

Philippine Country Report Asia Securities Forum

22nd to 24th November 2012

PHILIPPINE COUNTRY REPORT: EXECUTIVE SUMMARY

- **The Philippine economy has been growing robustly this year.** In 1H12, Philippine GDP grew 6.1% (from 4.2% in 1H11), the third highest growth in Asia, next to China (7.9%) and Indonesia (6.4%). The growth was also substantially higher than the average GDP growth of 4.7% from 2001 to 2011.
- **Services and consumption were the main growth drivers.** Services, which accounted for 57% of GDP on the supply side, grew by 7.8%. It contributed 73% or 4.5 percentage points to the 1H12 GDP growth of 6.1%. On the demand side, private consumption, which accounted for 69% of GDP, grew by 5.4%. It contributed 60% or 3.7 percentage points to the 1H12 GDP growth of 6.1%. Government provided a boost by accelerating public spending by 12.3%, a marked turnaround from negative growth last year. Public infrastructure surged by 51% in 1H12.
- **Despite the high-growth environment, inflation remains modest and the BSP's monetary policy continues to be accommodative.** Inflation from January to August averaged 3.2%, at the low end of the government's target range of 3% to 5%. The BSP has cut policy rates three times this year to 3.75% and 5.75%, gradually easing by 25 bp each in January, March and July. Of the three cuts, the last one in July was the least expected as core inflation reached 4.7% in August, averaging 3.7% YTD. Effective 13 July, BSP cut its SDA rates by 3bp. The 7-day SDA rate was reduced to 3.78% from 4.06%, the 14-day SDA rate was reduced to 3.84% from 4.13% and the 32-day SDA rate was reduced to 3.91% from 4.19%. All in all, The July cuts signaled that the central bank's policy continues to be supportive of economic growth
- **The financial system is awash with liquidity, but remains stable.** To demonstrate, the Special Deposit Account, a liquidity management tool by the BSP, totaled P1.8 trillion or 18% of GDP as of August 2012. As a preventive measure, the BSP tightened SDA rules to curb speculation. The ample liquidity is translating into healthy loan growth of 18.4% (July 2012) against a backdrop of a stable banking system with NPL of only 2.7% and CAR of 17.6%.
- **OF remittances and BPO revenues contributed largely to the current account surplus of \$3.7b in 1H12** and are expected to carry on with their implicit, yet significant contribution to growth. OF remittances reached \$10.1b in 1H12, 5.1% higher y-y and are projected to grow 5% in 2012 and 2013 to new record levels of \$21.1b and \$22.2b. BPO revenues have grown from \$1.5b in 2004 to \$11b in 2011. Despite exhibiting exponential growth in the past few years, it is still capable of growing 20% annually through 2016.
- **The external position of the Philippines is strong with sufficient buffers against shocks.** Overall balance of payments reached \$4.5b in 1H12, exceeding 2012 target of \$2.6b. GIR reached \$80.8b in August, equivalent to 12 months of imports, 32% of GDP (2012F) and 83% of external debt (2012F). It is also ahead of the government's full-year target of \$77b-\$78b. Furthermore, foreign debt exposure has improved to 40% in 1H12 from 49% in 2003. These buffers provide reasonable justification why the country is a net creditor to the IMF. It lent \$1b to the fund in 2Q12.
- **The outlook for the Philippine economy remains positive.** The country is expected to sustain above-average growth over the coming years. The government projects GDP growth of 5.0%-6.0% in 2012 and 6.0%-7.0% in 2013. Over the medium-term, the government is aiming for an average of 7.0%-8.0% yearly growth. Among the other medium-term targets of the government are: 22% investment-to-GDP by 2016, 1 million new jobs per year, 2% deficit-to-GDP by 2013 and to achieve investment grade ratings by 2016 (which may be achieved early next year).
- **The Philippines expects to achieve investment-grade status in early 2013** on account of a flexible fiscal position and steadily declining debt-to-GDP. The government is determined to improve revenue collection to 13.8% of GDP in 2013. Its debt to GDP has been steadily declining from 74% in 2004 to 51% in 2011. In 7M12 budget deficit was only 0.7% of GDP, much lower than the 2.6% target for the year and 2.0% target in 2013. Based on the 2012 program, interest burden amounts to 3.5% of GDP, affording the country more flexibility to spend.
- **The financial markets have begun to reflect the country's anticipated investment-grade status.** The Philippine stock and bond markets are the best-performing in the region (up to July 2012). MSCI Philippines Equity Index is up 27% (in \$) and 21% (in Php), nearly four times higher than the average Far East Ex-Japan return of 6.8% (in \$) and 5.8% (in Php). Capital raisings from IPOs, follow-ons, private placements and stock rights are up 63% to P175b. The iBoxx Philippines Bond Index is up 10.6% (in \$), more than double the HSBC ALBI return of 4.6%.
- **What we are seeing is only the tip of the iceberg.** From January to July, net portfolio inflows to the Philippines reached \$1.9b, as the risk-on wave of foreign inflows into Asia searched for higher returns. While the figure is already huge by historical standards, it is only 0.8% of market capitalization, relatively miniscule when compared to net portfolio inflows into investment-grade countries such as Thailand (5.9% of market cap.), Indonesia (9.3% of market cap.) and S.Korea (7.9% of market cap.).

Philippines: Macroeconomic Outlook

	Actual					Projections	
	2008	2009	2010	2011	2012	2012	2013
Real GDP Growth (%)	4.2	1.1	7.6	3.9	6.1 (1H)	5.0-6.0 ¹	6.0-7.0 ¹
Headline Inflation (%) ¹	8.3	4.1	3.9	4.6	3.2 (Jan-Aug)	3.0-5.0 ¹	3.0-5.0 ¹
Exports Growth (%) ²	(2.5)	(22.1)	34.0	(6.9)	7.7 (Jan-Jun)	10.0 ¹	12.0 ¹
Imports Growth (%) ²	5.6	(24.0)	27.5	9.5	0.4 (Jan-Jun)	12.0 ¹	14.0 ¹
OF Remittances ³							
Amount (USD bn)	16.4	17.3	18.8	20.1	10.1 (Jan-Jun)	21.1 ⁴	22.2 ⁴
Growth Rate	13.7	5.6	8.2	7.2	5.1 (Jan-Jun)	5.0 ⁴	5.0 ⁴
Current Account (USD bn)	3.6	9.4	8.9	7.1	0.9 (Jan-Mar)	4.6 ⁴	3.1 ⁴
Balance of Payments (USD bn)	0.1	6.4	14.3	10.2	4.5 (Jan-Jul)	2.6 ⁴	2.7 ⁴
GIR (USD bn)	37.6	44.2	62.4	75.3	80.8 (Aug)	77.0-78.0 ⁴	80.7 ⁴

Source: Bangko Sentral ng Pilipinas, National Statistics Office

¹ Budget Expenditures and Sources of Financing 2013

² Based on NSO data

³ "Cash remittances" under the BOP6 definition.

⁴ Based on BSP projections as approved by the Monetary Board on 15 June 2012.

