targets were not released) on 2007 tax revenues is a decline of roughly P29.65 billion. With such ballpark figure, then almost P25 billion in the reduction of P54.6 billion in the assumed tax revenue target for 2007 would still have to be explained by import levies and the fiscal performance of the revenue generating agencies.

TABLE 2
SENSITIVITY OF 2007 REVENUES TO INDICATORS
IN BILLION PESOS

Particulars ¹	Revenues ¹	Possible Outcomes ²	Possible Impact on Revenues ³
P1 Depreciation in Foreign Exchange	1.9	Appreciation from P51 to ~P46.50	(8.55)
1% pt. (100bps) Increase in T-bill Rate	5.8	Decline from 5.5% to ~3.2%	(13.34) ⁴
1% pt. Decrease in Imports	(4.0)	Official targets were not released	-
1% pt. Increase in Inflation	7.2	Decline from 4.1% to ~2.6%	(10.8)
1% pt. Increase in Real GDP	7.6	Increase from 5.7% to 6.1%	3.04
	Approximate Impact on 2007 Revenues		(29.65)

¹ Sourced from 2007 Sensitivity Indicators, Department of Finance

² Based on low-end assumptions in the 2007 BESF and CPBD updated estimates/forecasts for 2007

³ CPBD approximations using 2007 Revenue Sensitivity Indicators from the Department of Finance and 2007 BESF macroeconomic low-end assumptions

⁴ Ballpark figure only because the BESF was using the 91-day T-bill rate as an assumption while the DOF released sensitivity figures using all maturities for the T-bill rate.

MACROECONOMIC OVERVIEW

Economic Performance. The 7.5% GDP growth in the second quarter of 2007, as reported by the National Statistical Coordination Board (NSCB), is the highest quarter-on-quarter growth recorded since 1986. It surpassed the 5.8% average forecast of firms surveyed by Bloomberg². The 7.5% GDP growth recorded in the second quarter, though lower than that of China (11.5%) and Singapore (8.6%), exceeded that of Hong Kong (6.9%), Indonesia (6.3%), Malaysia (5.7%), Taiwan (5.1%), and South Korea (4.9%).

The GDP growth in the second quarter drew much from the following sectors:

- *On the supply side*, the services sector, which makes up 49.8% of total GDP, contributed the most with 4.1 percentage points of the 7.5% GDP growth. The services sector grew by 8.4% in the second quarter from 5.7% last year. Key areas of growth in the services sector include finance (up by 11.8%), transportation, communication and storage (up by 9.8%), private services (up by 8.6%), and trade (up by 8.4%). In the industry sector, the construction, as well as, the mining and quarrying subsectors surged by 33.3% and 21.0% respectively, but had smaller contribution to the total growth since they represent only a combined 7.5% of GDP.
- *On the demand side*, Personal Consumption Expenditure, which accounts for 63.2% of GDP, improved by 6.0% from 5.4% last year. Investments in Fixed Capital Formation rebounded by 10% from a 1% drop in the previous year mainly due to an upsurge in public construction (which included continuing infrastructure projects not covered by the election ban) by 46.7% from 18.1% last year. Partly owing to the conduct of the elections, strong government spending, which rose 13.5% from 3.3% in the same quarter in 2006, buoyed GDP growth.

Nonetheless, while the GDP growth in the second quarter is remarkable, other key drivers of growth – agriculture and manufacturing where substantial gains in employment and value-added come from, slowed down.

- ***Slowdown in Agriculture.*** Coming from a 6.7% expansion last year, the agriculture sector slowed down to 3.9% in the second quarter of 2007. Despite the fact that the second quarter is usually a harvest period for major crops, palay production slowed down to 4.4% from 10.3% growth last year, and corn output even dropped by 2.5% compared to a 49.2% expansion in the same period last year. This may be due to the mild El Niño phenomenon experienced during the second quarter of 2007.

² Bloomberg is a financial information services company. The Bloomberg surveyed investment companies, which include among others Development Bank of Singapore, Standard Chartered Bank, UBS securities, etc., on their quarterly economic growth forecast of economies in Asia.

