12006 Philippines

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Long-term Rating	BBB+
Outlook*	Positive
Short-term Rating	-

*Long-term Rating refers to Foreign Currency Long-term Issuer Rating in principle.

1. Overview

The Republic of the Philippines is an island state comprising more than 7,000 islands, which broadly form the Luzon region in the north, the Visayas region in the central and the Mindanao region in the south. Its land area is 299,000 square kilometers (about 80% of that of Japan).

The country's population totaled 106.6 million in 2018, the second largest after Indonesia in Southeast Asia. Its nominal GDP stood at USD 330.9 billion in 2018, the sixth largest after Indonesia, Taiwan, Thailand, Singapore and Malaysia, making it one of the largest economies in Southeast Asia.

Currently, the Philippines is made up of 70 ethnic groups which include Tagalog, Cebuano, Tausug, among others. In addition, there are nationals of Chinese and Spanish ancestry. The native language is Filipino which is based on Tagalog. Both Filipino and English are the official languages. The Philippines is the only Christian nation in the ASEAN, and more than 80% of the population is Catholic. Muslims account for about 5%, many of them residing on the island of Mindanao in the southern part of the country.

2. Social and political bases

Rodrigo Duterte, who took over as president in July 2016 after serving as mayor of Davao for more than 20 years, has a track record of significantly improving the city's security situation. He has strongly pursued his campaign against illegal drugs since assuming the presidency. Despite some criticisms in the international community regarding his campaign against illegal drugs, President Duterte and his proactive approach to the problem continue to receive strong public support.

President Duterte's economic team has been actively promoting deregulation and attracting foreign investment by building on the gains of its predecessors to ensure continuity and consistency of policies, programs and projects to accelerate growth through macroeconomic stability and liberalization of industries to foreign capital. Against this backdrop, overseas investors' confidence towards the administration has been bolstered.

The president also gives strong policy consideration for low-income households with the aim of reducing poverty. The large-scale infrastructure development projects promoted by his administration are focused on improving the country's connectivity, e.g. enhance linkages between metropolitan centers to regional centers to equalize economic opportunities and access to social and welfare services. Against the backdrop of these measures, the net satisfaction with the general performance of the Duterte Administration reached a new record-high at +72 or "Excellent" in March 2019 based on the survey done by the Social Weather Stations (SWS), a local social research institution. Among the six presidents who took office after the People Power Revolution in 1986, President Duterte is the first to enjoy rating consistently above +50 during the first three years. In the latest survey conducted by SWS from June 22-26, 2019 President Duterte obtained a high net satisfaction rating of +68 or "Very Good".

During the recently held mid-term elections in May 2019, the ruling coalition allied with President Duterte won a landslide victory. This bodes well for the early passage of the administration's priority bills such as package 2 of its Comprehensive Tax Reform Program (CTRP). President Duterte's strong leadership and the solid public support for him are expected to give a major boost to the administration's economic policies. The Philippine president's term of office is six years and re-election is prohibited by the Constitution.

In the Philippines, on the other hand, the confrontation between Christians, who account for the majority of the population in Mindanao in the southern part of the country, and Muslims, who account for only about a quarter of Mindanao's population, has led to long-standing anti-government activities by Muslim forces who advocate separation and independence from the Philippines. Currently, major Islamic separatists group are the Moro National Liberation Front (MNLF) and the Moro Islamic Liberation Front (MILF). Peace negotiations between the government and MILF have been progressing since the Arroyo administration. A Comprehensive Agreement on the Bangsamoro was finally reached in March 2014 under the Aquino administration. As a result, the process to establish an autonomous government to replace the Autonomous Region of Muslim Mindanao was started and the "Organic Law for the Bangsamoro Autonomous Region of Muslim Mindanao (BARMM)" was finally enacted in July 2018. An interim government, the Bangsamoro Transition Authority, is in place pending the elections of Bangsamoro government officials to be held in 2022.

