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Selling the Philippines short ??

Back in October 2005 we mentioned in our article that *many Filipinos tend to undermine themselves or sell their own country short.* Despite all the positive things that have been happening, a lot of Filipinos remain hypercritical. It is therefore not surprising that what was highlighted in the media last week was the State of Emergency declaration and not the attempted coup d'etat. But what is more alarming than some groups trying to overthrow the government thru violent means?

We believe, however, that the investment community has looked beyond all these political distractions and has simply focused on the positive long-term fundamentals of the country. And just as we predicted in our column titled ***"Failed coups and the stock market"*** last week, our market continues to be resilient. In fact, it ended up 4% higher compared to the low established during the day of the preempted coup – making it a losing proposition for those investors who decided to sell the Philippines short.

Philippine economy … resurrected

While many choose to remain "doubting Thomases", we in Philequity, believe that the Philippine economy has long been resurrected for the following reasons:

1) **The fiscal recovery story remains intact**

   - 2005 budget deficit of 2.8 percent of GDP beating initial target of 3.4 percent and revised target of 3.0 percent of GDP. In just three years, the deficit to GDP ratio was nearly halved from a peak of 5.3 percent in 2002.

   - The budget deficit is expected to fall for the fourth consecutive year following the implementation of 2nd phase of EVAT. This should allow the government to easily meet its 2006 deficit target of 2.1 percent of GDP.

   - The primary surplus (which is computed by netting out interest payments in the fiscal balance) is expected to hit 3.4 percent of GDP. This should allow the government to reduce its debt to GDP ratio which will further boost the country's creditworthiness.

2) **The external sector (capital and current accounts) continues to be the country's major strength**

   - Current accounts surplus of $1.2 billion as of Sept 2005, up 106% from the previous year. OFW Remittances, which reached $10.7 billion in 2005, continue to post double digit growth.

   - Capital accounts surplus of $2.5 billion as from Jan-Sept 2005 compared to a deficit of $407 million in Jan-Sept 2004. Net foreign portfolio investments surged 332 percent to $2.1 billion in 2005. Foreign direct investments was up 64 percent to $863 million as of October 2005.

- The strong current accounts and capital accounts pushed overall BOP position to a surplus of $2.4 billion in 2005 compared to a deficit of $280 million in 2004.

- This year, the government has successfully sold 1.5 billion USD and 500 million Euro bonds in January. Net foreign portfolio investments reached $513m in February after the successful IPO of First Gen Corporation and additional offering of Universal Robina Corp.

3) Key macro indicators remain bullish

- The peso is already up 3.6 percent year-to-date against the US dollar, following a 5.7 percent appreciation in 2005. We have previously indicated an exchange rate target of P50:$1. Now, even foreign houses are coming out with more bullish targets for the peso. Goldman Sachs reportedly is eyeing a one-year target of P48:$1 and HSBC was recently quoted as saying that the peso could strengthen to P47.50:$1 by 4Q06 if government's revenue targets would be hit.

- The stock market, which is a leading indicator of the Philippine economy, has gained for three consecutive years (+41.6 percent in 2003, +26.4 percent in 2004, +15 percent in 2005).

- There is no major threat on the inflation front (6.7 percent in January). The stronger peso will help mitigate the one-off upward price adjustment of the EVAT, and at the same time, it will continue to limit the pass-through of high oil prices into domestic inflationary expectations.

- Interest rates are at historic lows. The yield on the benchmark 91-day Treasury bills, for example, fell to as low as 4.86 percent in January. Meanwhile, 25-year bond issued at the start of the year was priced at 7.875 percent coupon, a far improvement from the 25-year bond issued in 2005 which was priced at 9.5 percent.

4) Financial sector reforms are ongoing

- The non-performing loans (NPLs) of banks are at 8-year lows, 8.51% of total loans as of end-2005. Non-performing assets (which includes foreclosed assets) are at 8.62% of total assets as of end-2005, down from 11.41% in end-2004.

- NPL coverage improved to 78.35% from 60.4% the previous year. NPA coverage improved to 42.12% from 35.56% the previous year.

- The SPV is extended for another two years which should allow for continued cleanup of balance sheets.

5) Investment community (both foreign and local) and credit rating agencies see room for upgrade

- Standard and Poor's and Fitch Ratings upgraded the outlook for the country's credit rating from negative to stable following the implementation of the 2nd phase of EVAT in February.

- Positive assessments also came from Wilshire Associates (the consulting firm of US pension fund CALPERS) which upgraded the country's investment standing. In addition, the Japanese credit rating agencies such as Japan Credit Rating Agency (JCRA) and the Rating & Investment Information Inc. (RII) are also expected to issue favorable reviews.

- In the domestic front, the latest Business Expectations Survey (BES) outlook – which covered businesses in NCR and select areas outside NCR – showed that the business sector is very optimistic for the first two quarters of 2006. The survey also showed that sentiment across all sectors is bullish.

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