PHILEQUITY CORNER

Tax reform measures - crucial in sustaining momentum of positive confidence

Global investors are slowly placing the Philippines back into their radar screens given the tax reform measures being put in place.

Last week, the Philippines sold $1.5bn in 25-year dollar-denominated bonds last week. This is the single biggest debt sale so far after the issue sized was increased by 50% as investors ordered five times over the initial offer size.

Meanwhile, the Philippine stock market is so far the best performing market in the region since the start of 2005. It gained 10.5% so far as foreign investors poured in $205m during the first four weeks. This is already 70% of last year's figure. At the same time, the average daily traded value in the Philippine Stock Exchange surged to P1.9bn since the start of the year compared to only P836m in 2004.

This long rally in Philippine stocks has long been awaited. Most other countries in the region are already trading above or near their highs prior to the Asian crisis in 1997. So, even at current levels the Phisix is still far from its 1997 high.

Selected Asian Stock Market Indices	1997 High	2/1/2005 Current	%Chg
Indonesia (JCI)	740.83	1,047.53	41%
South Korea (KOSPI)	792.29	923.69	17%
Singapore (STI)	2,252.46	2,094.65	-7%
Thailand (SET)	858.97	708.73	-17%
Malaysia (KLSE)	1,278.94	916.27	-28%
Philippines (PHISIX)	3,447.60	1,992.46	-42%

Source: Bloomberg

Likewise, the peso also fared well against the US dollar since the start of the year, appreciating to as high as P55.03:$1 from P56.28 as of end-2004. The global weakening of the US dollar coupled with the steady inflow of OFW remittances is causing the peso to appreciate. And if the fiscal worries continue to dissipate, this in turn will lead to an inflow of foreign capital, which in turn leads to further appreciation in the peso.

Looking again at the countries hit during the '97 Asian crisis, most of their currencies have already recovered substantially, except the Philippines.

Selected Asian Stock Market Indices	1997 High	2/1/2005 Current	%Chg
Indonesia (JCI)	740.83	1,047.53	41%
South Korea (KOSPI)	792.29	923.69	17%
Singapore (STI)	2,252.46	2,094.65	-7%
Thailand (SET)	858.97	708.73	-17%
Malaysia (KLSE)	1,278.94	916.27	-28%
Philippines (PHISIX)	3,447.60	1,992.46	-42%

Source: Bloomberg

Even from 2004, the Thai baht has already appreciated by 7% against the US dollar. Likewise, the Euro & the Japanese Yen went up by 10% against the US dollar from their lows last year. So, an exchange rate at P50:$1, which is just 11.4% off all-time lows, is not that far-fetched.

Selected Currencies vs. USD (2004 - Current)	2004 Low	2/1/2005 Current	Currency Appreciation
Korean Won	1210.4	1,027.90	15%
Euro	1.18	1.30	10%
Japanese Yen	114.67	103.70	10%
Thai Baht	41.7	38.60	7%
Singaporean Dollar	1.76	1.64	7%
Indonesian Rupiah	9570	9,213.70	4%
Philippine Peso	56.45	55.00	3%
Malaysian Ringgit	3.87	3.80	2%

Source: Bloomberg

We believe that the single biggest deterrent to foreign capital right now is the perceived high sovereign risk due to the problems in public finances. If Congress gets its act together and pass the remaining tax measures, we see the growing positive confidence towards the Philippine economy by domestic and foreign investors alike being sustained.

BULLISH on the Philippines assuming this reforms are passed.

So far, everything is falling into place. The domestic economy, which probably expanded 6.2% last year, is growing at its fastest rate in 15 years. The current account is in surplus. Interest rates are stable despite rising inflation. The peso is appreciating against the US dollar.

On the fiscal side, the 2004 budget deficit was way below target. Two crucial fiscal reform bills have been passed. The Napocor privatization is on track. If the government continues to play its cards right and eventually get its grip on its finances, we see a pickup in foreign direct investments and significant foreign portfolio inflows.

Assuming that the remaining fiscal reform measures are passed , we expect the P/$ rate to continue to appreciate to P50/$1 on the back of increasing investor confidence and the appreciation of regional currencies against the US dollar. As the peso strengthens and attracts more foreign capital, we expect the PHISIX to reach 2,660 and the value traded on the PSE to expand to P3bn-P4bn daily from the current P1bn-P2bn. We maintain our OVERWEIGHT recommendation on the market.