The Abu Sayyaf, designated by the Philippine government as a terrorist group appears to be weakening in the long-lasting armed conflict with the government. In recent years, the group has repeatedly committed criminal acts such as kidnapping and robbery in pursuit of pecuniary profit, and the successive administrations have declared that they would not engage in any negotiations with terrorist organizations including Abu Sayyaf. A firefight erupted in Marawi, Mindanao, on May 23, 2017 between the Armed Forces of the Philippines on one hand and Abu Sayyaf and the Maute Group, another armed Islamic group, on the other, prompting President Duterte to declare martial law on the island on the same day. The combat ended in October that year, but the deadline for the martial law was extended till the end of December 2019 to ensure security. JCR holds that these events will have only a negligible direct impact on the investment environment in the Philippines.

Successive administrations have also pursued peace processes with anti-government communist forces, but such initiatives have made little headway in recent years. The Philippine Communist Party (CPP), a major communist force in the Philippines, was established in 1968 and its armed unit, the New People's Army (NPA), was formed soon afterward. The former Aquino administration initially announced a policy to seek peace with NPA but their negotiations hit a snag as NPA repeated its attacks. The Duterte administration also pushed ahead with peace negotiations with NPA but discontinued them in November 2017 as NPA kept on its armed fighting. They remain in confrontation so far.

3. Economic base

The Philippines has the second-largest population in Southeast Asia after Indonesia. It is particularly noteworthy that it has a large number of young population in terms of demographics. According to the United Nations Population Prospects 2019, the share of the country's productive age population (15-64 years old) was 63.1% in its latest estimate in 2015, which is the lowest among the major sovereigns rated in the BBB-A range by JCR (Indonesia, India, Thailand, Turkey, Mexico and Brazil). However, the growth of the Philippines' share of productive age population is projected to continue for a long period until the 2050s compared to these countries. This is expected to contribute to the country's medium- to long-term stable economic growth from a demographic perspective.

The Duterte administration launched the Philippine Development Plan (PDP) 2017-2022 in February 2017, defining its plans and strategies for the country to become an upper middle-income country by 2022. The PDP 2017-2022 is guided by the Duterte Administration's 0-10 point Socioeconomic Agenda, the national government's strategy to spur growth and development underpinned by safe, peaceful and orderly communities. One of the policy reforms under the Agenda calls for implementing a large-scale infrastructure development program dubbed "Build, Build, Build" to upgrade the country's infrastructure network , which is one of the constraints to the country's economic growth. A total of 8,062 projects costing around USD 237.6 billion have been in progress as of March 2019 under this Public Investment Program (PIP, 2017-2022). Those include 75 flagship projects. More than 60% of them have advanced from the preparation stage to the implementation stage, indicating that the projects under the program are steadily progressing. The large-scale infrastructure development program is expected to significantly improve the investment climate, a long-standing challenge for the Philippine economy, and underpin its sustainable growth. To finance the massive infrastructure program, 78% of funding will come from the national government and 17% from ODA. In other words, the public sector is the main source of funding. This was based on the experience that the progress on the infrastructure development plan during the former Aquino administration was slow as it focused on Public Private Partnership (PPP) for funding. The Duterte administration's infrastructure development plan is highly feasible in terms of financing.

The Philippines' per capita GDP remained at USD 3,104 in 2018. However, its economy has kept growing faster than 6% level in recent years on strong domestic demand. Its real GDP growth rate in 2018 slowed moderately from 6.7% in the previous year to 6.2% due mainly to the greater negative contribution of external demand caused by increased imports largely due to higher demand for capital goods to support the massive investments in public infrastructure. Although the government's target (6.5-6.9%) was not achieved, its growth still remained relatively high. JCR believes that the growth rate will stay higher than 6% in 2019 and beyond, driven by a solid expansion of private consumption and gross fixed capital formation.