Medium-Term Targets

7.0-8.0% average GDP growth per year

22.0% investment-to-GDP by 2016

1 million employment generation per year

6.8% unemployment rate by 2016

16.6% poverty incidence by 2015

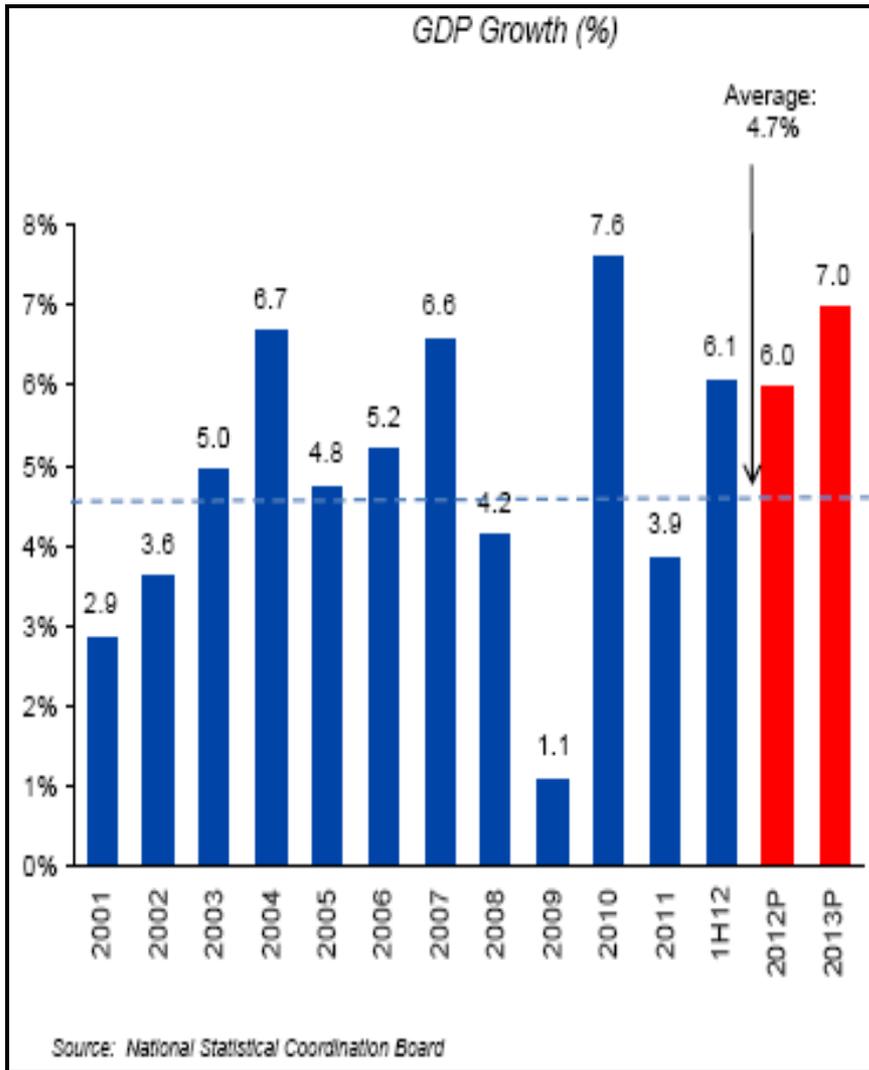
2.0% deficit-to-GDP by 2013

Upper 30% in global governance and competitiveness rankings by 2016

Investment grade sovereign credit ratings before 2016

Robust And Sustainable GDP Growth

1H12 GDP Growth Of 6.1%, 3rd Highest In Asia



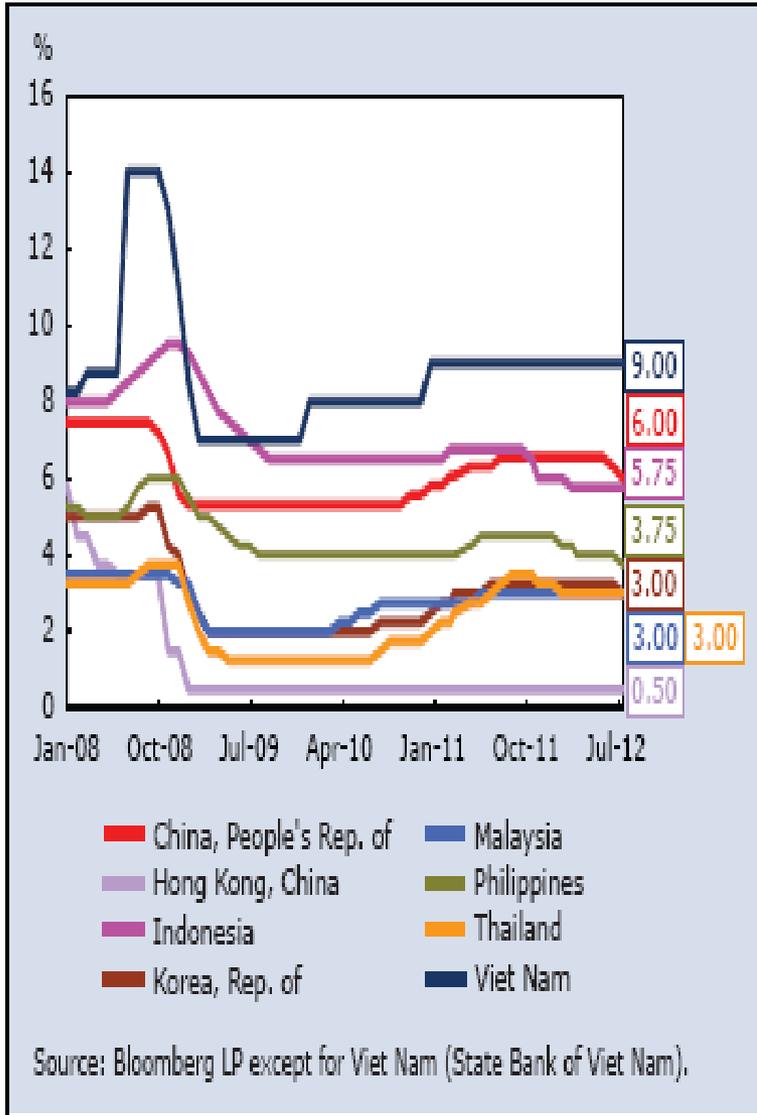
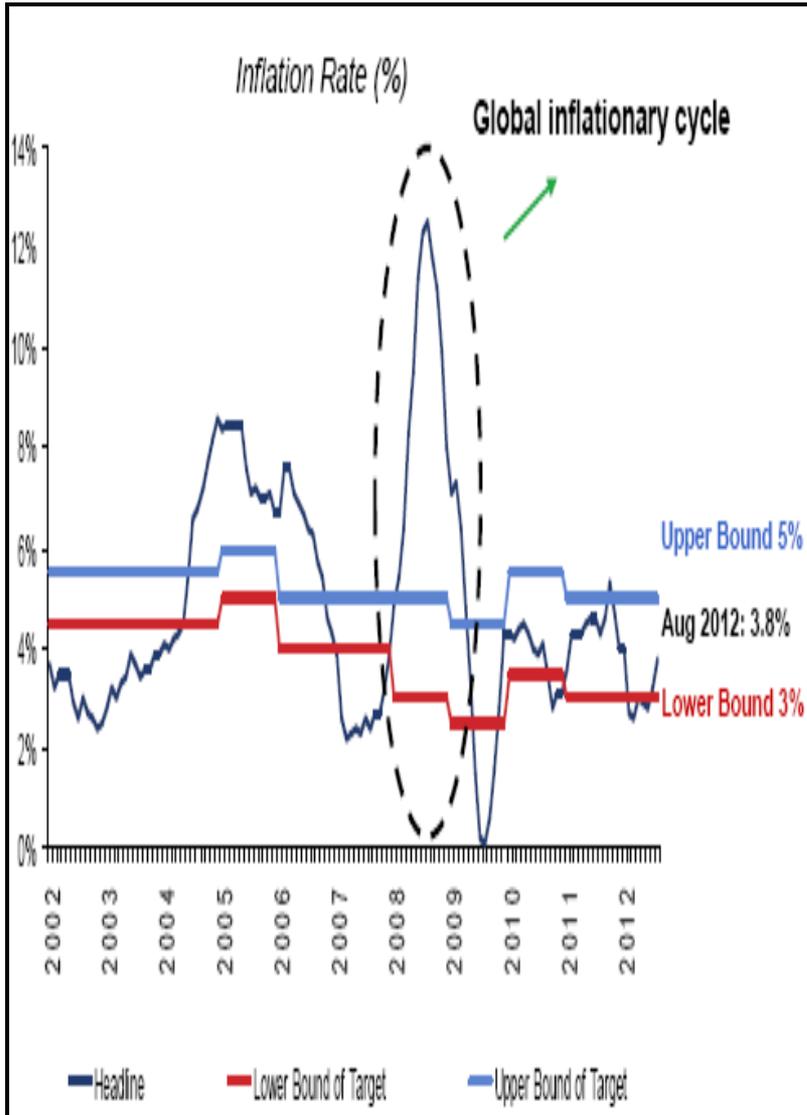
Country	2012 GDP Growth (%)		
	Q1	Q2	S1
China	8.1	7.6	7.9
Indonesia	6.3	6.4	6.4
Philippines	6.3	5.9	6.1
Malaysia	4.9	5.4	5.2
Vietnam	4.0	4.4	4.2
South Korea	2.8	2.4	2.6
Thailand	0.4	4.2	2.3
Singapore	1.5	2.0	1.8

