Euler Hermes Economic Research

Country Risk Analysis

Philippines

Robust growth and improving macroeconomic fundamentals

General Information

GDP	USD250.3 billion (World ranking 40, World Bank 2012)
Population	96.7 million (World ranking 12, World Bank 2012)
Form of state	Republic
Head of government	Benigno AQUINO Jr.
Next elections	2016, presidential

Strengths

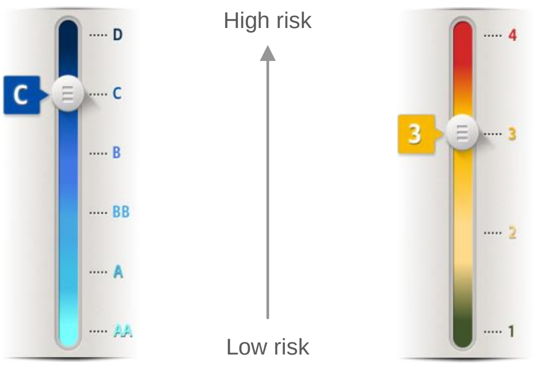
- Robust GDP growth since 2002 and resilience of the economy to the global economic crisis 2008-2009 as well as recent external headwinds
- Solid monetary and fiscal policies in recent years
- Continued currect account surpluses since 2003
- Relatively low external debt
- Ample foreign exchange reserves

Weaknesses

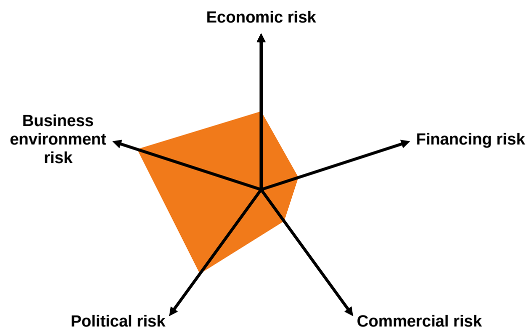
- History of political turmoil and ongoing security issues threaten political stability
- History of government ineffectiveness and sluggish structural reform
- High dependency on electronics exports and tourism
- Public debt, though declining, is still comparatively high
- Underdeveloped banking sector
- Weak business environment

Country Rating C3

Country Grade | **Country Risk Level**



Risk Dimensions



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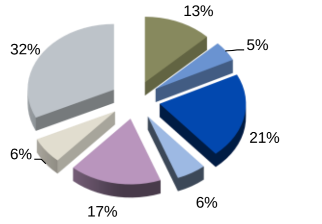
Economic Structure

GDP breakdown (% of total, 2011)



Sources: UnctadStat, Euler Hermes

Trade structure (% of total, 2011)

Exports		Rank		Imports
Japan	18%	1	16%	China
United States	15%	2	12%	Japan
China	13%	3	9%	United States
Singapore	9%	4	8%	Korea, Republic of
China, Hong Kong SAR	8%	5	8%	China, Taiwan Province of

Exports		Rank		Imports
Electrical machinery, apparatus and appliances, n.e.s.	30%	1	21%	Petroleum, petroleum products and related materials
Office machines and automatic data processing machines	12%	2	13%	Electrical machinery, apparatus and appliances, n.e.s.
Road vehicles	6%	3	5%	Road vehicles
Cork and wood manufactures (excluding furniture)	5%	4	4%	Office machines and automatic data processing machines
Fixed vegetable oils and fats, crude, refined or fractionated	4%	5	3%	Specialised machinery

Economic Forecasts

	2009	2010	2011	2012	2013f	2014f
GDP growth (% change)	1.1	7.6	3.6	6.8	6.0	5.0
Inflation (%, end-year)	4.4	3.6	4.2	2.9	2.8	3.0
Fiscal balance (% of GDP)	-2.6	-2.5	-0.6	-0.9	-0.8	-0.9
Public debt (% of GDP)	58.1	54.8	55.7	54.5	51.3	48.7
Current account (% of GDP)	5.2	4.2	3.1	2.8	3.5	2.7
External debt (% of GDP)	38.3	36.9	33.9	31.1	28.8	27.1

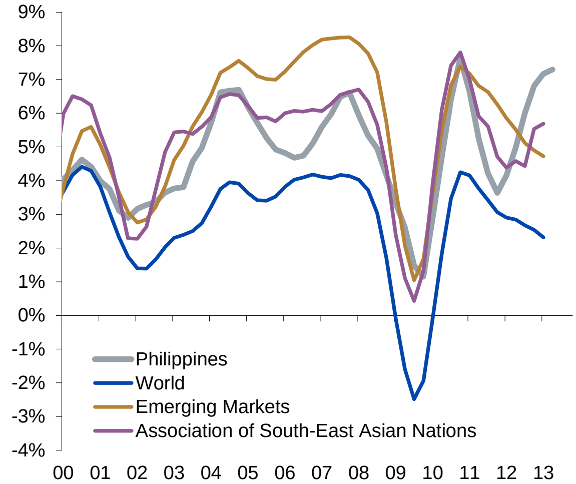
Sources: IHS Global Insight, national sources, Euler Hermes