The consumer price index (CPI) inflation rate turned upward at the beginning of 2018 and rose to 6.7% in October 2018, substantially exceeding the government's inflation target range (3 ± 1%) mainly due to supply side shocks coupled by some issues related to the implementation of the package 1 of the government's multiphase Comprehensive Tax Reform Program (CTRP) which raised the tax rates on petroleum products and tobacco and introduced a new tax on sugary drinks. In order to arrest the risks to the inflation outlook, including those coming from the uncertainty in the external environment amid tighter global financial conditions, and preempt further second-round effects., the central bank raised its policy rate by a cumulative 175 basis points, bringing it to the highest level since 2009. On top of the bank's swift actions, oil prices turned lower in the latter half of 2018 and the impact of the tax reform subsided in 2019. As a result, the CPI inflation rate began declining toward the end of 2018. CPI further declined to 0.9% in September 2019, and averaged 2.8% year-to-date to settle within the inflation target range. This is mainly due to lower food, electricity, and domestic petroleum prices. As the inflation outlook continued to be manageable and the risks to the inflation outlook remain broadly balanced in 2019, the central bank made a decision to cut its policy rate by 25 basis points (bps) in May 2019, 25 bps in August 2019, and another 25 bps in September 2019, bringing the total policy rate cut to 75 bps in 2019.

4. External position

The country's current account balance was in consecutive surplus from 2003 to 2015 as chronic trade deficits were more than offset by service account surpluses backed by growing revenues in the business process outsourcing (BPO) industry, and primary and secondary income balance surpluses stemming from steady remittances by overseas Filipinos (OF). The Duterte administration's large-scale infrastructure development has led to a significant increase in imports of capital goods and a widening of goods trade deficit since 2016. As a result, the current account balance slipped into deficit in 2016 and the deficit has since been widening. The deficit in 2018 was equivalent to 2.6% of GDP. While the current account deficit is expected to continue in light of the infrastructure development plan, it may remain in the 2% range of GDP, given the steady inflows of OF remittances and the expansion of service exports by the BPO and tourism industries.

On the financial account, net foreign direct investment (FDI) inflows have been on an increasing trend since the start of the former Aquino administration in 2010. Meanwhile, the net FDI inflows grew to USD 10.26 billion (3.2% of GDP) in 2017 and remained high at USD 9.80 billion (3.0% of GDP) in 2018. For the period January to July 2019, FDI inflows reached USD 4.1 billion. It shows that efforts of the government to ensure continuity coupled with the Duterte Administration's initiatives to improve the investment climate by pursuing key economic reforms such as large-scale infrastructure development plan and CTRP have translated to positive investor sentiment. Thus, the Philippines has forged a structure whereby current account deficits are largely covered by stable FDI inflows over the medium to long term. For this reason, JCR holds that even if a current account deficit continues, serious concerns are unlikely to arise about its financeability.

As for portfolio and other investments, non-resident investments in government bonds and corporate bonds of domestic financial institutions significantly increased in 2018 in response to the growing demand for funds associated with infrastructure development, resulting in excess inflows (positive net incurrence of liabilities) equivalent to 1.0% of GDP for the first time in five years. In other investments, external borrowings by the general government and domestic financial institutions also grew steeply in 2018, ending up with excess inflows (positive net incurrence of liabilities) equivalent to 0.6% of GDP. The growing international confidence in the Philippines has allowed the country's residents to enjoy better access to external financial and capital markets.

The country's foreign reserves (official reserve assets) have remained high at around USD 80 billion despite the widening current account deficit since 2016. At the end of 2018, they declined slightly to USD 79.19 billion from the end of the previous year. However, the reserves have been on the rise since the beginning of 2019 amid increased capital inflows due mainly to the National Government's net foreign currency deposits, the BSP's income from its investments abroad and revaluation adjustments on its foreign currency-denominated reserves. It stood at USD 86.16 billion as of the end of September 2019, or equivalent to 5.4 times the country's short-term external debt based on original maturity and 3.9 times based on residual maturity.

The country's external debt had kept declining moderately from 2012- 2017, but turned upward in 2018 due to an increased external debt funding since 2018. The external debt rose to USD 81.3billion at the end of June 2019 from USD 79.0 billion at end-2018. However, it has constantly remained smaller than the foreign reserves since 2012. Its ratio in GDP terms has been broadly on a downtrend trajectory since the most recent peak in 2009. It stood at 23.8% of GDP at the end of June 2019, which is extremely low as compared to other countries rated in the BBB range by JCR. These prove that the Philippine economy remains highly resilient to external shocks.

5. Financial system

Currently, the Philippine banking sector consists of universal banks, commercial banks, thrift banks, rural banks and cooperative banks. Of these, universal banks are authorized to engage in investment banking business including securities transactions in addition to general commercial banking business. They account for approximately 80% of the total assets held by the banking sector (excluding the central bank).