TABLE 3
ECONOMIC PERFORMANCE
(GROWTH RATE, %)

PARTICULARS	Semestral (YoY)		Quarterly (YoY)	
	2006H1	2007H1	2007Q1	2007Q2
<i>By Industrial Origin</i>				
Agriculture, Fishery & Forestry	5.3	4.0	4.1	3.9
Industry	4.9	7.2	6.3	8.0
Services	6.2	8.6	8.8	8.4
<i>By Expenditure Share</i>				
Personal Consumption Expenditure	5.3	6.0	5.9	6.0
Government Consumption	5.3	11.8	9.9	13.5
Capital Formation	0.9	7.5	6.9	8.2
Exports	17.2	6.8	9.9	4.2
Imports	2.5	-7.0	-2.1	-11.2
GDP	5.6	7.3	7.1	7.5
Net Factor Income from Abroad	14.9	15.6	14.5	16.6
GNP	6.4	8.0	7.7	8.3

Source: National Statistical Coordination Board

TABLE 4
COMPARATIVE GROWTH PERFORMANCE
(GROWTH RATE, %)

ECONOMIES	2006	2007Q1	2007Q2
Philippines	5.45	7.05	7.50
Malaysia	5.93	5.34	5.65
Indonesia	5.55	5.97	6.30
Thailand	5.23	4.26	4.70
Singapore	7.88	6.13	8.65
India	9.33	9.27	*
Korea	5.23	4.00	4.93
Taiwan	4.57	4.80	5.10
China	10.70	*	11.50
Vietnam	8.40	*	*

Source: Bangko Sentral ng Pilipinas

- **Weak Manufacturing Performance.** Manufacturing, which comprised 67% of the industry output, decelerated by 3.7% in the second quarter this year compared to the

4.2% gain last year. The weak manufacturing output could be explained by the continuous drop since the start of the year until June 2007 in the value of production index (VaPI) and the volume of production index (VoPI)—which can be gleaned from the results of the Monthly Integrated Survey of Selected Industries (MISSI) conducted by the National Statistics Office (NSO). The VaPI and VoPI declined on the average by 3.1% and 5.0%, respectively, in the second quarter. The decline in investments in manufacturing-related durable equipment which include among others sugarmill machineries (down by 76.7%), textile machineries (down by 28.9%), and sawmill and logging machineries (down 15.9%), could further weaken manufacturing over the medium-term.

- **Fragile Exports.** The exports sector substantially weakened as it registered a meager 4.2% growth compared to its 21.2% increase in 2006. The strong Peso partially explains the sluggish performance of the exports sector. Even food manufacturers voiced their concern over the adverse impact of the appreciating peso on their operations. Worse, merchandise exports that have huge local content—or those products where most of its raw materials are sourced domestically, plummeted during the period. These include among others: garments (down by 15.1%), crude coconut oil (down by 26.1%), centrifugal sugar (down by 100%), cathodes and section of cathodes of refined copper (down by 31%).

Economic Outlook in 2008. The proposed 2008 budget is based on a projected economic growth rate. In turn, the growth of the economy as measured by gross domestic product (GDP) is based on a set of macroeconomic assumptions such as inflation rate, oil price based on the Dubai rate, Treasury (T) bill rate, and the exchange rate.

TABLE 5
COMPARATIVE PHILIPPINE GDP GROWTH FORECAST

PARTICULARS	2007	2008
BESF / NEDA	6.1 – 6.7	6.1 – 6.8
CPBD	6.4 – 6.7	5.6 – 6.0
ADB	6.6	6.0
IMF	5.8	5.8
WB	5.6	6.0

Sources: BESF, NEDA Presentations, CPBD Staff Estimates
Various ADB, IMF, WB publications, pronouncements

The official GDP growth target range for 2008 is 6.1%-6.8%, almost similar to the target this year. Unlike in the past when the official target was often more optimistic than the forecast of three multilateral institutions, the projections by both the Asian Development Bank (ADB)

and the World Bank (WB) of a 6.0% GDP growth in 2008 is now lower by only 0.1 percentage point from the low-end official target. The forecast of the International Monetary Fund (IMF) is the most conservative at 5.8% which is similar to its 2007 forecast.

