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Upward and Onward: The Philippines' Quest for an Investment Grade Credit Rating

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One of the key economic goals that President Benigno Aquino III set for his administration is for the Philippines to be awarded an investment grade (IG) credit rating. This goal came one step closer to realization as Moody's Investor Service (Moody's) upgraded the local and foreign currency long-term bond ratings of the Philippine government from Ba2 to Ba1 last October 29, 2012. Moody's was the latest to upgrade the country's local and foreign rating to one notch below IG joining counterparts, Standard & Poor's (S&P) and Fitch Ratings (Fitch). Fitch was the first to upgrade the country's credit rating to one notch below IG, raising its long-term foreign currency rating to 'BB+' from 'BB' and long-term local currency rating to BBB- from BB+ on June 23, 2011 while S&P raised both the country's long-term local and foreign currency rating to BB+ on July 04, 2012. On December 20, 2012, S&P took a step further and revised its outlook on the Philippines from 'stable' to 'positive', which increases the likelihood for the agency to raise its rating in 2013. It should be noted that all these upgrades occurred during President Aquino's term.

Table 1 shows the foreign and local currency long-term ratings assigned by three of the most well-known credit rating agencies (CRAs) to sovereign nations in the Asia-Pacific region. As seen on this table, the Philippines is rated lower as compared with its neighbors that have an IG status. However in terms of Credit Default Swap (CDS) spreads, it seems that the market has priced the Philippines as if it carried the same or even less risk than other IG nations such as Malaysia and Indonesia. This finding suggests that they have been anticipating that the country is well on its way to obtain its IG status.

Table 1. Credit Ratings of Countries in the Asia-Pacific Region

	Foreign Currency Long Term			Local Currency Long Term			
	Moody's	S&P	Fitch	Moody's	S&P	Fitch	5yr CDS[1]
Australia	Aaa	AAAu	AAA	Aaa	AAAu	AAA	42.67
New Zealand	Aaa	AA	AA	Aaa	AA+	AA+	48.17
Singapore	Aaa	AAAu	AAA	Aaa	AAAu	AAA	NA
Hong Kong	Aa1	AAA	AA+	Aa1	AAA	AA+	42
China	Aa3	AA-	A+	Aa3	AA-	AA-	60.06
Japan	Aa3	AA-u	A+	Aa3	AA-u	A+	74.99
Taiwan	Aa3	AA-u	A+	Aa3	AA-u	AA-	NA
South Korea	Aa3	A+	AA-	Aa3	AA-	AA	61.81
Malaysia	A3	A-	A-	A3	A	A	72.1
Thailand	Baa1	BBB+	BBB	Baa1	A-	A-	91.79
Kazakhstan	Baa2	BBB+	BBB+	Baa2	BBB+	A-	NA
India	Baa3	BBB-u	BBB-	Baa3	BBB-u	BBB-	NA
Indonesia	Baa3	BB+	BBB-	Baa3	BB+	BBB-	125.74
Philippines	**Ba1**	**BB+**	**BB+**	**Ba1**	**BB+**	**BBB-**	**98.79**
Sri Lanka	B1	B+	BB-	B1	B	NR	NA
Vietnam	B2	BB-	B+	B2	Bu	NR	203.74
Pakistan	Caa1	B-	NR	WR	NR	NR	818.05

Source: Bloomberg

Does the Philippines deserve an IG rating?

To determine whether the Philippines is deserving of an IG rating, we cite the common concerns of the CRAs: a low revenue base, high public sector debt, and low per capita income. Table 2, which uses figures as of 2011, shows that the Philippines as compared to other IG nations[2] still has some ways to go.

For instance, the government's debt-to-revenue ratio was at 364, considerably higher than the 216 median. Furthermore, the country's GDP per capita stood at just US$2,357 versus the US$10,770 median. Lastly, foreign direct investments (FDI) was much lower at 0.6 compared to the 2.3 median.