The consolidated capital adequacy ratio of universal and commercial banks (UKBs) stood at 15.4% at end-Dec 2018 and 15.95% at end-June 2019, well above the 10% limit set by the central bank. The nonperforming loan ratio of UKBs remained low at 1.7% on a gross basis and 0.8% on a net basis at the end of August 2019. Overall, the soundness of the banking sector is high.

Although the sector's gross loan assets had been increasing at a pace of 15-20% year-on-year in recent years, the rate of growth has been markedly slowing after the second half of 2018 which may be attributed to supply-side factors as banks have opted to be more discerning in the grant of credit to borrowers. The growth rate slowed to 10.5% at the end of August 2019. The rate is expected to stay at the steady 10% level in 2019 due in part to the central bank's policy rate cut. The loan-to-deposit ratio was in the 70% range, indicating that the sector's funding stays stable.

The Philippine authorities provide no statistics on the debt outstanding for each economic entity such as households and corporates. Yet, the household debt can be estimated from the balance of consumer loans in GDP terms. The debt based on this formula is about 9% of GDP. In addition, IIF Global Debt Monitor periodically publishes the estimates of such debt across countries. According to IIF, the household debt in the Philippines is estimated at about 15% of GDP. Both rates are considerably lower than those in other countries. IIF estimates also shows that the non-financial corporate debt in the Philippines is around 60% of GDP, which is also relatively low as compared to the countries rated in the BBB-A range by JCR.

The loans outstanding to the real estate sector grew faster than 20% year-on-year in 2014 and 2015. Since 2016, however, the growth rate has slowed to less than 20% due to the base effect, coming from a particularly high growth of real estate loans in 2015 along with banks' implementation of more prudent lending standards which led to lower NPLs. As of June 2019, growth rate fell to 7.7% as banks continue to maintain prudent credit standards in granting real estate loans. Real estate prices, for which government statistics are available only for residential property, have risen by about 2.9% in 2018 amid stable housing supply, staying much slower than the growth of nominal GDP. To ramp up its monitoring of real estate loans, the central bank has strengthened its reporting requirement for loans made by domestic banks. The central bank law has also been amended to allow it to collect necessary information from the nonbanking sector as well. As of Q2 2019, the Residential Real Estate prices grew by 0.4% year on year.

The Philippines annually receives a large amount of OF cash remittances, which rose to the USD 20 billion level (7% of GDP) in recent years. As of July 2019, cash remittances already amounted to USD 17.2 billion.

Foreign currency-denominated deposits held by the FCDUs (Foreign Currency Deposit Units), which are authorized to engage in foreign currency-denominated transactions, have been on the rise in recent years, reaching USD 38.72 billion at the end of December 2018 and USD 41.0 billion as of July 2019. This exceeds the banking sector's external debt, which stood at USD 21.35 billion at the end of December 2018 and USD21.6billion as of June 2019. The foreign currency-denominated loan-deposit ratio at FCDUs remains relatively low at around 40%.

6. Fiscal base

Like many of its neighbors, the financial state of the Philippine government worsened after the Asian currency crisis in 1997. The central government budget deficit expanded to 5.0% of GDP in 2002, with the ratio of the national government debt to GDP soaring to 74.4% in 2004. However, public finance improved markedly thanks to the persistent efforts made by the Arroyo and Aquino administrations for fiscal consolidation. The fiscal deficit was dramatically reduced to 0.6% of GDP in 2014 under the Aquino Administration, with national government debt reduced to 45.4% of GDP at the end of the same year. The efforts by past administrations for fiscal consolidation have enabled the Duterte administration to adopt a proactive fiscal expansion stance enabling massive spending in infrastructure and social services. Under its Medium-Term Fiscal Program, the Duterte administration will expand the fiscal deficit to 3.2% of GDP in 2019-2022 and substantially raise its infrastructure expenditure from 5% of GDP in 2018 to 6.3% in 2022. In fact, the budget deficit widened from 0.9% of GDP in 2015 at the end of the former administration to 3.2% in 2018 under the Duterte administration to support pro-growth investments in infrastructure and human capital development. The deficit in the first semester of 2019 stood at 0.5% of GDP.