In view of the surprising macroeconomic developments in the first half of 2007 and the updated statistics from the NSCB, the CPBD has revised its 2007 growth projection by a full percentage point from its high-end projection in January 2007. The new 2007 forecast by the CPBD now ranges from 6.4%-6.7% which is higher than the 6.1% low-end official target but with the same upper-bound. For 2008, the CPBD reckons GDP growth to be within the 5.6%-6.0% range³. While the economy may be moving toward a higher growth path, the CPBD is concerned that the economy remains vulnerable to global downside risks in 2008 and could still be weighed down by domestic issues. Hence, it is worthwhile to reiterate the counsel in the World Economic Outlook (September 2006): *Policymakers ... should take advantage of the broadly favorable growth outlook to implement structural reforms aimed at promoting fiscal sustainability and reducing vulnerabilities.*

TABLE 6
CROSS-COUNTRY GDP GROWTH FORECAST

ECONOMIES	2006	2007			2008		
	Actual	ADB	IMF	WB	ADB	IMF	WB
Philippines	5.4	6.6	5.8	5.6	6.0	5.8	6.0
Indonesia	5.5	6.2	6.0	6.3	6.4	6.0	6.5
Malaysia	5.9	5.6	5.5	5.6	5.7	5.8	5.8
Thailand	5.0	4.0	4.5	4.3	5.0	4.8	4.5
Vietnam	8.2	8.3	8.0	8.0	8.5	7.8	8.0
<i>Advanced Economies</i>	3.1		2.5			2.7	
U.S.	3.3		2.2			2.8	
Japan	2.2		2.3	2.3		1.9	2.4
Euro Area	2.6		2.3			2.3	

Sources: WEO April 2007. IMF estimates may still change. It is expected to release its WEO update by end of this month. ADO 2007 Update, September 2007, and East Asia Update as of April 2007.

Across countries, the trend in the GDP growth forecast of ADB, IMF, and WB are similar. Vietnam is expected to be the fastest growing economy in the ASEAN next year with the ADB projecting it to grow by as high as 8.5%. Indonesia with an average GDP growth forecast of 6.3% follows Vietnam by a wide margin. The Philippines fares comparatively well with other ASEAN countries, with an average GDP forecast of 5.9% surpassing Malaysia's 5.8% and Thailand's 4.8%.

³ If the sectoral outlook continues to remain favorable, buoyant, and supportive of higher sectoral growth in 2008, this tight range could extend to a 6.2% GDP growth.

Sectoral Growth Assumptions. The CPBD's estimated GDP growth range of 5.6%-6.0% in 2008 represents a deceleration from its 6.4%-6.7% growth forecast this year, and is also lower than the official DBCC target of 6.1%-6.8%. With a projected net factor income growth of 8.9%-11.2%, the CPBD expects gross national product (GNP) to grow by 5.9-6.5% in 2008. The CPBD's growth projections were derived using a combination of forecasting, sectoral analysis, and programming techniques. Table 7 shows the details of the growth projections both by industrial origin and by expenditure shares.

TABLE 7
SECTORAL GROWTH ASSUMPTIONS

PARTICULARS	2006	2007			2008	
	Actual ¹	Actual H1 ¹	DBCC ² Targets	CPBD ³ Fcast	DBCC ⁴ Targets	CPBD ⁵ Fcast
<i>By Industrial Origin</i>						
Agriculture, Fishery & Forestry	3.8	4.0	4.0-4.8	3.3-3.9		3.8-4.2
Industry	4.5	7.2	6.3-6.8	6.3-7.0		5.2-6.0
Services	6.7	8.6	6.7-7.4	7.7-8.5		6.5-6.7
<i>By Expenditure Share</i>						
Personal Consumption Expenditure	5.5	6.0		5.7-5.9		5.8-5.9
Government Consumption	6.1	11.8		9.3-9.9		4.6-5.5
Capital Formation	2.7	7.5		5.0-7.0		1.1-2.2
Exports	11.2	6.8		6.2-8.4		6.3-8.6
Imports	1.9	-7.0		-4.2-(3.7)		6.7-8.8
GDP	5.4	7.3	6.1-6.7	6.4-6.7	6.1-6.8	5.6-6.0
Net Factor Income from Abroad	13.3	15.6		12.3-15.2		8.9-11.2
GNP	6.1	8.0	6.2-7.1	6.9-7.8	6.3-7.1	5.9-6.5