- 1H12 GDP growth of 6.1%, from 4.2% in 1H11
- 2Q12 GDP growth of 5.9%, from 3.6% in 2Q11
- GDP growth projection of 5.0%-6.0% in 2012 and 6.0%-7.0% in 2013
- Higher than average of 4.7% from 2001 to 2011

Medium-term Target: 7%-8% Average GDP Growth Per Year

Modest Inflation And Accommodative Monetary Policy

Jan. - Aug. average inflation of 3.2%, at the low end of 3% to 5% target range



- Inflation rose to 3.8% in August due to floods in July
- Readings below 3.0% in May and June
- Core inflation reached 4.7% in August, and 3.7% YTD
- YTD, BSP cut rates by 75bp to 3.75% and 5.75%

BSP has cut rates three times this year, totaling 75bp, despite YTD core inflation of 3.7%

GDP Growth Drivers

Services And Private Consumption Contributed 73% And 60% Of 1H12 GDP Growth Of 6.1%
Turnaround In Government Expenditure: Growth of 12.3% In 1H12 From Negative Growth In 1H11

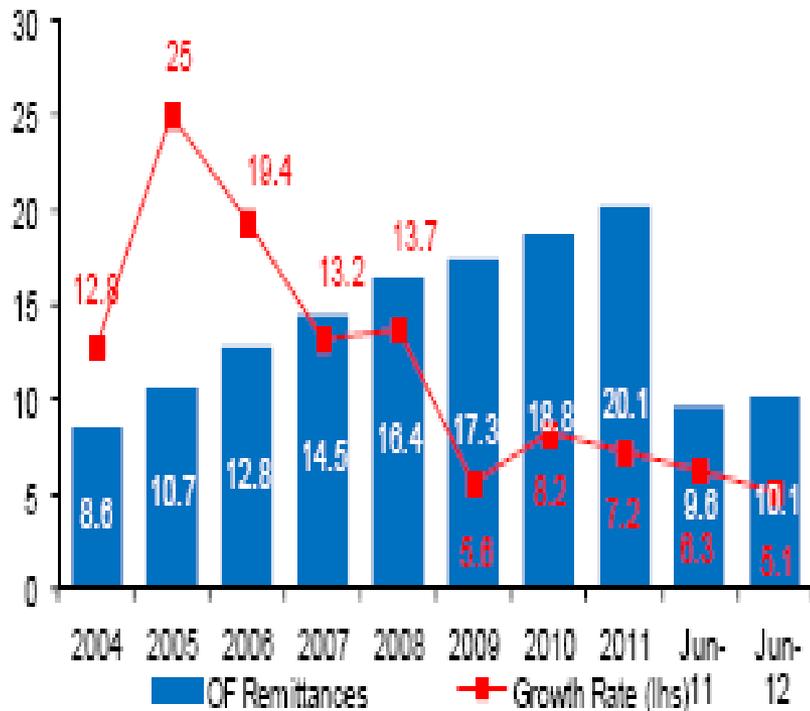
ITEM	2011	Q2		S1 2012	Share to GDP (%)
		2012	Growth Rate (%)		
GNI	2.4	5.6	5.4		
Net Primary Income	-1.1	4.5	3.1		
GDP	3.6	5.9	6.1		
Agri, Fishery, Forestry and Hunting	8.3	0.7	0.8		10.9
Industry	-1.4	4.6	4.9		32
Services	5.6	7.6	7.8		57.1
Household Final Consump. Exp	5.6	5.7	5.4		68.8
Gov't Final Consump. Exp	6	5.9	12.3		11.3
Capital Formation	-10.1	2.3	-13.2		16.8
Exports	0.2	8.3	9.5		52.4
Imports	-1	4.4	0.6		-48.2

Source: National Statistical Coordination Board

GDP Growth Drivers: OF Remittances And BPO Revenues

Remittances Soar to a Record of USD20.1bn in 2011

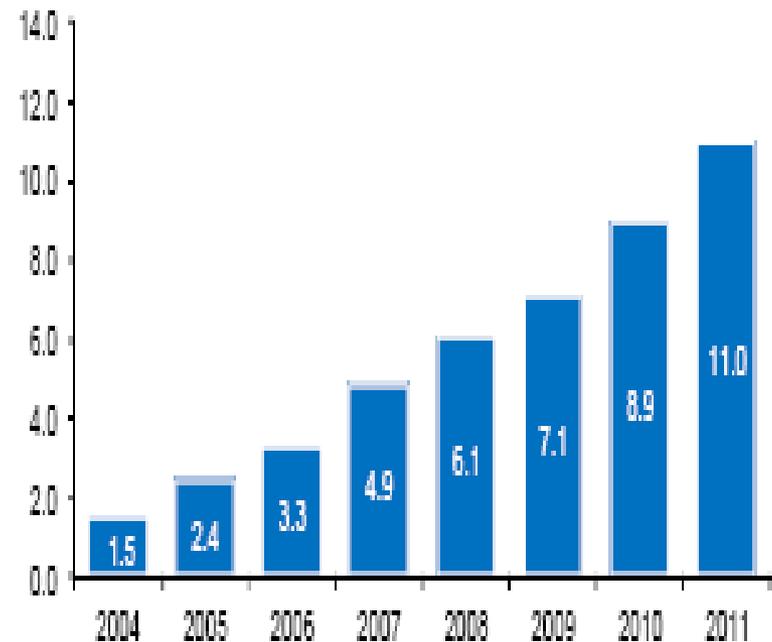
Overseas Filipinos' Remittances (USD bn and % Growth)



- OF remittances reached \$10.1b in 1H12, 5.1% higher y-y
- Projected to grow 5% in 2012 to \$21.1b and 5% in 2013 to \$22.2b-RP

BPO revenues continue to grow rapidly

BPO Revenues (USD bn)

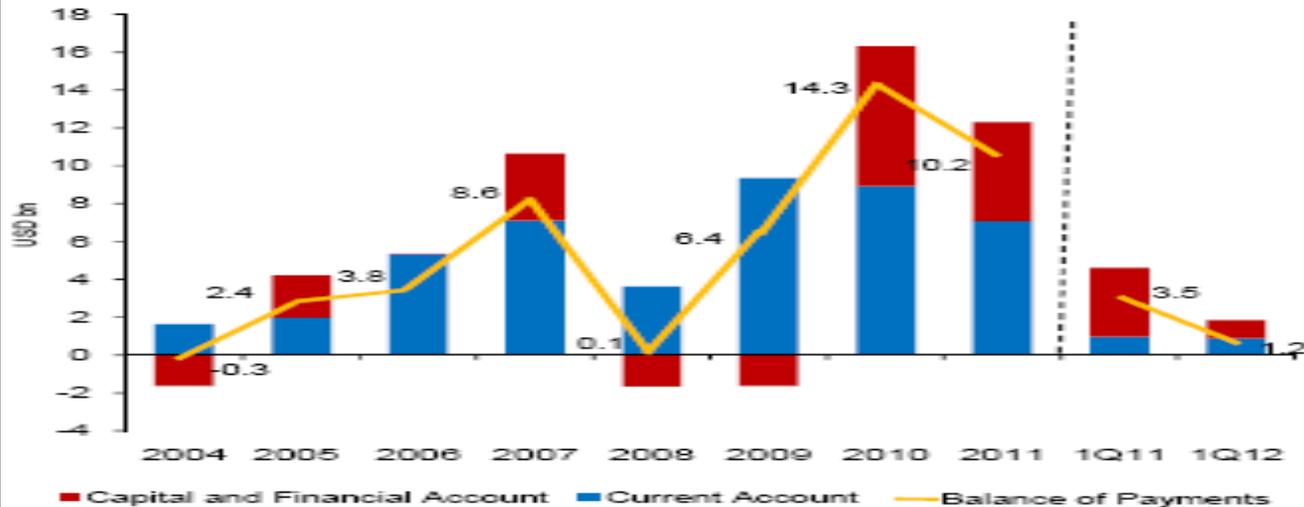


- BPO revenues have grown from \$1.5b in 2004 to \$11b in 2011
- Projected to grow 20% annually through 2016-ADB