The administration has been promoting budget reforms to ensure faster budget implementation and prudent spending. The initiatives have resulted in positive results. The budget execution rate has improved significantly, with the expenditure budget execution rate reaching 100% since 2017.

While expanding infrastructure expenditures, the Duterte administration has been vigorously pushing ahead with the Comprehensive Tax Reform Program (CTRP) as part of initiatives to fund the infrastructure expenditures in an effort to keep the momentum for fiscal consolidation. CTRP broadly consists of four packages, with the President enacting into law Package 1A, Package 1B, and Package 2 Plus while, calling Congress to pass the remaining tax reforms in his 4th State of the Nation Address. Package 1A dubbed TRAIN (Tax Reform for Acceleration and Inclusion) which includes a reduction of the personal income tax, an increase in excise tax on automobiles, petroleum and tobacco products, expansion of value-added tax base, introduction of excise tax on sugar-sweetened beverages and cosmetic, and simplification of donor’s tax was passed in December 2017 and implemented in January 2018. Package 1B which provides for amnesty on estate tax and tax on delinquencies was passed in February 2019 and enforced in April 2019. The President also recently signed a new law imposing an increase in the excise tax on tobacco products (half of Package 2 Plus). The administration aims to have the remaining tax reforms e.g., CITIRA (Corporate Income Tax and Incentives Reform Act) bill (Package 2) which includes a cut of the corporate income tax rate and rationalization of tax incentives; an increase in the excise tax on alcohol (other half of Package 2 Plus); reforms in property valuation (Package 3); and PIFITA (Passive Income Tax and Financial Intermediary Tax) bill or Package 4 enacted within 2019. CTRP envisages expanding fiscal revenues by almost PHP 900 billion by 2022 and covering about 14.1% of total infrastructure expenditures. It has been making steady headway to date.

Meanwhile, national government debt to GDP ratio is on a downtrend amid continued high economic growth. It declined to 41.8% at the end of 2018. While front loading of Government fund raising slightly increased central government debt-to-GDP to 43.7% at end-June 2019, the ratio is still expected to decline by end-December 2019 amid repayment of large maturities in November 2019. The administration plans to reduce it further to 39.0% by end of 2022. JCR expects the ratio will keep moderately declining in the years ahead given the strengthened tax collection base and continuing high growth, and holds that the government is highly likely to achieve its plan. As seen above, large-scale infrastructure development and fiscal discipline have now become compatible in the Philippines.

The Philippines has a bond sinking fund (BSF), which is 2.9% (national government portion held by BSF) of GDP in size at end 2018. The debt owed by the local governments is kept less than 1% of GDP. The consolidated general government debt, which includes outstanding debt of central government, social security institutions and local governments reached 36.0% of GDP, which is lower than the ratio of the central government debt to GDP.

7. Conclusion and Rating Outlook

The ratings mainly reflect the country's high and sustainable economic growth performance underpinned by solid domestic demand, resilience to external shocks supported by an external debt kept low relative to GDP and the accumulation of foreign exchange reserves, and the government's sound fiscal position. The improvement of the investment environment through infrastructure development had been a long-standing policy issue for the Philippines. However, infrastructure development has accelerated under the Duterte administration amid expanding expenditures based on its Public Investment Program and improved budget execution rate brought by budget reforms. As part of its efforts to secure the necessary financial resources for such expanding expenditures, the government has been vigorously pursuing its Comprehensive Tax Reform Program (CTRP). The strong collaboration between the Executive and Legislative branches together with the support of the President had enabled the successful passage of the first phase of tax reforms. A strengthened tax base and increasing revenues brought by robust economic growth have made infrastructure development possible while maintaining fiscal discipline. JCR holds that the country's fiscal deficit will be maintained at manageable levels and the government debt as a percentage of GDP will keep declining moderately in the future. JCR has left the ratings unchanged in view of the need to assess progress on infrastructure development and CTRP, but has changed the rating outlook from Stable to Positive. JCR will monitor future developments and reflect the outcome on the ratings.