¹NSCB Update as of August 2007. The CPBD reported in a memo to the House Members dated 01 February 2007 the comparison between the CPBD forecast and the 2006 data initially released by the NSCB in January 2007. ²As of July 2007 ³Note that CPBD raised its forecast by a full percentage point from its high-end projection in January 2007 in view of the surprisingly unexpected 1st half 2007 economic performance ⁴The DBCC/NEDA have not released the sectoral assumptions underpinning the official 2008 growth targets ⁵CPBD Forecast as of September 2007 from simulations by the Congressional Economic Planning Service.

Supply Side.

Agriculture. The CPBD estimates the growth in agriculture in 2007 between 3.4% and 3.9%, which is lower than the 4.0% posted in the first half of the year. Factors that may curtail further expansion in the sector for the year include foot-and-mouth diseases that may adversely impact on hog production, the late planting season owing to the longer dry spell that could subsequently be exacerbated by the La Nina phenomenon, and the possible decrease in commercial fisheries production. On the other hand, expansion is foreseen for tropical fruits and aquaculture fisheries. In 2008, the CPBD expects agriculture to tread a path of 3.8%-4.2% subject to the usual vagaries of the weather.

Industry. The industry sector is estimated to slow down to 5.2%-6.0% next year. Although the Industry Sector output shot up by 7.2% in the first half of 2007, the deceleration in manufacturing is a concern. The manufacturing sector accounts for over 20% of the total domestic output. The decline in investments in manufacturing-related durable equipment in the second quarter does not indicate a positive outlook for the manufacturing sector in the medium-term. Further, an appreciating peso that could hurt exports would also impact adversely on manufacturing. High growth sub-sectors such as mining and quarrying have exhibited rather volatile growth in the past. Construction would still contribute to industry sector growth owing to demand from business process outsourcing (BPO) and residential developments stimulated in part by OFW remittances.

Services. While the services sector will continue to be the major driver of economic growth, it may cool down a bit next year. The CPBD expects the services sector to decelerate from 7.7%-8.5% in 2007 to 6.5%-6.7% next year. Finance, transportation, communication, and storage (TCS), and trade have been fuelling growth in the sector. Although some sectors have downplayed the impact of subprime mortgages in the U.S. credit market, risk aversion emanating from such adverse developments may yet have a bearing on the local finance sub-sector. The TCS sub-sector will not have an “election engine” in 2008 but a more robust BPO industry would serve in good stead. Private services is an emerging growth area. Tourism, particularly medical tourism, should be tapped as these also generate employment.

➤ *Demand-Side.*

Personal consumption expenditure is expected to sustain its growth in 2008 and will continue to propel growth on the demand side. As demand for Filipino workers overseas remain strong, the hefty inflow of remittances will continue to boost private spending. However, other than an appreciating peso hurting OFWs and higher oil prices dampening consumer spending, growth fueled by remittances is a double-edged sword since any upheaval in foreign shores could affect OFWs and easily translate adversely on consumption expenditure. Even without drastic change, remittances used for consumption is not growth-sustaining, hence the call continues for tapping remittances for capital formation or development projects.

Government Consumption is expected to taper off to its usual growth path without the added push from election spending.

Investment (capital formation) figures have tended to be erratic. Though the CPBD forecast indicates a slowdown in 2008, public construction projects and private sector investment in construction may yet continue to shore up capital formation next year.

Exports would continue to be affected by developments in the global economy, especially the downturn in the U.S. and the slowdown in Europe. The expected moderation in exports growth from its two-digit growth last year is likely to be maintained in 2008. The continued strengthening of the peso against the US dollar, which tends to make local goods and services more expensive to the rest of the world, is another factor that does not augur well for exports. *Imports* growth is expected to recover in 2008 from a possible contraction this year.