Strong External Position

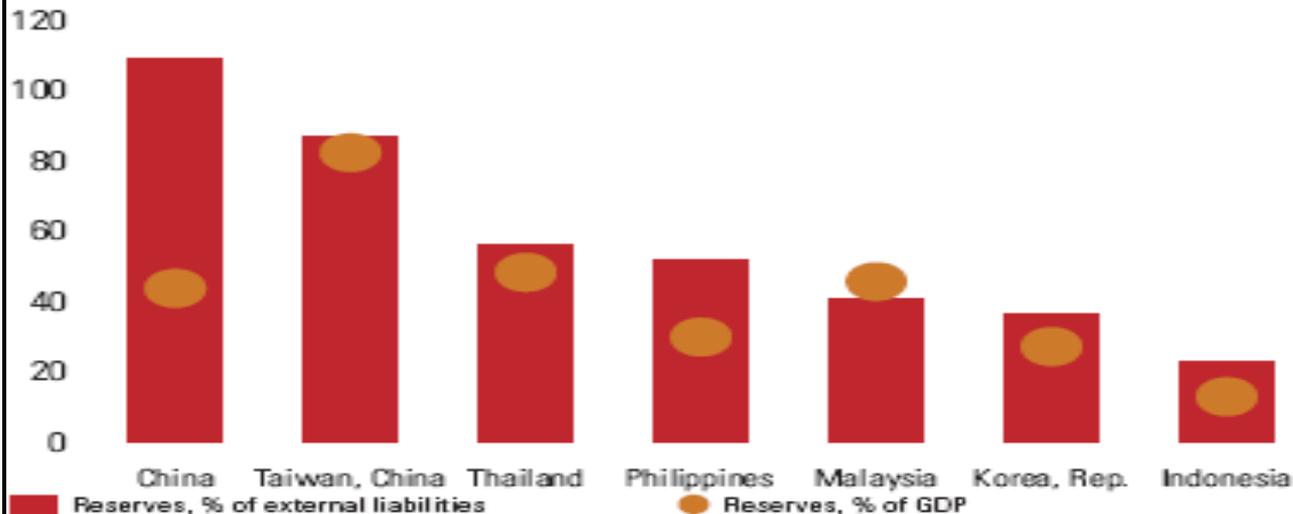
BoP surplus Of \$4.5b in 1H12, Exceeding 2012 Target Of \$2.6b

Balance of Payments (USD bn)



- BPO and OF remittances contributed largely to current account surplus of \$3.7b in 1H12
 - Capital and financial account posted net outflows of \$1.2b
 - FDI of \$917m

Reserves, in percent of total external liabilities, and GDP, end-2011

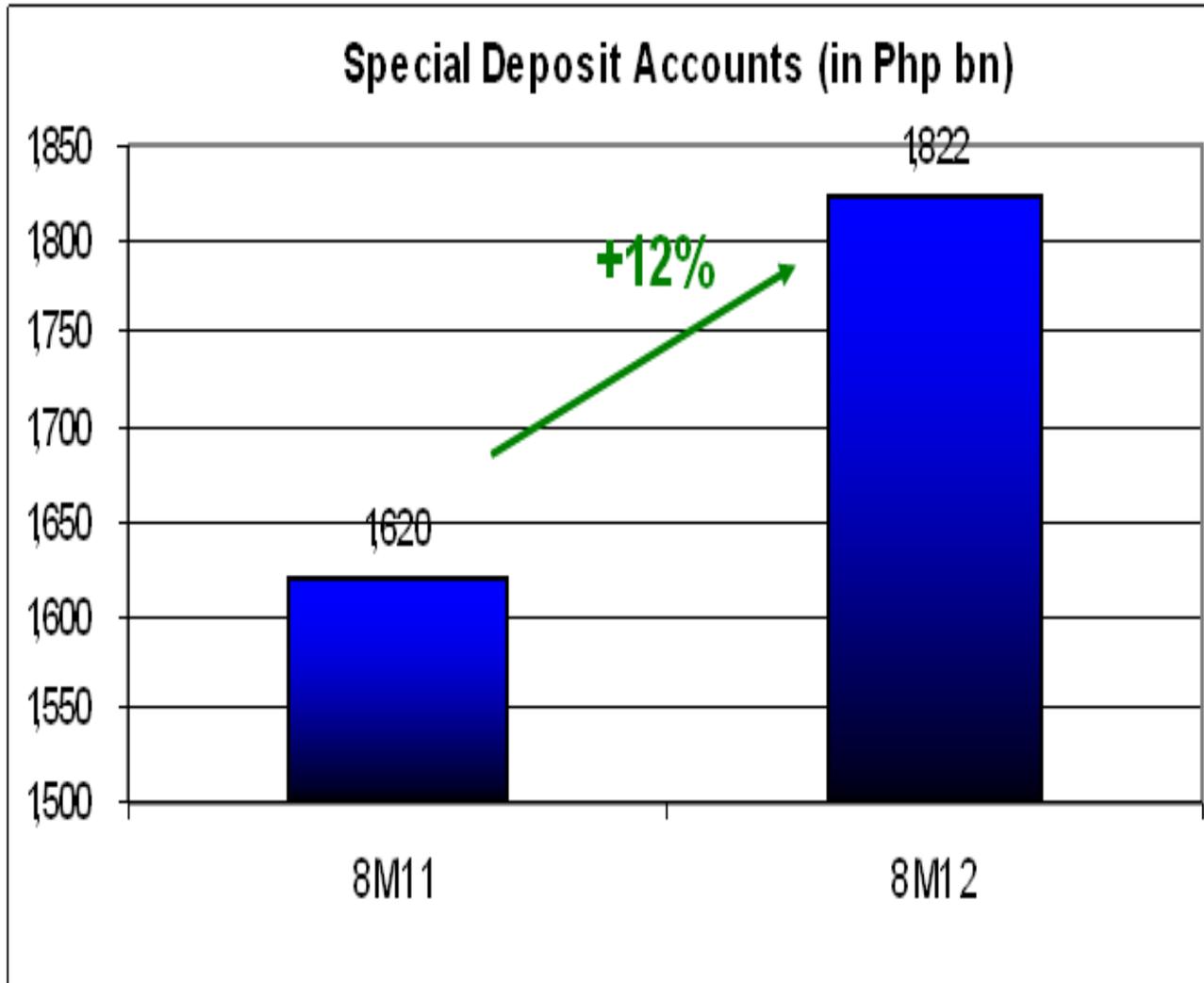


Source: WB, World Development Indicators and IMF, International Financial Statistics.

- GIR reached \$80.8b in August, equivalent to 12 months of imports
- Lent \$1b to the IMF in 2Q12