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Consolidated Financial Summary

		2014	2015	2016	2017	2018
Nominal GDP per capita	USD	2,849	2,883	2,953	2,989	3,104
Real GDP growth	%	6.1	6.1	6.9	6.7	6.2
CPI inflation (annual average)	%	3.6	0.7	1.3	2.9	5.2
Central government primary balance to GDP	%	2.0	1.4	-0.3	-0.3	-1.2
Central government fiscal balance to GDP	%	-0.6	-0.9	-2.4	-2.2	-3.2
Central government debt to GDP	%	45.4	44.7	42.1	42.1	41.8
General government debt to GDP	%	36.4	36.2	34.6	36.6	36.0
Current account balance to GDP	%	3.8	2.5	-0.4	-0.7	-2.6
Trade balance to GDP	%	-6.1	-8.0	-11.7	-12.8	-15.4
Financial account balance to GDP	%	3.4	0.8	0.1	-0.9	-2.6
Official reserve assets	bn USD	79.5	80.7	80.7	81.6	79.2
Official reserve assets to imports of goods and services	months	9.9	9.9	8.8	7.8	6.9
Official reserve assets to short-term external debt	x	4.9	5.3	5.6	5.7	4.9
External debt to GDP	%	27.3	26.5	24.5	23.3	23.9
Foreign exchange rate (annual average)	PHP/USD	44.4	45.5	47.5	50.4	52.7
Capital adequacy ratio of Universal and Commercial Banks	%	16.2	15.8	15.1	15.0	15.4
Nonperforming loan ratio of Universal and Commercial Banks	%	1.8	1.6	1.4	1.2	1.3
Domestic claims to GDP	%	55.8	59.0	63.5	66.3	69.1

* Figures for the most recent period could be indicators based on preliminary figures.
Source: Philippines Statistics Authority, Central Bank, Department of Finance, Bureau of Treasury, IMF and CEIC

Ratings

(millions of yen)

	Rating	Outlook*	Amount	Rate (%)	Issue Date	Maturity Date	Release
Japanese Yen Bonds 8th Series (2018)	BBB+	-	107,200	0.38%	2018.08.15	2021.08.13	2019.04.19
Japanese Yen Bonds 9th Series (2018)	BBB+	-	6,200	0.54%	2018.08.15	2023.08.15	2019.04.19
Japanese Yen Bonds 11th Series (2018)	BBB+	-	40,800	0.99%	2018.08.15	2028.08.15	2019.04.19
Japanese Yen Bonds 12th Series (2019)	BBB+	-	30,400	0.18%	2019.08.15	2022.08.15	2019.08.02
Japanese Yen Bonds 13th Series (2019)	BBB+	-	21,000	0.28%	2019.08.15	2024.08.15	2019.08.02
Japanese Yen Bonds 14th Series (2019)	BBB+	-	17,900	0.43%	2019.08.15	2026.08.14	2019.08.02
Japanese Yen Bonds 15th Series (2019)	BBB+	-	22,700	0.59%	2019.08.15	2029.08.15	2019.08.02
Foreign Currency Long-term Issuer Rating	BBB+	Positive	-	-	-	-	2019.04.19
Local Currency Long-term Issuer Rating	BBB+	Positive	-	-	-	-	2019.04.19

History of Long-term Issuer Rating (Foreign Currency Long-term Issuer Rating or its equivalent)

Date	Rating	Outlook*	Issuer
1996.07.29	BBB-	-	Philippines
1997.06.13	BBB	-	Philippines
2001.06.12	BBB	Stable	Philippines
2002.12.27	BBB	Negative	Philippines
2005.04.15	BBB-	Stable	Philippines
2005.07.15	BBB-	Negative	Philippines
2006.04.24	BBB-	Stable	Philippines
2007.07.06	BBB-	Positive	Philippines
2009.03.04	BBB-	Stable	Philippines
2011.04.28	BBB-	Positive	Philippines
2013.05.07	BBB	Stable	Philippines
2015.07.06	BBB+	Stable	Philippines
2019.04.19	BBB+	Positive	Philippines

*Outlook for Foreign Currency long-term issuer rating, or direction in case of Credit Monitor

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