FACTORS AFFECTING ECONOMIC PROSPECTS

➤ *Inflation Rate.* Price movement has been on the downtrend since the start of the year from 4% in January to 2.6% in August bringing the total average inflation rate for the first eight months to 2.6%. The supply of food, which accounts for over 50% of the inflation basket, has been generally stable throughout the year. To some extent, the strong peso has also contributed to the moderation in the movement of prices.

The DBCC forecasts inflation rate to slow down to 2.6%-3.1% this year and will slightly go up to 3%-4% in 2008. The forecast of CPBD nearly matches that of the DBCC for this year but the inflation rate projection of CPBD will increase to 3.8%-4.2% for 2008.

TABLE 8
FACTORS AFFECTING ECONOMIC PROSPECTS

PARTICULARS	2006	2007		2008	
	Actual	DBCC ¹	CPBD ²	DBCC ¹	CPBD ²
Inflation Rate, CPI (2000=100)	6.2	2.6 – 3.1	2.6 – 3.0	3.0 – 4.0	3.8 – 4.2
Dubai Oil Price (US\$/Barrel)	61.48	61 – 64	61.75 – 67.75	62 – 70	73 – 83
91-day Treasury Bill (%)	5.4	3.1 – 3.9	3.1 – 3.9	4.0 – 5.0	4.0 – 4.8
Exchange Rate (P:\$)	51.31	46 – 48	45.50 – 47.50	46 – 48	43 – 45

Notes: ¹Per BESF 2008

²As of September 2007

➤ *Dubai Oil Price.* Since the start of the year, the price of Dubai oil has been steadily increasing from \$51.53 per barrel in January to \$73.35 in September. With the expected

increase in demand for the winter season, analysts predict that price may exceed \$80 per barrel by year-end.

As of September, actual Dubai oil price is already way beyond the DBCC forecast of \$61.00-\$64.00 per barrel for this year including its 2008 forecast of \$62.00-\$70.00 per barrel. Even the high-end of the CPBD forecast of \$61.75-\$67.75 has been surpassed as early as July 2007. For 2008, the CPBD projects the Dubai oil price to average between \$73.00 and \$83.00 per barrel. There are expectations though that a global slowdown might just cool down demand that would corollary lead to a softening in oil prices.

- *91-day Treasury Bill.* The DBCC forecasts the benchmark interest rate in 2008 to range 4%-5%, about one percentage point higher than its forecast for 2007. The CPBD also expects the interest rate to increase to 4.0%-4.8% in 2008 from 3.1%-3.9% this year. The continued strengthening of the peso, however, may necessitate further cuts in interest rate.
- *Exchange Rate.* The CPBD is again a little more optimistic than the DBCC in the expectations of the P/\$ rate both for this year and next year. The DBCC maintained its 2007 foreign exchange forecast of P46.00-P48.00:\$1.00 for 2008. The CPBD, on the other hand, forecasts further strengthening of the peso in 2008 to P43.00-P45.00:\$1.00 from its updated projection of P45.50-47.50:\$1.00 for this year.

Stronger inflow of remittances expected from the increasing number of workers going abroad will support a strong peso. The adverse impact of a strong peso should, however, be checked. As of the first week of October, the peso closed at P44.75 against the dollar. Expectations of further strengthening to P40:\$1 may force companies to shut down. For instance, about 30% of food exporters in the country have already scaled down their operation.⁴

⁴ Jennifer A. Ng. *Peso hurts food exporters.* *Business Mirror*. 8 October 2007.