Financial System: Awash With Liquidity, But Remains Stable

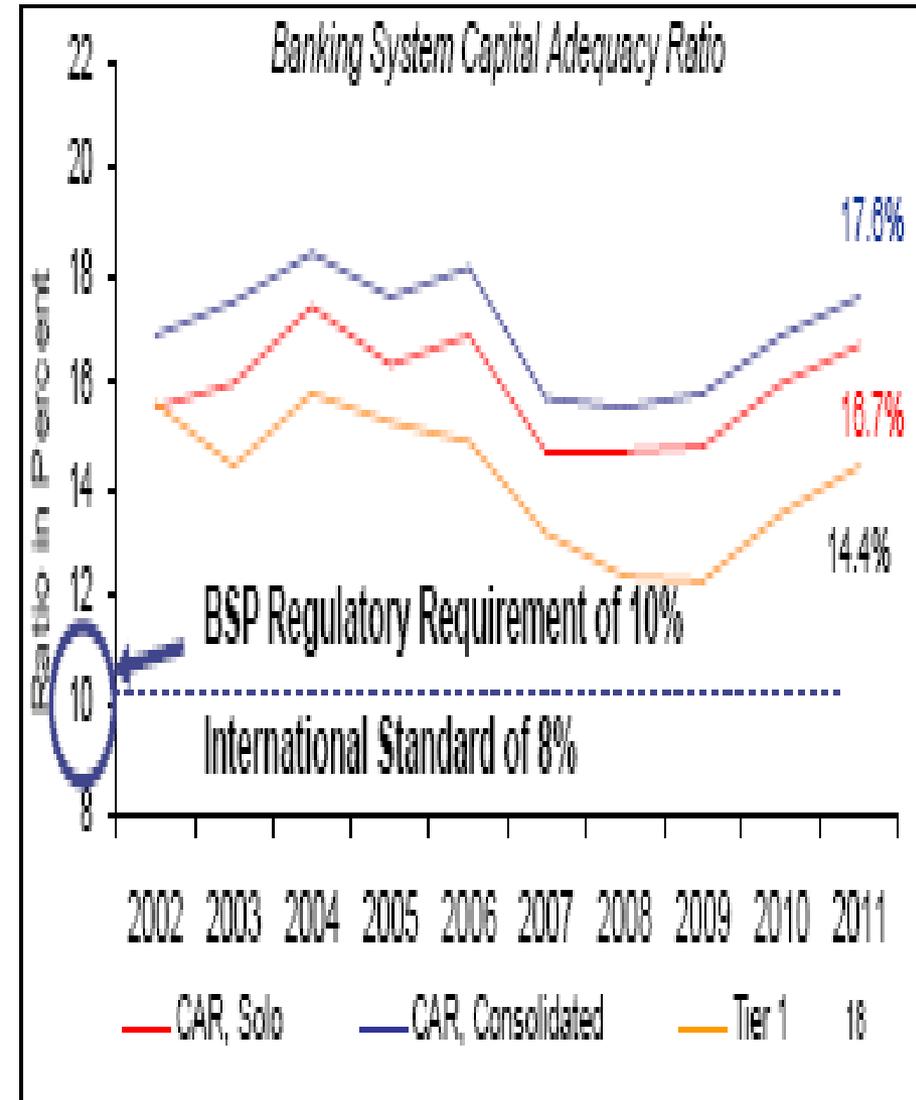
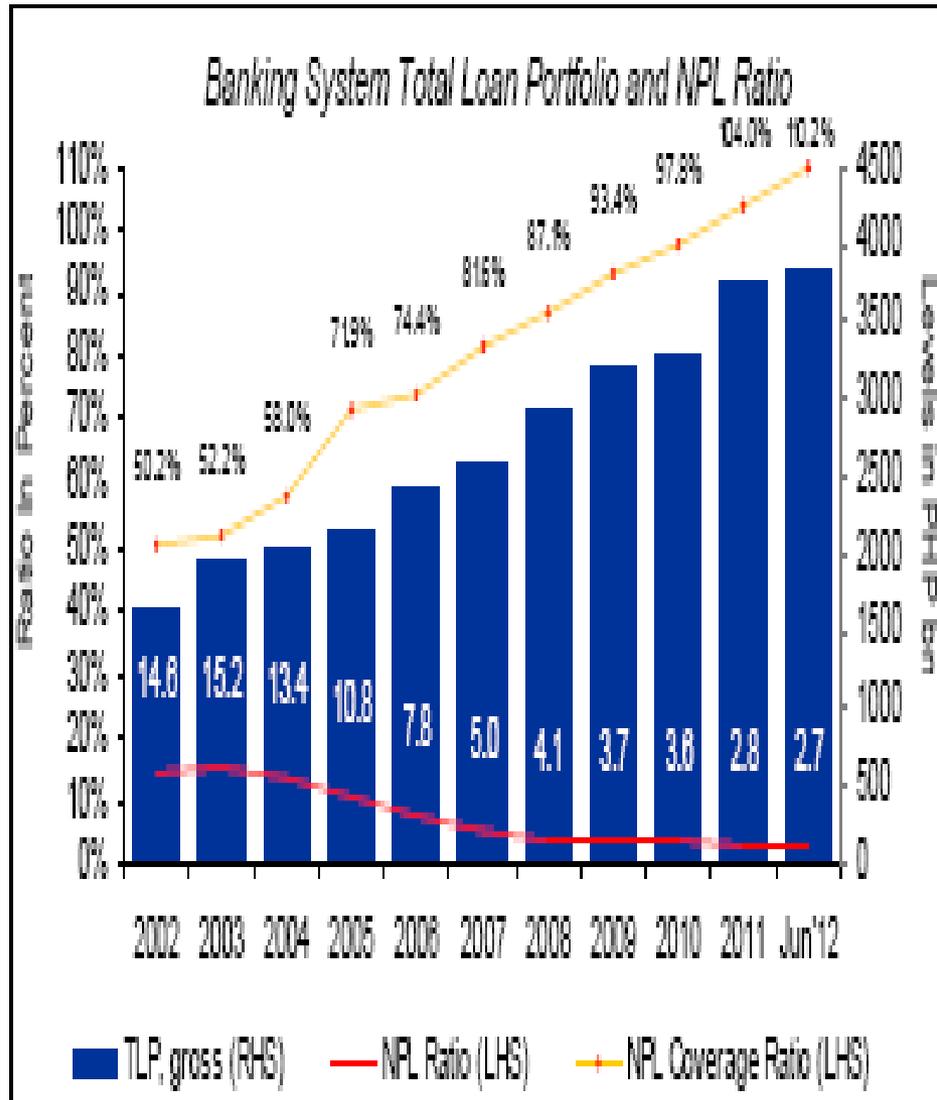
Special Deposit Accounts Of P1.8 Trillion = 18% Of GDP



- **SDA is a tool to manage liquidity**
- **Effective 13 July, BSP cut its SDA rates by 3bp**
 - 7-day SDA rate reduced to 3.78% from 4.06%
 - 14-day SDA rate reduced to 3.84% from 4.13%
 - 32-day SDA rate to 3.91% from 4.19%
- **BSP tightened SDA rules to curb foreign speculation**
 - Banks and trust entities are required to certify funds are sourced locally

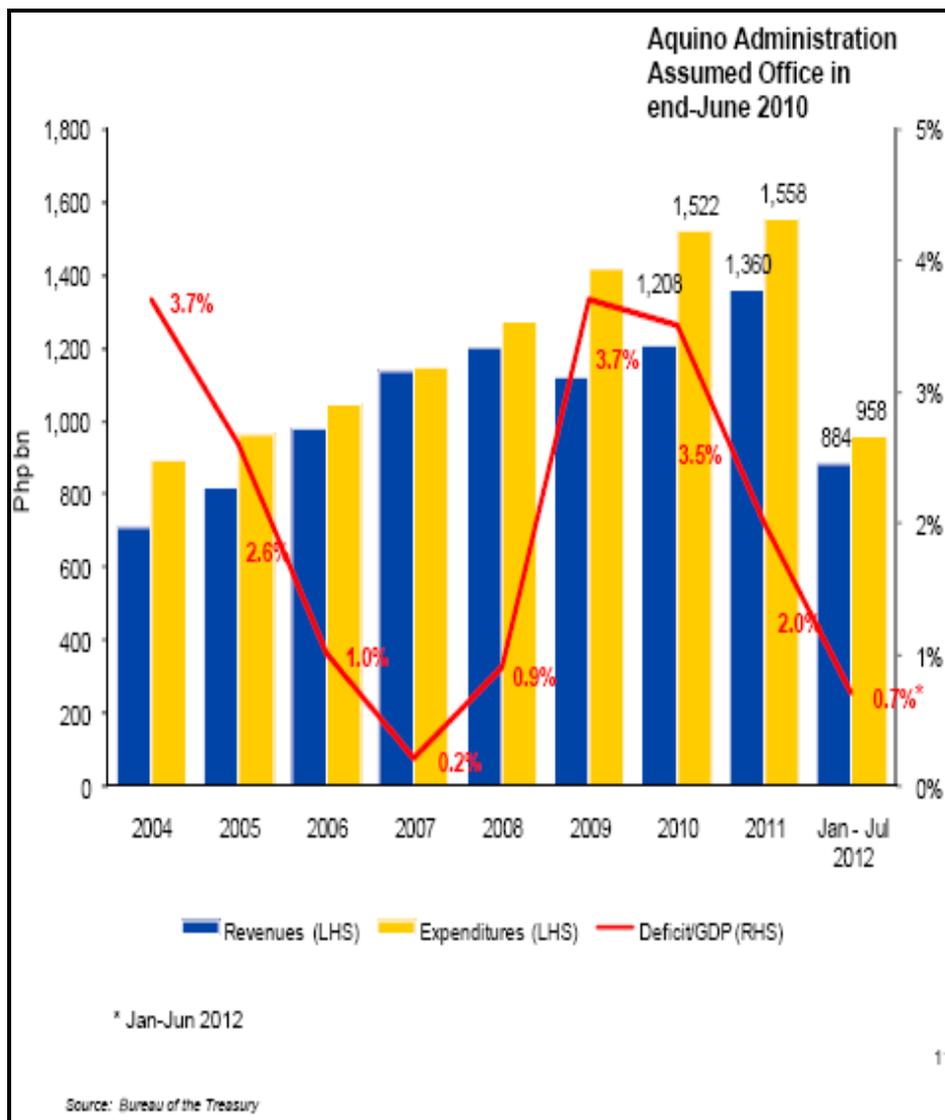
Healthy Loan Growth Resulting From Ample Liquidity