Table 2. Comparisons of Economic Indicators[3]

2011 Figures	Median[4]	Philippines	Colombia	Croatia	Iceland	India
Gen. Gov. Debt/Gen. Gov. Revenue	216.1	**364.3**	145.7	126.9	286.4	372.3
Gen. Gov. Revenue/GDP	30.5	**14.0**	25.1	35.9	41.7	18.7
GDP per capita (US$)	10,770.0	**2,357**	7,088	14,452	43,803	1,496
Net Foreign Direct Investment/GDP	2.3	**0.6**	1.5	3.1	8.1	0.2

Source: Moody's Investors Service

The CRAs have also given advice on what could trigger a rating action:

> **Fitch**: "Strengthening of the fiscal revenue base, generating the resources to meet the administration's public investment and social spending plans…A longer track record of improvements in governance and the business environment, leading to stronger investment and firmer medium-term growth prospects…"[5]
>
> **Moody's:** "…the passage and effective implementation of structural revenue reforms; a more rapid reduction in the general government debt stock; and an acceleration of investment spending that puts the economy on a sustainably higher growth trajectory."[6]
>
> **S&P:** "…an improved government revenue structure, a continued diminished reliance on foreign currency government debt financing, or a lower government debt burden…if institutional and structural reforms lead to improved investment environment, and thus better growth potential."[7]

We do note that the government is fast-tracking efforts to address these concerns with the help of various policy tools and measures. These efforts are evident in, among others, the sin tax bill and the planned mining revenues, the recent ROP buyback and upcoming peso debt swap, and infrastructure spending and the roll-out of the public-private partnership (PPP) projects. The sin tax bill, signed by President Aquino on December 20, 2012, seeks to collect around Php34 billion in additional revenues from increased taxes on tobacco and liquor. The planned mining revenues will likewise increase government income through a revenue-sharing scheme between the government and the mining industry. In an effort to control and properly manage debt levels, the government holds bond swaps to lengthen the maturity profile of its debt stock and to take advantage of current low borrowing costs. Lastly, spending on infrastructure and capital outlays has increased 65% in the first ten months of 2012, offsetting the slow progress on the government's PPP program.

These improvements were met with strong approval by foreign investors with the year-to-date FDI reaching US$3.7 billion as of November 2012, exceeding the BSP's full-year forecast of US$3.2 billion.

When will the Philippines obtain an IG status?

The Philippines received its first 'positive' outlook from S&P recently, which suggests that the Philippines may get an upgrade in the next 6 to 18 months. However, there's still a possibility that the 2 other CRAs may upgrade the country first because a 'positive' or a 'negative' outlook is not necessarily a precursor of a rating change.

In assessing the country, CRAs will continue to look for indications that would demonstrate the government's capability to deliver on its promises. A better-than-expected GDP figure for 2012 (which CRAs expect to be between 5.2% and 5.5%)[8] will suggest that the government has, in ways, progressed in its attempt to address structural economic weaknesses of the country. Successful collections from sin taxes, an amenable revenue-sharing scheme for the mining sector, and the awarding of bigger PPP projects may be triggering events to the long sought IG status.

[1] CDS spreads are as of December 18, 2012. The higher the number, the greater the perceived risk.
[2] In rating sovereigns, CRAs use similarly rated nations for basis.
[3] Colombia, Croatia, Iceland, and India are sovereigns unanimously rated by all 3 CRAs one notch above IG.
[4] The median figure is computed using the 5 countries in the table.
[5] Fitch Ratings. (2012). *Philippines Full Rating Report*. 20 June 2012
[6] Standard & Poor's Financial Services. (2012). *Research Update: Republic Of The Philippines Outlook Revised To Positive; 'BB+/B' And 'axBBB+/axA-2' Ratings Affirmed*. 20 December 2012
[7] Moody's Investor Service. *Credit Opinion: Government of Philippines.* 17 December 2012
[8] We expect 2012 GDP to register between 6.0%-6.5%.