June 16, 2011

Moody's Sovereign Credit Upgrade Affirms the Philippines' Bright Prospects Moving Forward

Global credit watchdog, Moody's Investors Service (Moody's) upgraded yesterday the Philippines' long-term sovereign credit rating by a notch from Ba3 to Ba2. The move was somewhat expected given that the ratings agency had already changed its outlook on the country from "Stable" to "Positive" weeks ago. The decision manifests the financial community's growing confidence towards the Aquino administration's prudent fiscal management and the country's rosy economic prospects.

- Specifically, Moody's cited several key drivers for the decision: Progress made to pursue fiscal consolidation,
- Sustained nature of macroeconomic stability,
- Continued strength in the external payments position, and
- Significant pick-up in the momentum for economic growth.

With the upgrade, the Philippines is just a notch below Indonesia in terms of sovereign credit ratings given by the top 3 credit watchdogs (Moody's, Fitch, and Standard & Poor's), and is already two notches ahead of Vietnam in terms of Moody's and Fitch ratings. Larger neighboring economies such as Malaysia and Thailand, on the other hand, are both in investment grade territory already. Despite lagging behind in ratings, Philippine bonds have been trading close to investment grade (IG) instruments as shown in the table where the CDS spread for Philippine debt was plotted against those of IG counterparts. As of June 15, 2011, the Philippine 5-year CDS spread was at 132.84 basis points, lower than spreads offered by Peruvian and Polish government paper. This implies that the investor community may have already priced-in Philippine sovereign debt as investment grade paper, way ahead of the ratings agencies' action and an affirmation of Finance Minister Cesar Purisima's comments that the country would be ready to attain an investment grade status within President Aquino's term. Serious in its pursuit of fiscal reforms, the Philippine government is targeting to bring the budget deficit to 3.2% of Gross Domestic Product (GDP) this year and to just 2.0% by 2013. For the first four months to April, the government reported a slight budget surplus of approximately Php61 million, much better than the Php131.8 billion shortfall recorded in the same period in 2010, owing to spending cuts by the government and elevated collections by the Bureau of Internal Revenue which has doubled its efforts running after tax evaders and smugglers.

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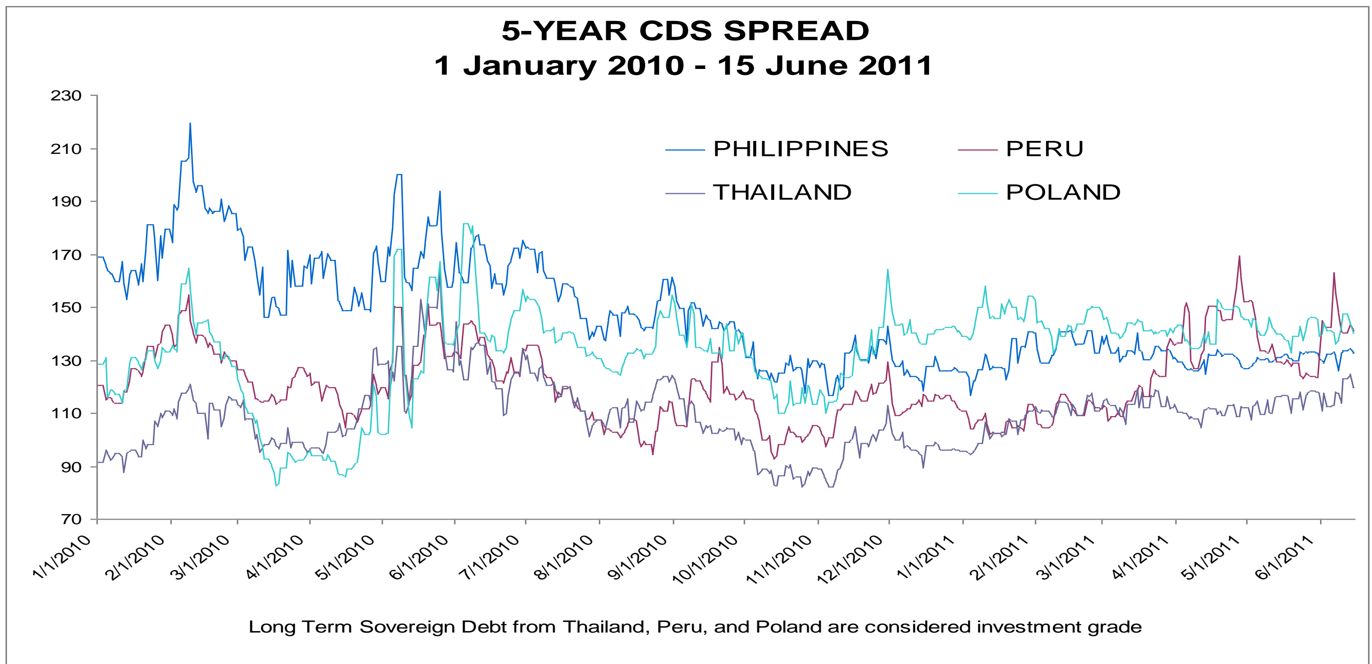

5-Year CDS Spread (in basis points)				
	Philippines	Peru	Thailand	Poland
June 15, 2011	132.84	141.159	119.506	140.124

Showing remarkable resilience, the economy managed to grow by 4.9% in the first quarter of the year despite the severe underspending by the government and the headwinds coming from higher and volatile oil prices, civil unrest in the MENA region (Middle East and North Africa) and the still unresolved debt crisis in the Euro-zone. Although growth fell below the consensus estimate of 5.1%, and was much lower than the revised 7.6% full year expansion in 2010, economic expansion was still marginally above the 4.8% average growth of the past 10 years. We retain our 5.0% to 5.5% GDP growth estimate for the year, anticipating a recovery in government expenditure in the second half and buoyant consumer spending and capital investments.

The upgrade, we believe, is well deserved, backed by sustained improvements in the closely watched debt ratios; the build-up of foreign exchange reserves; and management of inflation and economic growth. For the banking sector, the notable gains in asset quality, capitalization, and profitability were observed amid recovery of lending growth.

Looking ahead, do we see further credit ratings upgrades to bring the country to investment grade status? Highly likely, although much more will be required of government. As Moody's stated - what could change the ratings up will be continued policy prudence, additional fiscal reforms, and improvements in the investment environment. Clearly, the fiscal sector remains to be a work-in-progress and it is in this area where the Aquino administration's sincerity in putting the national government finances in order will be tested. As Moody's also warned, a downgrade will happen if financing conditions are compromised by a deterioration in government finances, a structural weakening in the Balance of Payments and if inflation runs out of control. The Aquino government has the remaining five years to work on these.

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