	OFFICIAL		CPBD SCENARIOS BASED ON:			
	BESF TARGETS /		CPBD-assumed		CPBD-assumed Tax	
	ASSUMPTIONS		GDP Growth Rates		and BIR efforts	
Real GDP Growth Rate						
2007	6.1	6.7	6.4	6.7	6.4	6.7
2008	6.1	6.8	5.6	6.0	5.6	6.0
Nominal GDP (P billion)						
2006	6,032.6		6,032.6	6,032.6	6,032.6	6,032.6
2007	6,609.7	6,844.2	6,628.7	6,841.3	6,628.7	6,841.3
2008	7,284.7	7,704.1	7,272.0	7,645.7	7,272.0	7,645.7
Tax Effort (Tax/GDP)						
2007	14.73		14.73	14.73	14.23	14.23
2008	15.22		15.22	15.22	14.89	14.89
Tax Revenues (P billion)						
2007	973.58		976.37	1,007.69	943.21	973.46
2008	1,108.89		1,106.96	1,163.84	1,082.61	1,138.24
BIR Effort (BIR/GDP)						
2007	11.21		11.21	11.21	10.81	10.81
2008	11.60		11.60	11.60	11.25	11.25
BIR Revenues (P billion)						
2007	741.27		743.40	767.24	716.27	739.24
2008	844.95		843.48	886.82	818.32	860.37
BOC Revenues (P billion)						
2007	223.25		223.89	231.07	217.59	224.57
2008	254.48		254.04	267.09	254.48	267.56
Non-Tax Revenues (P billion)						
2007	145.19		145.61	150.28	148.99	153.76
2008	127.34		127.12	133.65	140.31	147.52
Revenue Effort (Tot Rev/GDP)						
2007	16.93		16.93	16.93	16.48	16.48
2008	16.97		16.97	16.97	16.82	16.82
Total Revenues (P billion)						
2007	1,118.77		1,121.98	1,157.97	1,092.20	1,127.23
2008	1,236.23		1,234.08	1,297.49	1,222.93	1,285.77
Total Disbursements						
2007 Disbursements (P billion)	1,181.76		1,181.76	1,181.76	1,181.76	1,181.76
2008 Disbursements (P billion)	1,236.23		1,236.23	1,236.23	1,236.23	1,236.23
Estimated Deficit						
2007 Deficit (P billion)	(62.99)		(59.78)	(23.79)	(89.56)	(54.53)
Ratio to GDP	(0.95)		(0.90)	(0.35)	(1.35)	(0.80)
2008 Deficit (P billion)	-		(2.15)	61.26	(13.30)	49.54
Ratio to GDP			(0.03)	0.80	(0.18)	0.65

ECONOMIC AND FISCAL SCENARIOS

Under the official low-growth scenario of 6.1% real GDP growth both in 2007 and 2008, the government's deficit reduction strategy is hoped to achieve balanced budget by 2008 coming from a deficit target of P63 billion in 2007. With upbeat prospects for the macroeconomy, the realization of a balanced budget would hinge essentially on fiscal performance.

Assuming the official tax and revenue efforts, even the CPBD's low-growth scenario of 6.4% GDP growth in 2007 and 5.6% in 2008 would most likely yield deficit estimates of P59.8 billion (0.9% of GDP) in 2007 and P2.15 billion (or only 0.03% of GDP) in 2008.

The same official tax and revenue efforts coupled with the CPBD's high-growth scenario of 6.7% and 6.0% in 2007 and 2008, respectively, may lead to a projected surplus of P61.3 billion. Even if the CPBD's conservative tax and revenue efforts were applied on its high-growth scenario, the result could still be an almost P50 billion surplus in 2008.

Only with a combination of the CPBD's low-growth assumptions and conservative tax and revenue efforts would the CPBD's estimated deficit outcomes of P89.6 billion in 2007 and P13.3 billion in 2008 be worse than the official deficit targets. However, the CPBD's projected deficit for 2007 is higher than the official target of P63 billion even when its low GDP growth assumption of 6.4% is higher than the BESF target of 6.1%. This, in effect, would imply that fiscal performance is a key factor in meeting deficit targets or even the planned balanced budget in 2008.

CONCLUSION

Attainment of the macroeconomic assumptions used in putting together the 2008 budget is crucial in the realization of the fiscal targets. While the DBCC growth target translates to a balanced budget by next year, this hinges primarily on the pursuit of continued fiscal reform and enhancing fiscal performance. Sustaining the better-than-expected macroeconomic performance may even lead to a surplus as early as next year. However, the caveat to this scenario remains to be determined essentially by fiscal considerations.

While macroeconomic fundamentals appear to be strong overall, it is imperative to sustain the growth momentum. As yet, there remains a host of factors that may adversely impact on the economic gains.

