

# Commentary

## No easy fix

*This commentary was prepared for despatch in the first week of November but unforeseen circumstances delayed circulation for which we apologize.*

During recent weeks, the economic news from around the world has gone from bad to worse and with no sign yet that the recent crisis that has affected global markets is bottoming out, the Philippines Government has shown, for once, a gritted determinism to avoid signs of panic, despite the worsening situation.

Both Malacañang Palace as well as the Central Bank of the Philippines have sought to put the best possible gloss on a bad situation by pointing out that the exposure of the Philippines to souring global assets is minimal and that there is no need to panic; but many within the local business and investment community are traumatized by current events nonetheless.

For much of the past month, the usual diatribe of salacious news relating to the latest scam to be perpetrated by those in a position to do so has been set aside to be replaced by wire service coverage—supported by local analysis of varying quality—related to the global crisis. Unfortunately much of this analysis has been of the rhetorical and self-congratulatory kind: “...isn’t it lucky that the Philippines held back from integrating into the global economy?”

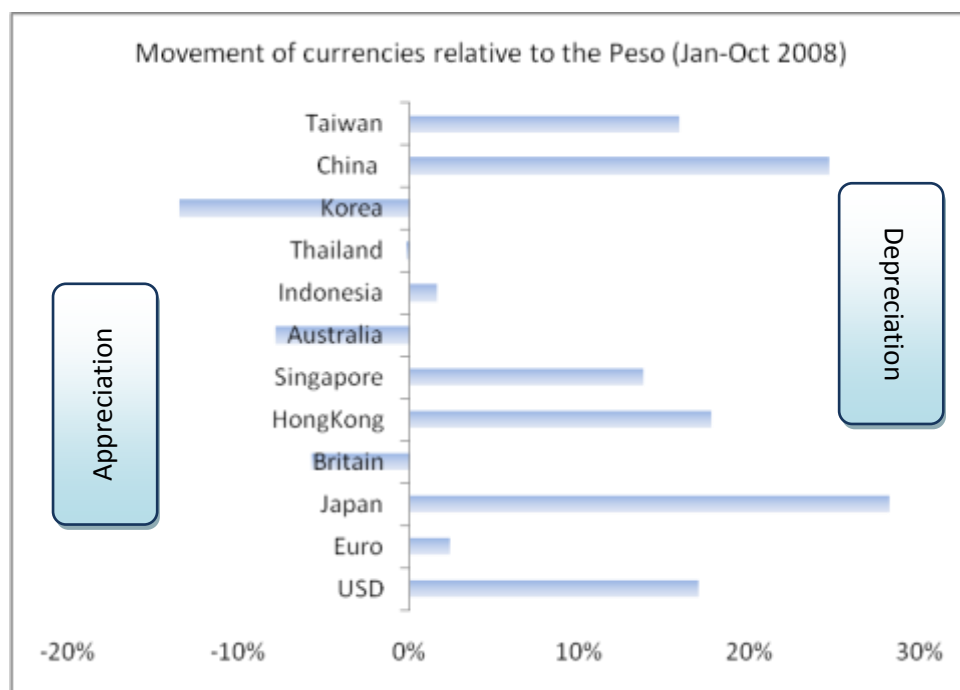
Looked at in the short term, such analysis does have some validity. The immediate exposure of the Philippines is indeed limited and local companies, especially those in the property sector, are busily buying up the local assets of Lehmann Brothers and the like at bargain-basement prices. The banking sector too has gone a long way to cleaning up its books and is not nearly as vulnerable as it was when the Asian crisis hit ten years ago. The major banks are showing no signs of faltering liquidity nor of troublesome balance sheets although the government has, as a precaution, made moves to shore up this sector with increased funds to the local deposit insurance corporation.

Non-performing loans of the banking sector are at a low 3.88 percent although this is one number that will need to be watched in coming months as will the level of credit card debt. However, on the downside the value of mutual funds has been sliding. Even so with the latest Central Bank data showing the Philippines posting its highest balance of payments deficit in more than four years (\$482 million in September) the government is taking no chances. The Bankers Association of the Philippines has recently approved new measures to help financial regulators contain any possible fallout from a currency flight. These measures include tighter scrutiny of offshore investments and the opening of a new inter-bank lending facility using government securities as collateral.

Government debt too is less exposed now to the vagaries of currency exchange movements since the Philippine began to source much of its monetary needs from the local market. Total debt service payments in the first three quarters reached P535 billion (US\$11 billion approx.) Of this amount,

P162 billion (around 30 percent) was in foreign currency obligations and the remainder in local currency. Interestingly, P301 billion was for principal repayments and P35 billion for interest payment. From more than 30 percent eight years ago, interest payments now account for only 23.3 percent of total debt servicing and are expected to fall below 22 percent by the end of this year. This is one area where far-sightedness has paid off.

But in spite of this, the past month has seen the peso slide further against the US currency and it is now trading again at around 48-49 to the dollar as compared to a rate of around 41 at the beginning of the year. This is the same rate as recorded in January 2007. Volatility is evident.



