Philequity Corner
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IT'S TIME TO MAKE MONEY

You should be buying Philippines now! After evaluating all the risks and the rewards, we maintain our BUY recommendation on Philippine assets.

A word of caution. People mistake our recommendation as short-term in nature but we are actually buying for the long-term. It is hard to predict what will happen tomorrow, next week or even next month but it is clear to us that the long-term trend is up. We see a clear path towards fiscal revitalization and sustained economic upturn.

Philippine assets are on the way up and you should be buying ROPs, Philippine debt papers, equities and the Peso.

THUMBS UP ON OCTOBER FISCAL STATS

The market welcomed the October budget figures released last Thursday, closing on a high note on Friday with the PHISIX up by 23.85 pts or 1.2 percent. While the effects of the first phase of the EVAT (removal of exemptions on oil and power, increase of corporate income tax from 32% to 35%) have yet to kick in, the government's fiscal performance, nonetheless, have beaten expectations month after month.

Below are the highlights of the government fiscal performance in October:

1) The October budget deficit came in at P7.1 billion, beating the target of P10 billion set for the month.
2) Both the BIR and Customs exceeded their monthly targets. Tax revenues were up 20.8 percent year-on-year, while customs collections grew 29.2 percent.
3) The deficit for the first 10 months of 2005 amounted to P115.5 billion, down 21.8 percent year-on-year and well within the full-year target of P180 billion.
4) The primary surplus surged 91.8 percent to P151.4 billion.
5) Notable is the increase in expenditures by 18 percent in October. This signals a likely policy shift to reduce government under-spending and boost GDP over the next few quarters to ease the impact of the EVAT implementation.

National Government Fiscal Performance

	October Pm	%Chg Year-on-year	Jan-Oct Pm	%Chg Year-on-year
Revenues	71.7	18.4%	661.2	14.6%
BIR	47.5	20.8%	440.4	14.9%
BOC	13.6	29.2%	116.7	14.1%
BTr	6.0	-2.9%	60.0	15.7%
Others	4.6	0.5%	44.0	11.0%
Expenditures	60.6	18.3%	776.7	7.2%
Fiscal Surplus / (Deficit)	(7.1)	21.4%	(115.5)	-21.8%
Primary Surplus / (Deficit)	24.6	6.4%	151.4	91.8%

Source: Bureau of Treasury

Given the results above, the government is clearly ahead of the game and the market reacted positively. Investors are now looking forward on news regarding the revenue take coming from the VAT on fuel and power which will only be reflected this November.

ON TRACK TOWARDS A BALANCED BUDGET BY END-2008

Annualizing the fiscal deficit during the Jan to Oct period amounts to around P140 billion or 2.6% of GDP. Even if the government will be more lenient on spending cuts going towards the Christmas season, we expect the deficit to GDP ratio to be cut to 2.8% in 2005 from 3.9% in 2004. Note that in just three years, the government is on its way of halving the debt to GDP ratio from a high of 5.3% in 2002. If this positive trend continues (on the assumption that the 2% VAT rate increase is implemented the soonest next year), we may see a balanced budget in another three years which is in line with the government's target of zero deficit by end-2008.

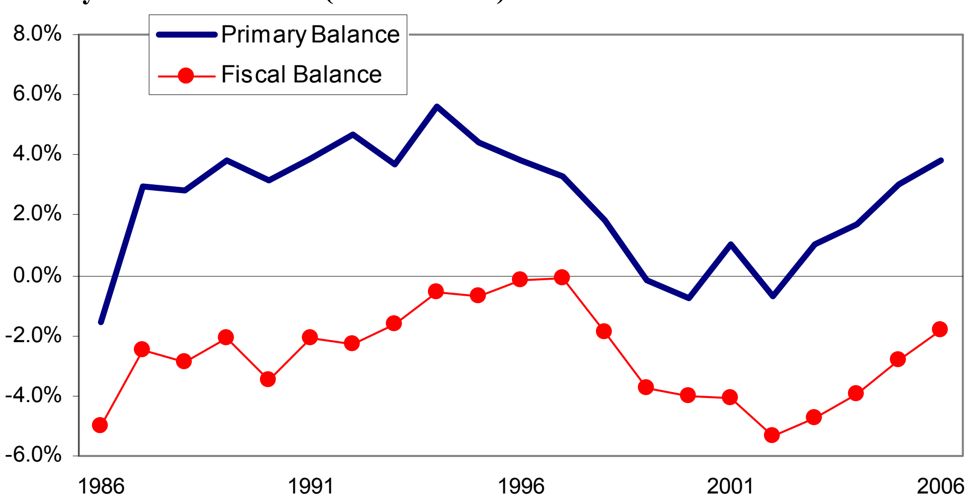
LOWERING THE DEBT STOCK

Having a large primary surplus is vital to a sustainable fiscal recovery. It is computed by netting out interest payments in the computation of the fiscal balance. The recent data show that the primary surplus surged 92% to P151.4bn during the period Jan to Oct 2005 (as seen in the table above). At this rate, we expect the primary surplus to hit 3% of GDP this year and 3.8% of GDP by 2006 (upon full implementation of the EVAT).

We reckon that the government needs to maintain 4% to 5% of primary surplus in order to reduce its outstanding debt stock which stood at P3.81 trillion or 80.4% of GDP as of end-2004.

Looking back, the Ramos administration was successful in reducing the debt-to-GDP ratio from 77% in 1992 to 54% in 1996 by running an average primary surplus of 4.5% during the period.

Primary & Fiscal Balance (as % of GDP)



Source: Dept. of Finance, Bureau of Treasury

2% VAT HIKE – GOOD TO GO BY FEB 1, 2006

Last week, Finance Secretary Gary Teves and National Treasurer Omar Cruz assured market that the 2% VAT hike will be implemented in February 1. This affirms the government's resolve to push through with the final phase of the EVAT law and removes any doubt in investors' minds that the delay is a result of lack of political will.

Although one month short of the original target, raising the VAT rate from 10% to 12% in February 1 ensures that the government follows the law as two conditions need to be met before the President can implement it. First is that the deficit to GDP ratio must be greater than 1.5%. Second is that VAT collections as a percentage to GDP must be greater than 2.8%. These figures, however, are set to come out only by late January. The delay, therefore, is not pertinent and should not be a cause of concern.

For comments and inquiries, you can email us at gime10000@yahoo.com or info@philequity.net