Philequity Corner (May 6, 2019)
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And now the good news

After enduring a water crisis, a power shortage, and a budget impasse, investors cheered as the country received good news last week. On April 30, S&P Global Ratings (S&P) upgraded its long-term sovereign credit rating for the Philippines. S&P now rates us at 'BBB+', our highest credit rating in history and two notches above investment grade. The upgrade lifted investor sentiment, causing the PSE Index to pierce above 8,000 and Philippine bonds to strengthen. The peso likewise appreciated and closed below 52 on the back of the positive news.

A validation of strength

The upgrade is a welcome validation of the strength of the Philippine economy. In its statement, S&P cited the country's "above average economic growth, healthy external position, and sustainable public finances." The debt watcher stated that the Philippine economy is among the fastest growing in the world on a 10-year weighted average, per capita basis. Moreover, S&P expects this trajectory to be sustained over the medium term, supported by domestic consumption and investment growth.

A seal of responsible housekeeping

S&P credited the Duterte government for continuing the prudent economic and fiscal policies of previous administrations. It also acknowledged the government's comprehensive tax reform program (TRAIN) which shored up tax revenues in support of a massive infrastructure push. The credit rating agency lauded the administration's fiscal responsibility and efforts to keep budget deficit within 3% of GDP despite a programmed increase in government spending.

Meanwhile, dollar inflows from OFW remittances, BPO revenues, exports, and tourism should cushion a widening current account deficit stemming from rising imports of capital goods. According to S&P, these should enable the Philippines to maintain manageable current account and fiscal deficits over the medium term, thereby leading to stable external and public debt positions.

Bold reforms and sound economic policies

Finance Secretary Sonny Dominguez said that the credit rating upgrade is an affirmation of the government's "commitment to bold reforms and sound economic policies as embodied in the 10-point Socioeconomic Agenda of the administration." According to Secretary Dominguez, S&P's positive action is a nod to the government's focus in pursuing policy initiatives which are meant to sustain economic growth momentum, attract investments, and promote financial inclusion.

National Treasurer Rosalia de Leon stated that "The upgrade is a recognition of our sound policies on liability management. We have kept our debt in check even as we invest more on infrastructure and social services. We are committed to fiscal discipline, and this makes the Philippines a truly creditworthy sovereign in the eyes of the international financial community."

BSP Governor Benjamin Diokno said that the favorable rating action is an acknowledgement of "sound economic management, prudent monetary policy, and strong financial sector supervision."

Importance of fiscal reform

In our book "Opportunity of a Lifetime", we devoted one chapter to discuss the importance of fiscal reform to the stock market (see Chapter 5 – Fiscal Reform in the Philippines). In that chapter, we recounted how the country was able to avert a fiscal crisis and a looming default by implementing the expanded value-added tax (eVAT). Though eVAT was largely unpopular at that time, its implementation enabled the government to increase revenue generation, thereby stabilizing the country's fiscal position while also supporting the government's spending program. Not surprisingly, the implementation of eVAT ushered the bottoming of the peso on October 2005. This was the start of a virtuous cycle of fiscal consolidation and structural growth which led to the country's investment grade rating in 2013.

The bitter pill

As in the case of tax reform in previous governments, the implementation of TRAIN encountered heavy opposition from various sectors and groups. Many complained about higher excise taxes on oil products especially in light of surging inflation last year. Recently, however, inflation has moderated after supply-side concerns were duly addressed.

Looking back at our history, one can see that implementing tax reform can be likened to swallowing a bitter pill. Ingesting medicinal pills may be unpleasant for some but it can cure diseases and promote better health. In the same vein, raising taxes may be initially painful and unpopular. However, tax reform can yield tangible benefits if it is implemented to strengthen the country's fiscal position and in support of pro-growth initiatives such as infrastructure modernization.

Structural reforms support the bull market

The credit rating upgrade which we received from S&P has provided a lift to Philippine stocks, bonds, and the peso last week. For many, it is a reminder that our country's structural growth story has remained intact, notwithstanding looming risks and bad news which have hampered our stock market and economy. In addition, the upgrade illustrates the importance of fiscal reform and how it can support long-term economic growth. Going forward, the sustained implementation of transformative structural reforms should support the continuation of the current bull market.

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