Philequity Corner (December 18, 2017)
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All aboard

Last week, the first package of government's comprehensive tax reform program was ratified by the bicameral committee of Philippine lawmakers. This caused the PSEi to go up 1.2% last Thursday and close at 8,461 on P1.1b of net foreign buying.

TRAIN – full steam ahead

Finance Secretary Sonny Dominguez confidently stated last week that "we are now ready for the TRAIN (Tax Reform for Acceleration and Inclusion) to leave the station." He thanked the Congress and Senate for ratifying TRAIN and said that this is "a great Christmas and New Year's gift that the government will give to the Filipino people." The personal income tax cuts will boost the spending power of millions of Filipinos and stimulate domestic consumption, the primary driver of our economy.

TRAIN to fuel government spending

The TRAIN bill is now up for President Duterte's signature. This means that it can be implemented starting January 1, 2018. Net revenues from the tax measure will ensure that the government maintains fiscal responsibility even as it undertakes a programmed increase in infrastructure spending. Below, we enumerate the main provisions of the ratified TRAIN bill.

- Cuts on personal income tax rates except for the highest income bracket
- Higher taxes on oil, coal and mining
- Higher taxes on certain automobile purchases
- Higher taxes on sugar sweetened beverages and tobacco products
- Increased taxes on various passive income and investment transactions

Stronger and more inclusive growth

Admittedly, the tax package is not perfect as there are some sectors that will be negatively affected. Nonetheless, TRAIN is a net positive for the economy as it will support the government's goal of promoting stronger and more inclusive growth. Net revenues from TRAIN will be spent on improving basic services to the poor. Meanwhile, cuts on personal income taxes are expected to increase the spending power of Filipinos, especially those in the lower income segments. These, coupled with improved access brought by better infrastructure, should give rise to a stronger and bigger middle class that will bolster economic growth.

Markets reward fiscally responsible governments

Financial markets generally reward countries that implement structural reforms and practice good fiscal management. Time and again, we have witnessed how countries benefitted from rerating when fiscal reforms were implemented. In Chapter 5 of our book entitled "Fiscal Reform in the Philippines", we described the positive impact brought by the implementation of the expanded value-added tax (eVAT) in 2005. The implementation of TRAIN is likewise expected to result in a rerating of the PSE Index on expectations of stronger economic growth. In fact, international debt watcher Fitch Ratings upgraded our country's credit rating last week.

Winners and losers

Consumer and retail stocks such as SM Investments (SM), SM Prime Holdings (SMPH), Robinsons Retail Holdings (RRHI), Puregold (PGOLD) and Jollibee (JFC) have performed well this year as they are direct beneficiaries of higher consumer spending. Banking and property stocks have likewise rallied as they are expected to benefit from buoyant domestic consumption and stronger economic growth. Meanwhile, Universal Robina Corp (URC) and GT Capital Holdings (GTCAP) lagged the market because of concerns that they will be affected by higher taxes on sugary sweetened beverages and automobile purchases. However, both stocks recovered as the proposed taxes to their respective products were not as bad as expected in the final version. Lastly, coal and mining stocks fell because of the substantial increase in coal and mining taxes.

Contributing our share

The stock market was likewise hit by higher taxes. The stock transaction tax was raised from 0.5% to 0.6%, thereby increasing the friction cost of equity transactions. The PSE noted that the country's stock transaction tax is already the highest in the region even before any increase.

Not enough?

Last Friday, the stock market corrected due to last minute selling caused by the FTSE rebalancing. Moreover, market sentiment was dampened when news filtered out that revenues from TRAIN would only correspond to 2/3 of the DoF's proposed revenue target.

TRAIN and more

Though initial estimates may not meet the DoF's target, it is worth noting that the government is not the only entity that will shoulder all the funding. Below, we enumerate other modes that the government can undertake to bolster funding for infrastructure spending.

- Private sector participation via Private-public partnerships (PPPs)
- Asset securitization and listing of PPPs in the PSE
- Government borrowings via official development assistance (ODA) with other countries
- Bond issuances by the Philippine government or the project proponents
- Loans from the country's major banks which are ready and willing to finance big-ticket projects

With the availability of various modes of funding, the focus should now be on the efficient roll-out of the government's infrastructure program and the timely delivery of projects.

First step in the right direction

Last Friday, US indices again made new all-time highs in anticipation of the impending passage of their tax reform program. Investors are optimistic about the tax package because it will lower corporate taxes for companies that operate in the US (*A Tale of two tax reforms*, December 4, 2017). Similarly, we look forward to the next phases of our government's comprehensive tax reform program. Of particular interest is the lowering of corporate income taxes in the country and the rationalization of fiscal incentives. Many listed corporates and local businesses will benefit from the alignment of our corporate taxes to our regional peers. After seeing the impact of tax reform on US stocks, we believe that the lowering of corporate income taxes will be the next major catalyst that will drive our stock market to new highs and make our economy more competitive regionally.

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