Economic Growth

GDP growth has been resilient to external headwinds

The economy has shown notable resilience to the global economic crisis 2008-2009 as well as to more recent external weaknesses. Real GDP growth accelerated to +6.8% in 2012 and +7.8% y/y in Q1 2013, making the Philippines the fastest growing economy in the region in that quarter, as surging domestic demand offset weakening exports. Robust private consumption expanded by +5.1% y/y in Q1(+6.6% in full year 2012), infrastructure projects boosted government consumption growth to +13.2% y/y in Q1 (+12.2% in 2012) and strong construction activity propelled fixed investment by +16.8% y/y in Q1 (+10.4% in 2012). However, exports collapsed, falling by -7% y/y in Q1 (+8.9% in 2012), while imports retained modest growth of +1.6% y/y in Q1 (+5.3% in 2012). EH expects domestic demand to retain momentum amid an ongoing weak global environment in 2013, resulting in full year GDP growth of about +6%. Growth is forecast to ease to +5% in 2014.

GDP growth (% y/y, 4 qtrs cumulated)



Sources: IHS Global Insight, national sources, Euler Hermes

Solid monetary policy framework

Monetary policy is based on inflation targeting but, in practice, the central bank also aims a certain degree of exchange rate stability. The inflation targets have been set at 4%±1pp for 2013-2014. After a period of monetary easing, the key policy interest rates have been kept steady at 3.5% for overnight borrowing and 5.5% for overnight lending since October 2012.

Inflation will remain moderate

Consumer price inflation has been relatively benign since mid-2009 and remained mostly within the authorities' target range. Recently it has even fallen below that range, to 2.5% y/y in July 2013. We expect headline inflation to remain moderate at around 3% until the end of 2014.

Banking sector continues to improve though weaknesses remain

Banking sector profitability and liquidity have been robust over the past five years, showing resilience to global turbulences. Non-performing loans have continued to decline as a share of total loans, to 2.5% in Q3 2012. Private sector credit growth has accelerated to 15% y/y in mid-2013 (from 10% at end-2011) and requires some monitoring as banks are seeking larger margins while bank supervision is still weak. Generally, however, a comparatively low level of private sector credit in relation to GDP (about 31%) indicates that the banking sector has remained relatively underdeveloped.

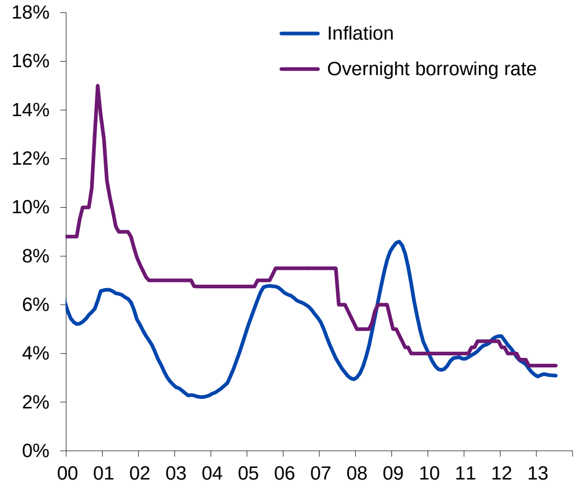
Recent exchange rate weakening appears unproblematic

Overall the PHP/USD exchange rate strengthened gradually from mid-2009 to early 2013 (in total by about 17%), reflecting the Philippine economy's remarkable resilience towards the global economic weakness. The central bank prevented excessive volatility during this period. From early May to mid-August 2013, however, the exchange rate has fallen by 6% or so—in line with many other emerging market currencies—as a result of hints by the US Fed that the latest round of Quantitative Easing will be slowing down. This shows that the exchange rate is not immune to external events such as net capital outflows from emerging markets if investors are reducing their exposure to these countries. However, the central bank has currently sufficient foreign exchange reserves to avert a more worrisome weakening of the currency.

Public finances have improved over the past decade

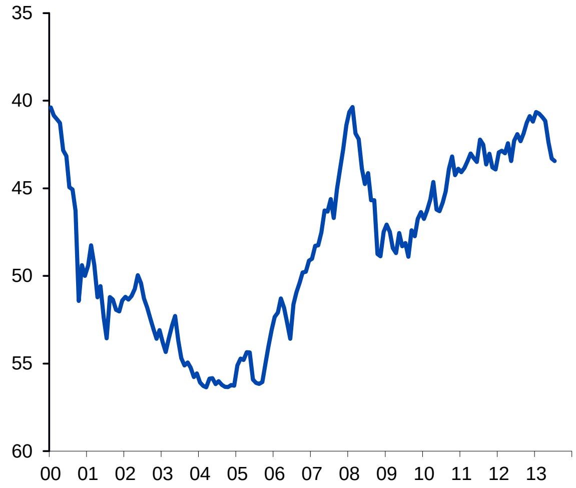
The general government fiscal deficit has been below 1% of GDP in 2011-2012 (and below 3% of GDP since 2006) and is forecast to remain so in 2013-2014 thanks to continued fiscal prudence. Even when taking into account government financial institutions and 14 large SOEs, the consolidated fiscal deficit has been just 1.6% of GDP in 2011-2012. Gross public debt has fallen from a high of 75% of GDP in 2004 to 55% in 2012 and is forecast to decline further. Both Fitch and S&P have upgraded the Philippines to investment grade in spring 2013. The drop of bitterness is, however, that the improvement was largely reached as a result of spending restraint. Revenues frequently fall short of budget projection. The chronically deficient tax collection retards, e.g., urgently needed infrastructure projects and could also undermine fiscal sustainability in the medium term.