Volatility of oil prices will remain to be a major issue in the long-term. While supply will remain relatively stable, the growing demand for oil particularly by big countries such as China and India will push prices at a higher level.

Expectation of further strengthening of the peso, which clearly has benefits, has also adverse effects on some sectors of the society. There is a need to strike a balance to mitigate the negative impact on the economy.

Investment growth in the first semester was due to the substantial public construction investment. Sustainability of this investment hinges on the attainment of fiscal targets to preclude continuing recourse to debt. On the other hand, private construction investments while showing signs of picking up remain weak. The inflow of private sector investment is a very important factor in the attainment of the growth targets. As such, there is need to improve the investment climate in the country by addressing pressing concerns on power, transport cost, policy stability, as well as reducing the cost of doing business in the country by limiting venues for corruption and red tape.

Addressing the critical issues is imperative. Reform efforts on the fiscal front will also help support the achievement of the macroeconomic assumptions which underpin the fiscal year 2008 national budget. In the end, a well-crafted development-oriented budget could serve as one of the means of ensuring that the benefits of improving macroeconomic fundamentals redound to the Filipino people.

**SENSITIVITY OF THE BUDGET TO MACROECONOMIC ASSUMPTIONS
AS PROVIDED BY THE EXECUTIVE***

The fiscal program is highly sensitive to the movement of four major macroeconomic indicators – exchange rates, interest rates, imports and real GDP growth. The table below summarizes the impact of each variable to revenues and disbursements and, consequently, to the budget deficit.

TABLE X
Sensitivity Indicators, 2008, (In Billion Pesos)

Particulars	Revenues	Disbursements	Deficit ¹
P1 appreciation in Foreign Exchange	(2.7)	(4.1)	1.4
1% point (100 bps) decrease in T-bill Rate ²	(5.8)	(4.7)	(1.1)
1% point increase in imports	4.0	0.0	4.0
1% point increase in inflation	10.5	0.0	10.5
1% point increase in real GDP	10.8	0.0	10.8

1/ A positive figure indicates a decrease in the deficit while a negative figure means an increase in the deficit.

2/ All maturities

Source: Department of Finance

Foreign Exchange Rate. The appreciation of the peso against the dollar has both positive and negative effects on the economy. It makes the country's exports less competitive while it makes imports cheaper. On the fiscal side, it reduces revenues from the lower peso proceeds from import taxes but also lessens expenditures through lower debt payments and decreases in other foreign exchange sensitive expenditures. DOF estimates show that a peso appreciation in foreign exchange will lessen revenues by P2.7 billion while also lowering expenditures by P4.1 billion.

Interest Rate. Lower T-bill rate, likewise, affects the fiscal position in two ways. It lessens revenues through lower withholding tax on interest income but also lessens disbursements through lower interest payments from domestic borrowing. Estimates show that a one-percentage point (100 basis points) decrease in the T-bill rate of all maturities would decrease both revenues and disbursements by P5.8 billion and P4.7 billion, respectively.

Imports. Revenues derived from international trade through import duties and taxes account for almost 20% of total revenues. Thus, an increase in imports would have impact positively on total revenue collections. Estimates show that a one-percentage point hike in imports would increase revenue collections by P4.0 billion.

Gross Domestic Product. The GDP is used as general indicator of a revenue base. When it increases, revenues would also rise assuming a constant revenue effort. Estimates show that a one-percentage point increase in real GDP growth rate would increase revenues by P10.8 billion, thereby reducing the deficit by the same amount.

GROSS NATIONAL PRODUCT and GROSS DOMESTIC PRODUCT
Actual 2002-2006 and CPBD Growth Scenarios: 2007 Update and 2008 Forecast