See Table 1 below for detail

On the stock exchange, the PSEi composite index has been on a slide for most of the year and is now at levels not seen since 2004. Indeed, one consequence of the global crisis is the outflow of money from emerging markets back to global headquarters. In September alone some \$312 million in capital was repatriated out of the Philippines. The local index has lost around 44 percent of its value this year, which is not as bad as some markets (Table 2). The Chinese bourse has taken a battering.

One item of good news is the roll back of oil prices amid current uncertainties. Oil prices have plunged to their lowest levels in 17 months as fears of a global recession (and this is generally taken to be a global rate of expansion of less than three percent per annum) has dampened demand—especially for oil and other commodity futures—and despite news that OPEC would cut oil output by 1.5 million barrels per day. According to the latest reports, Brent North Sea crude for December delivery has slumped to US\$61 per barrel, its lowest level since March 2007. New York’s main contract, light sweet crude for December delivery, tumbled to US\$62.85 a barrel, which was last seen in May last year.

As a consequence, pump prices in the Philippines have fallen dramatically. Top grade petroleum that was selling at the pump for close to Php65 per litre earlier this year has fallen back to Php45 per

litre. This represents a fall of around 30 percent. While this will be good for the transport sector and for consumer inflation as a whole, which has recently entered double digits; it will also dramatically reduce government windfall tax revenues from the high oil prices that the government was relying on to pay for many of its poverty alleviation programmes and reduce its overall budget deficit.

The Philippines Government has not yet solved its own budget deficit problem and little has been heard lately of the plan to balance the books by 2010. The present crisis situation will only compound the problem. This year the budget deficit for the first nine months reached Php53.4 billion as a result of higher than anticipated government spending and weaker than expected tax collections. While Finance Secretary Teves is still claiming that the deficit will come in within target this year; again this will be achieved, not by enhanced revenue collection but rather by further sale of assets.

Nevertheless, despite expected revenue shortfalls, the government, with private sector assistance, has mobilized a P100 billion crisis fund to finance programmes aimed at boosting the economy should such be necessary in the current climate. Half of the funds will be raised by government and the other half will come in the form of private sector investment. No specific projects have been announced and reports suggest that the money will be utilized rather as a form of stand-by facility to fund future pump-priming projects, particularly in infrastructure.

So far so good, for the short term: But the new environment in which the Philippines finds itself is likely to last well beyond the short-term and the global economy could take several years to rebound. Many leading analysts and their think-tanks do not expect a recovery until 2012-2013 at the earliest. As well as shorter-term tactical measures, the government will need to consider the broader strategic response. Will remittance income continue to shore up the local currency and support local consumer spending? Indeed, will there continue to be a demand for overseas Filipino workers or will demand contract along with the global economy?

This is surely the time to take a fresh look at overall competitiveness and productivity of the country as part of that strategic response. We will look at this issue in forthcoming commentaries.

		4-Jan-08	31-Oct-08	% change
United States	Dollar	40.955	47.92	17.01%
Eurozone	Euro	60.310	61.775	2.43%
Japan	Yen	0.3748	0.4805	28.20%
Britain	Pound	80.698	76.110	-5.69%
Hong Kong	HK Dollar	5.2499	6.1815	17.75%
Switzerland	Swiss Franc	36.827	41.033	11.42%
Canada	Canadian Dollar	41.392	41.56	0.41%
Singapore	Singapore Dollar	28.548	32.464	13.72%
Australia	Australian Dollar	36.085	33.255	-7.84%
Indonesia	Rupiah	0.004346	0.004416	1.61%
Thailand	Baht	1.3742	1.3723	-0.14%
Korea	Won	0.04372	0.03782	-13.49%
China	Yuan	5.6231	7.0087	24.64%
Taiwan	New Taiwan Dollar	1.2618	1.4621	15.87%
New Zealand	New Zealand Dollar	31.591	29.061	-8.01%

Source: Yahoo Finance

	4-Jan-08	31-Oct-08	% change
DJIA	13044.12	9336.93	-28.4%
NEW ZEALAND	4033.48	2820.86	-30.1%
LONDON	6479.4	4377.3	-32.4%
NASDAQ	2571.08	1726.33	-32.9%
SYDNEY	6387.7	3982.7	-37.7%
SEOUL	1853.54	1113.06	-39.9%
TAIEX	8134.04	4870.66	-40.1%
KUALA LUMPUR	1439.43	853.56	-40.7%
TOKYO	15155.73	8576.98	-43.4%
<b>MANILA</b>	<b>3487.64</b>	<b>1951.09</b>	<b>-44.1%</b>
SINGAPORE	3374.09	1775.86	-47.4%
HONG KONG	27004.34	13968.67	-48.3%
JAKARTA	2765.18	1256.7	-54.6%
SHANGHAI A	5591.6	1816.31	-67.5%
SHENZHEN A	1575.79	495.22	-68.6%
SHENZHEN B	719.19	225.26	-68.7%
SHANGHAI B	371.1	87.47	-76.4%

Source: Yahoo Finance

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