Inflation rate (12-month moving average, %) and policy interest rate (%)



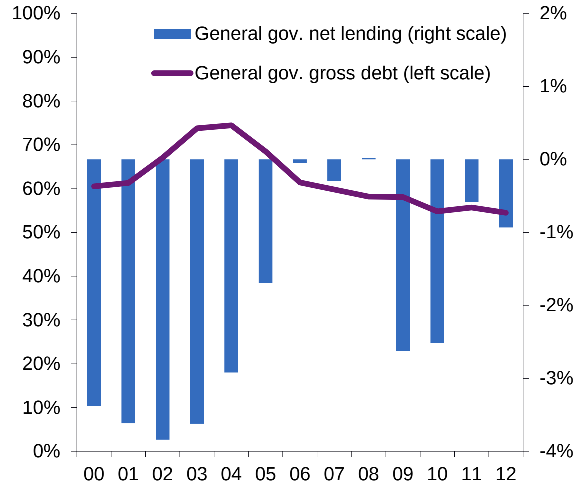
Sources: IHS Global Insight, national sources, Euler Hermes

Exchange rate (PHP/USD)



Sources: IHS Global Insight, national sources, Euler Hermes

Fiscal balance and public debt (% of GDP)



Sources: IHS Global Insight, national sources, Euler Hermes

External Sector

Current account will remain in surplus thanks to strong inflows of remittances

The external liquidity position is generally favourable. The trade deficit narrowed from 7.6% of GDP in 2011 to 6.1% in 2012 and 4.2% in Q1 2013. But the overall current account recorded surpluses of 3.1% of GDP in 2011 and 2.8% in 2012 thanks to robust surpluses of the services account and ongoing strong inflows of remittances. In Q1 2013, the current account surplus widened to 5.3% of GDP as the trade deficit narrowed by 43% y/y. Remittances grew by 6.2% y/y to USD11.8bn in H1 2013. We forecast current account surpluses of about 3.5% in 2013 and 2.7% in 2014.

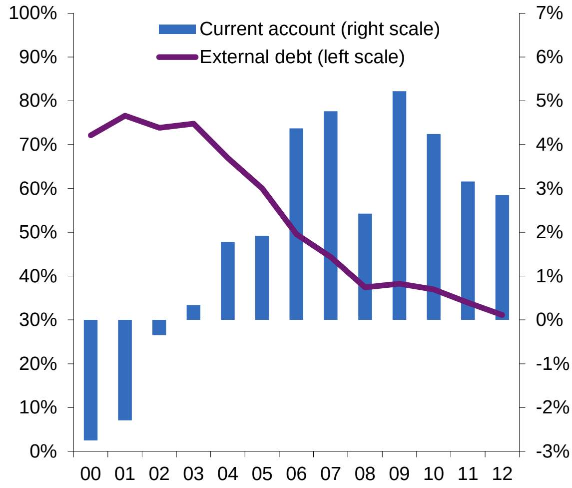
External debt burden is manageable

Total external debt stood at an adequate level of 31% of GDP or 110% of export earnings at end-2012. We expect these ratios to decline further in the next two years. The annual external debt-service in 2013 and 2014 will amount to around 17% of export earnings.

Ample foreign exchange reserves

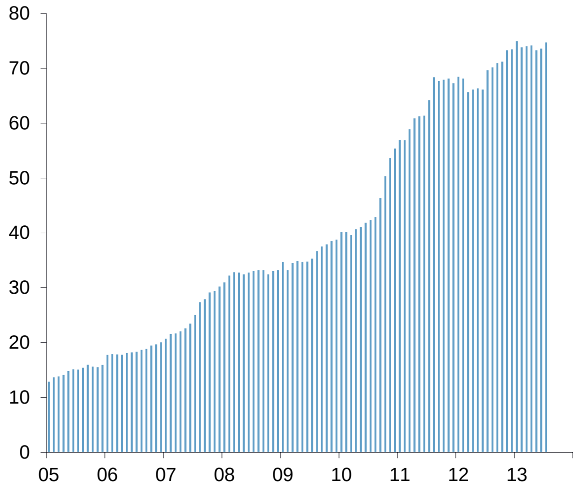
Foreign exchange reserves have increased rapidly in recent years to USD73.5bn at end-2012 and have remained relatively stable around that level in 2013 to date. Current reserves are sufficient to cover a healthy ten months of imports or, in other terms, four times all external debt payments falling due in the next 12 months.

Current account and external debt (% of GDP)



Sources: IHS Global Insight, national sources, Euler Hermes

Foreign exchange reserves (USD billion)



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