Bank lending grew 18.4% in July; NPL of 2.7%



Well-Capitalized Banking System: CAR of 17.6%, Higher Than International Standard Of 8%

Flexible Fiscal Position: Budget Deficit (2.6% of GDP), Interest Burden (3.0% of GDP)

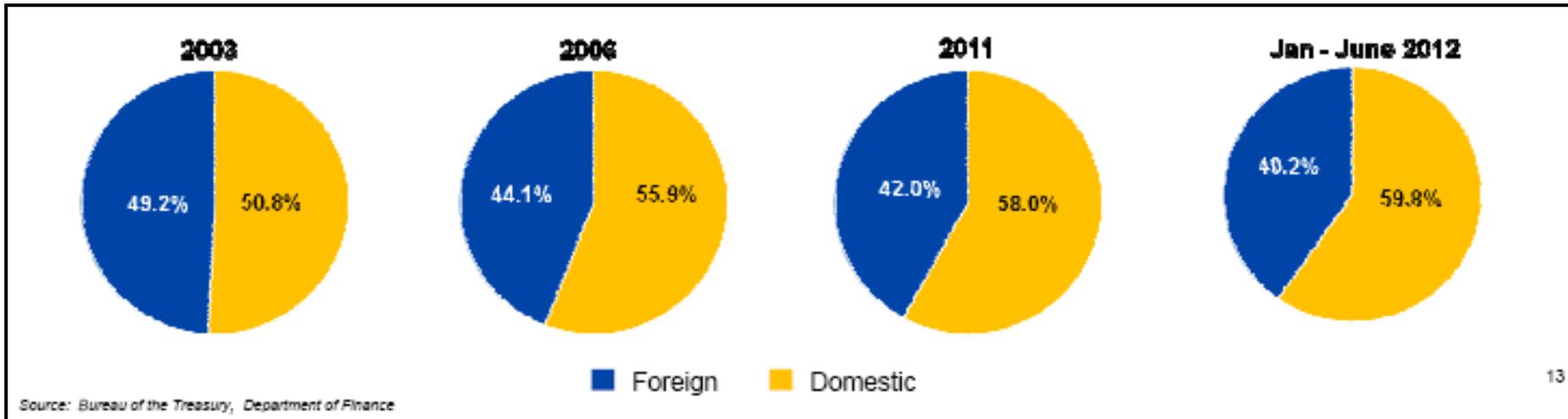
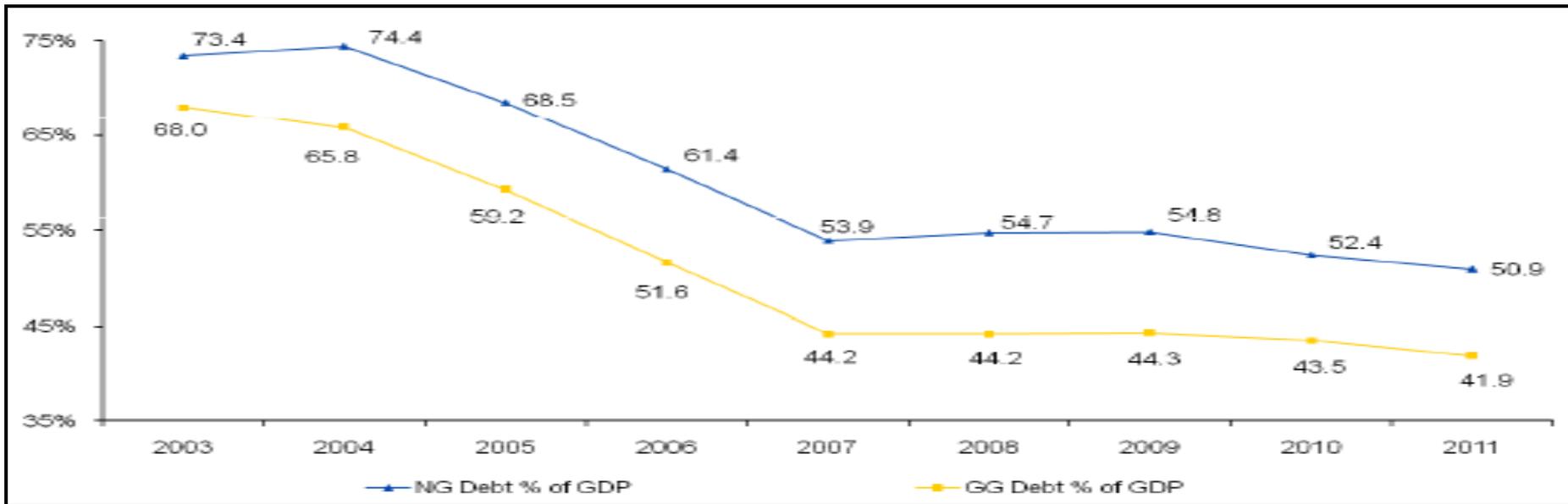


Particulars	Levels (Php Bn)		Percent of GDP		Growth Rate (%) 2012-2013
	2012 Program	2013 Proposed	2012 Program	2013 Proposed	
Revenues	1,560.6	1,780.1	14.5	14.9	14.1
Bureau of Internal Revenue	1,066.1	1,238.6	9.9	10.4	16.2
Bureau of Customs	347.1	397.3	3.2	3.3	14.5
Privatization	2.0	2.0	0.0	0.0	-
Others	145.4	142.2	1.4	1.2	(2.2)
Disbursements	1,839.7	2,021.1	17.1	16.9	9.9
Current Operating Expenditures	1,442.6	1,585.0	13.4	13.3	9.9
o.w. Interest Payments	317.7	333.9	3.0	2.8	5.1
Capital Outlays	374.1	409.6	3.5	3.4	9.5
Net Lending	23.0	26.5	0.2	0.2	15.2
Surplus/(Deficit)	(279.1)	(241.0)	(2.6)	(2.0)	(13.7)
Memo Item: GDP			10,734.2	11,951.9	

Government targets an increase in tax revenue to 13.8% of GDP in 2013

Steadily Declining Debt to GDP

From 74% In 2004 To 51% In 2011



Source: Bureau of the Treasury, Department of Finance

Improved Debt Profile: Mix Of 40% Foreign And 60% Domestic

Credit Ratings Upgrades

	S&P	Moody's	Fitch
China, People's Rep. of	AA-	Aa3	A+
Hong Kong, China	AAA	Aa1	AA+
Indonesia	BB+	Baa3	BBB-
Korea, Rep. of	A	Aa3	AA-
Malaysia	A-	A3	A-
Philippines	BB+	Ba2	BB+
Singapore	AAA	Aaa	AAA
Thailand	BBB+	Baa1	BBB

Note: Ratings as of 10 September 2012.
Source: Rating Agencies.

The lowest investment-grade ratings
 Ratings of long-term Philippines debt

Moody's	S&P	Fitch
Aaa	AAA	AAA
Aa1	AA+	AA+
Aa2	AA	AA
Aa3	AA-	AA-
A1	A+	A+
A2	A	A
A3	A-	A-
Baa1	BBB+	BBB+
Baa2	BBB	BBB
Baa3	BBB-	BBB-
Ba1	BB+	BB+
Ba2	BB	BB
Ba3	BB-	BB-
B1	B+	B+
B2	B	B
B3	B-	B-

Philippines expects to achieve investment grade status in early 2013

Tip Of The Iceberg

YTD Net Foreign Portfolio Inflows Of \$1.9b= 0.8% Of Market Cap.

