Philequity Corner (September 9, 2019)
By Wilson Sy

Bullish on the Philippines

We had three excellent speakers in Philequity's Investor Briefing last September 2. David Leechiu of Leechiu Property Consultants presented his insights on the country's real estate market. Our surprise guest speaker, Cong. Joey Salceda, outlined the next steps in the government's tax reform program. Miguel Agarao presented our outlook for the stock market.

Build, build, build to boost property sector

Mr. Leechiu is bullish on the property market because he is optimistic on the country's long-term growth prospects. Summarized below are the key takeaways from his presentation.

1. **Build, build, build to buoy property values.** The construction of new roads, rails, bridges, airports, and seaports will improve access and boost property values. Many of the major projects are slated to be completed by 2021 and this should contribute to the decongestion of Metro Manila.
2. **Development of Clark as a regional hub.** Clark is being developed as a special economic zone, making it an attractive location for foreign investors and BPO firms. Aside from this, Clark is being eyed as a government and business district which houses major government offices, corporate headquarters, manufacturing centers, and BPO offices.
3. **Sustained increase in land values.** Real estate values for various segments (commercial, residential, tourism, industrial, and condominiums) are currently at all-time or multi-year highs. Despite various historical events (Martial Law, various military coups, Asian financial crisis, and global financial crisis), residential values have grown at 14-17% CAGR in the past 60 years. This is proof of the country's attractiveness and the long-term structural growth that underpins our economy.

Tax reform to support growth acceleration

Our second speaker was Cong. Joey Salceda, Chairperson of the House Committee on Ways and Means. He explained the next phase of the government's tax reform agenda and how it will boost our country's economic growth. We outline below the salient points from his presentation.

1. **Reduction of corporate income taxes.** The Corporate Income Tax and Incentives Reform Act (CITIRA) seeks to cut corporate income taxes by 1% per year for the next ten years. This will bring down the corporate tax rate to 20% from the current 30% for as long as the deficit target is not breached. According to Cong. Joey, the net present value (NPV) of foregone taxes from CITIRA amounts to P5.6t. This is equivalent to 38% of the market capitalization of the entire Philippine stock market. The prospective tax cuts should unlock capex spending of local corporates while also making the country a more competitive investment destination.
2. **Rationalization of fiscal incentives.** According to Cong. Joey, fiscal incentives cannot go on indefinitely and should only be given to qualified businesses which meet specific criteria. In addition, the government has to recover foregone revenues from the corporate income tax cuts by removing incentives which are given to undeserving entities. He shares the view of Finance Secretary Sonny Dominguez that incentives should be performance-based, time-bound, targeted, and transparent.
3. **Harmonization of passive income taxes.** The Passive Income Tax and Financial Intermediary Taxation Act (PIFITA) will harmonize taxes on income from deposits, dividends, and sale of debt and equity instruments. It will lower the stock transaction tax by 0.1% each year from 0.6% in 2020 to

0.1% in 2025 to stimulate trading activity in the stock market. It will also remove the initial public offering (IPO) tax to encourage companies to list in the stock exchange.

Based on econometric projections made by Cong. Joey and his team, the upcoming packages of the tax reform program will generate an additional 1.4m jobs and add 0.9% to GDP growth in the near-term.

Philequity's market outlook

Miguel Agarao presented our outlook for the stock market. Listed below are the reasons why we remain bullish on the Philippines.

1. **Falling inflation.** The government reported that inflation in August slowed to 1.7%, below the central bank's target band of 2-4%. The downtrend in inflation has caused the peso to stabilize while also giving the central bank enough leeway to ease monetary policy.
2. **Lower oil prices.** Oil prices are trading at lower levels compared to last year. This has contributed in slowing down inflation while tempering our trade and current account deficits.
3. **BSP's monetary easing.** This year, the Bangko Sentral ng Pilipinas (BSP) has cut its policy rate by 50 bps and the reserve requirement ratio (RRR) by 200 bps. Slower inflation and Fed easing should allow the BSP to implement further cuts to its policy rate and the RRR amid a stable peso.
4. **Faster government spending in 2H19.** The delayed approval of the 2019 government budget should result in catch-up spending and faster GDP growth in 2H19. The budget release will support faster roll-out of major infrastructure projects under the Build, build, build program.
5. **Earnings growth of 10%/11% in 2019E/2020E.** Though many countries are anticipating slower earnings growth, we expect the PSEi's earnings to remain resilient and grow by 10% this year and 11% next year. This underpins our fair value estimate of 8,450 for the PSEi.

Solid domestic fundamentals but trade war looms

The three speakers in our briefing enumerated several reasons why we should be bullish on the Philippines. Indeed, domestic fundamentals remain solid. Our economic growth story is supported by Build, build, build; the government's fiscal reforms; and the BSP's proactive monetary policy. Notwithstanding these, the major risk is still the US-China trade war. A fresh round of tariffs by the US and China hampers the growth of the world's two largest economies. This exacerbates the ongoing global economic slowdown. Still, investors are hopeful that an amicable resolution or tangible progress will be achieved when face-to-face negotiations resume in October.