By Industrial Origin at Constant 1985 Prices, 2002-2008

	2002	2003	2004	2005	2006	2007 Revised Forecast*		2008 Forecast*	
						Low	High	Low	High
<i>(In billions of pesos)</i>									
Agriculture, fisheries and forestry	207.5	215.3	226.4	231.0	239.8	247.7	249.2	257.2	259.7
Nonagriculture	826.6	869.8	927.9	979.5	1,036.6	1,110.5	1,118.2	1,177.2	1,190.3
Industry	349.5	363.5	382.4	396.9	414.9	441.0	443.8	464.0	470.6
Services	477.1	506.3	545.5	582.6	621.7	669.4	674.4	713.2	719.7
Gross domestic product	1,034.1	1,085.1	1,154.3	1,210.5	1,276.4	1,358.2	1,367.4	1,434.4	1,450.0
Net income from abroad	71.6	81.8	88.8	108.6	123.1	138.2	141.8	150.5	157.7
Gross national product	1,105.7	1,166.9	1,243.1	1,319.1	1,399.5	1,496.4	1,509.2	1,584.9	1,607.6
<i>(Percentage change from previous year)</i>									
Agriculture, fisheries and forestry	4.0	3.8	5.2	2.0	3.8	3.3	3.9	3.8	4.2
Nonagriculture	4.6	5.2	6.7	5.6	5.8	7.1	7.9	6.0	6.4
Industry	3.9	4.0	5.2	3.8	4.5	6.3	7.0	5.2	6.0
Services	5.1	6.1	7.7	6.8	6.7	7.7	8.5	6.5	6.7
Gross domestic product	4.4	4.9	6.4	4.9	5.4	6.4	6.7	5.6	6.0
Net income from abroad	0.5	14.3	8.5	22.3	13.3	12.3	15.2	8.9	11.2
Gross national product	4.2	5.5	6.5	6.1	6.1	6.9	7.8	5.9	6.5

By Expenditure Shares at Constant 1985 Prices, 2002-2007

	2002	2003	2004	2005	2006	2007 Forecast*		2008 Forecast*	
						Low	High	Low	High
<i>(In billions of pesos)</i>									
Consumption	883.3	928.0	979.3	1,024.2	1,080.6	1,145.5	1,147.1	1,210.3	1,213.9
Private	810.8	853.6	903.8	947.6	999.2	1,056.5	1,057.7	1,117.3	1,119.6
Government	72.5	74.4	75.5	76.7	81.4	89.0	89.4	93.0	94.3
Investment	212.1	218.4	234.1	213.5	219.3	230.3	234.7	232.9	239.9
Domestic demand	1,095.4	1,146.4	1,213.3	1,237.8	1,299.9	1,375.8	1,381.8	1,443.2	1,453.9
Exports of goods and services	447.7	469.5	540.0	565.7	629.1	668.1	682.2	710.1	740.6
Imports of goods and services	536.5	594.6	628.9	643.8	655.8	628.4	631.8	670.3	687.2
Statistical discrepancy	27.6	63.7	29.9	50.8	3.3	-57.3	-64.7	-48.7	-57.4
Gross domestic product	1,034.1	1,085.1	1,154.3	1,210.5	1,276.4	1,358.2	1,367.4	1,434.4	1,450.0
Net income from abroad	71.6	81.8	88.8	108.6	123.1	138.2	141.8	150.5	157.7
Gross national product	1,105.7	1,166.9	1,243.1	1,319.1	1,399.5	1,496.4	1,509.2	1,584.9	1,607.6
<i>(Annual percentage change)</i>									
Consumption	3.4	5.1	5.5	4.6	5.5	6.0	6.2	5.7	5.8
Private	4.1	5.3	5.9	4.8	5.5	5.7	5.9	5.8	5.9
Government	-3.8	2.6	1.4	1.6	6.1	9.3	9.9	4.6	5.5
Investment	-4.3	3.0	7.2	-8.8	2.7	5.0	7.0	1.1	2.2
Domestic demand	1.8	4.7	5.8	2.0	5.0	5.8	6.3	4.9	5.2
Exports of goods and services	4.0	4.9	15.0	4.8	11.2	6.2	8.4	6.3	8.6
Imports of goods and services	5.6	10.8	5.8	2.4	1.9	-4.2	-3.7	6.7	8.8
Gross domestic product	4.4	4.9	6.4	4.9	5.4	6.4	6.7	5.6	6.0
Net income from abroad	0.5	14.3	8.5	22.3	13.3	12.3	15.2	8.9	11.2
Gross national product	4.2	5.5	6.5	6.1	6.1	6.9	7.8	5.9	6.5

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