Asian Infusion

Foreign investment in some Asian economies



PHILIPPINES
Net stock and
bond flows

***0.8%**



\$1.9 billion
Year to Aug. 3



THAILAND
Net stock and
bond flows

***5.9%**



\$20.4 billion
Year to Aug. 28



INDONESIA
Net bond flows

***9.3%**



\$25.1 billion
Year to Aug. 16



SOUTH KOREA
Net treasuries
and bonds

***7.9%**



\$79.0 billion
Year to July 31

Note: \$1 = 31.28 Thai baht; 9,514.90 Indonesia rupiah; 1,135.10 South Korea won

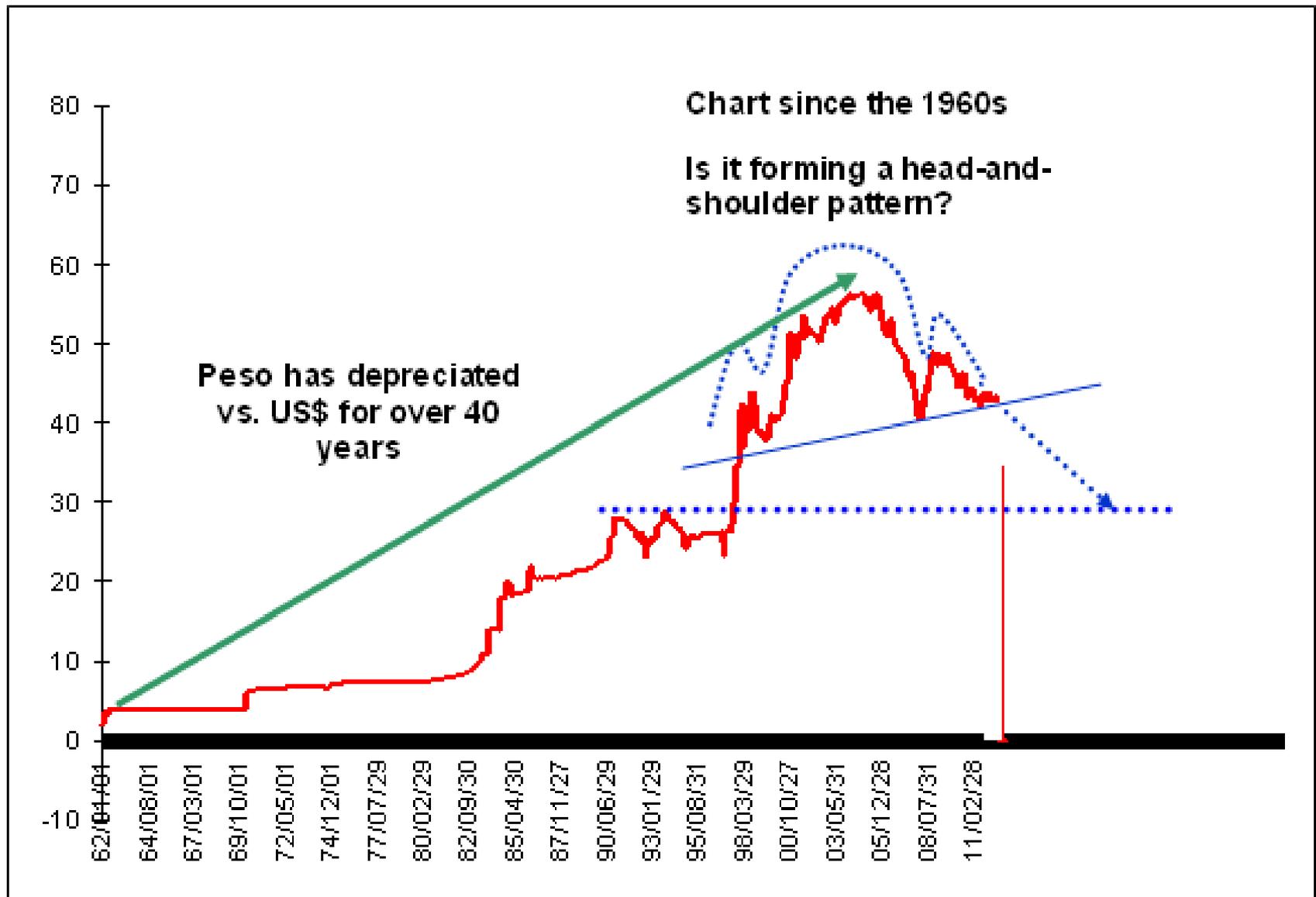
Sources: Central Bank of the Philippines; Stock Exchange of Thailand;
Bank Indonesia; Korea's Financial Supervisory Service

The Wall Street Journal

*% of Market Cap.

Net Inflows To S.E. Asia and S. Korea Have Swelled In Recent Months
As Global Markets Calmed And Risky Assets Became Popular Again

Php/US\$: Going, Going, Going 30 (?)



Source: BDO Private Bank Research

The Philippine Stock Market: Robust Stock Market Performance



	2008	2009	2010	2011	2012 (YTD as of Oct.11)
PSEi Performance	-48%	+63%	+38%	+4%	+22% (5394)
Average Daily Turnover (in Php bn)	P3.1b	P4.1b	P4.0b	P4.2b	P5.9b
Earnings Growth (in %)	-27%	+33%	+45%	-10%	+15%
PE Ratio (x)	32.1	24.1	16.6	18.4	16.0

PSEi: Sectoral Performances

	2008	2009	2010	2011	2012 (YTD as of Oct.9)
Financials	-47%	+47%	+44%	+7%	+38%
Industrial	-51%	+116%	+56%	-2%	+18%
Holding Firms	-56%	+80%	+110%	+3%	+33%
Property	-58%	+73%	+47%	-6%	+39%
Services	-40%	+32%	+5%	+2%	+10%
Mining and Oil	-61%	+234%	+30%	+69%	-17%
PSEi	-48%	+63%	+38%	+4%	+22%

Market Capitalization: Sectoral Breakdown

	Market Cap.		% of total
	In Php	In US\$	
Financials	P2.7T	\$65.7B	26%
Industrial	P2.8T	\$66.5B	26%
Holding Firms	P1.8T	\$44.2B	17%
Property	P1.1T	\$27.3B	11%
Services	P1.5T	\$35.9B	14%
Mining and Oil	P585b	\$14.1B	6%
Total	P10.5T	\$253.9B	100%

*P41.70 per US\$

As of End-September

Asian Stock Market Performances

MSCI Philippines: Best Performing Equity Index, +27% (Up to July 31)

Table 10: MSCI Index Returns

Market	2010 Returns (%)		2011 Returns (%)		2012 YTD Returns (%)	
	LCY terms	US\$ terms	LCY terms	US\$ terms	LCY terms	US\$ terms
China, People's Rep. of	2.6	2.3	(20.4)	(20.3)	2.6	2.7
Hong Kong, China	20.0	19.7	(18.5)	(18.4)	9.3	9.5
Indonesia	25.8	31.2	4.7	4.0	4.6	0.2
Korea, Rep. of	22.1	25.3	(11.5)	(12.8)	6.1	8.2
Malaysia	19.3	32.5	(0.2)	(2.9)	4.7	6.0
Philippines	23.5	30.3	(3.1)	(3.2)	20.6	26.7
Singapore	8.1	18.4	(20.0)	(21.0)	16.5	21.3
Thailand	36.4	50.8	(1.7)	(5.6)	15.1	15.3
Far East ex-Japan Index	12.5	16.7	(15.6)	(16.8)	5.8	6.8
MSCI US	-	13.2	-	(0.1)	-	9.6

- = not applicable, LCY = local currency, MSCI = Morgan Stanley Capital International, US = United States, YTD = year-to-date.

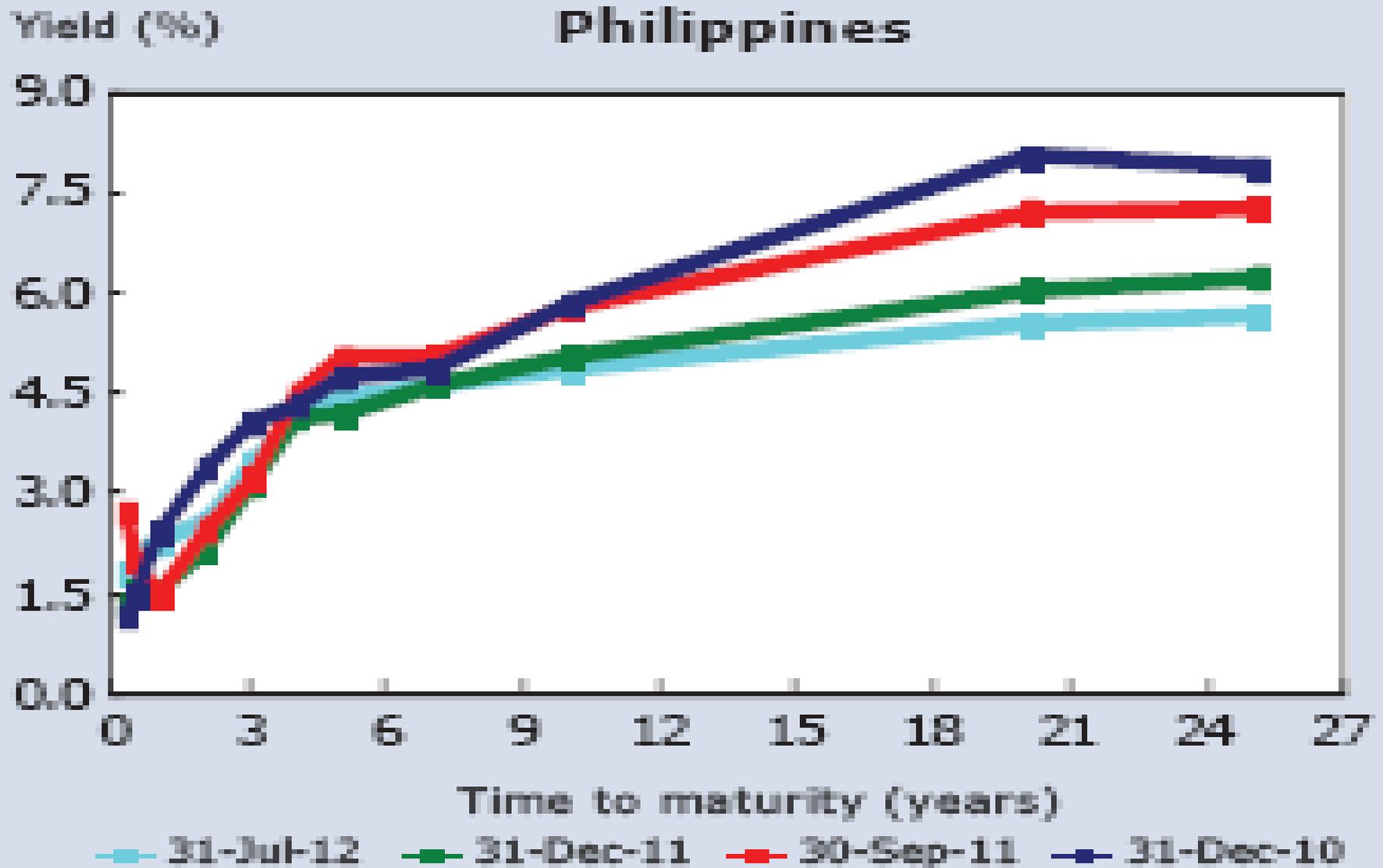
Notes:

1. Market indices are from MSCI country indexes. 2012 returns are year-to-date as of 31 July 2012.

2. Far East ex-Japan includes the People's Republic of China; Hong Kong, China; Indonesia; the Republic of Korea; Malaysia; the Philippines; Singapore; Taipei, China; and Thailand.

Source: *AsianBondsOnline* and Bloomberg LP.

Flattening Yield Curve



Asian Bond Market Performances

iBoxx Philippines: Best Performing Bond Index, +11% (Up to July 31)

Table 9: iBoxx Asia Bond Fund Index Family Returns

Market	Modified Duration (years)	2010 Returns (%)		2011 Returns (%)		2012 YTD Returns	
		LCY Total Return Index	US\$ Unhedged Total Return Index	LCY Total Return Index	US\$ Unhedged Total Return Index	LCY Total Return Index	US\$ Unhedged Total Return Index
China, People's Rep. of	6.24	1.5	5.1	5.4	9.9	2.9	1.7
Hong Kong, China	4.28	2.0	1.8	5.2	5.2	2.9	3.1
Indonesia	7.04	19.3	23.7	19.7	18.4	6.8	2.9
Korea, Rep. of	4.57	8.0	10.6	6.2	4.7	5.1	6.9
Malaysia	4.99	5.2	15.6	4.7	1.8	3.0	4.1
Philippines	7.15	14.3	19.7	14.8	14.7	5.9	10.6
Singapore	6.35	2.5	11.3	6.3	5.0	3.5	7.7
Thailand	5.04	5.4	15.4	4.9	0.3	2.4	2.3
Pan-Asian Index	5.48	-	10.2	-	6.8	-	4.5
HSBC ALBI	7.48	-	11.5	-	4.9	-	4.6
US Govt. 1-10 years	4.01	-	5.3	-	6.8	-	1.9

- = not applicable, ALBI = Asian Local Bond Index, LCY = local currency, US = United States, YTD = year-to-date.

Notes:

1. The Asian Bond Fund (ABF) indices contain only government debt and government-guaranteed debt obligations.
2. Market bond indices are from iBoxx Index Family. Returns for 2012 are year-to-date as of 31 July 2012.
3. Annual returns are computed for each year using a natural logarithm of end-of-year index value/beginning-of-year index value.
4. Duration as of 31 July 2012.

Source: AsianBondsOnline and Bloomberg LP.

Capital Market Trends: New Products

Initiative	Updates
<p>Personal Equity Retirement Account (PERA) Promotes voluntary long-term savings, through investments in PERA products designed to be locked for at least 5 years until retirement age of investor</p>	<p>Awaiting two implementing rules and regulations:</p> <p>First is to be issued by the DOF, BIR, SEC, the Insurance Commission, and the BSP, intended to implement the regulatory and non-tax provisions</p> <p>The second (or the Tax IRR) is to be issued by the DOF, upon the recommendation of the BIR Commissioner; DOF has not yet issued the Tax IRR</p>
<p>Real Estate Investment Trust (REIT) Seeks to provide a legal and regulatory framework and create a favorable market environment for real estate investment companies The REIT Act of 2009 requires REITs to list its shares on the PSE. The REIT must distribute 90% of its income as dividends to avail of tax incentives</p>	<p>Lapsed into Law on December 17, 2009; Implementing Rules and Regulations issued by SEC on May 13, 2010; Awaiting BIR Implementing Rules and Regulations</p> <p>Delayed implementation of the REIT due to issues on the tax structure including the value-added tax (VAT), transfer taxes, and the high minimum public offer (MPO) level</p>
<p>Exchange-Traded Fund (ETF) Listing Rules Will allow local and foreign ETFs, with minimum asset size of P250m and \$10m, respectively, to list on the PSE</p>	<p>Approved by the PSE on April 2008 and submitted to the SEC for approval</p> <p>Awaiting implementing rules and regulations from the SEC</p> <p>May be implemented before the year ends, according to the SEC</p>

Capital Market Trends: Listing Boards

	Updates
<p>PSE Consolidation of First and Second Boards</p>	<ul style="list-style-type: none"> • Under the approved guidelines, the first and second boards would be merged into a new listing board to be called Main Board while the SME board will be retained to present the emerging companies • Under the PSE's proposed rules, companies that will list on the main board should have an authorized capital stock of at least P500m, and at least three years of operating history • These companies should also have cumulative earnings before income tax, depreciation and amortization of at least P50m for the last three years prior to listing
<p>Minimum Public Ownership</p>	<ul style="list-style-type: none"> • 27 listed firms in the PSE currently have yet to comply with the 10% minimum public ownership requirement; <ul style="list-style-type: none"> –Non-compliant companies have until January 1, 2013 to comply with the requirement –A six-month suspension awaits companies that fail to meet the PSE rule –Failure to address the matter during the six-month suspension period would merit delisting •PSEi (Top 30 firms) listed companies are now required to have 12%