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Research Update:

Ratings On The Republic Of The Philippines Affirmed At 'BBB/A-2'; Outlook Stable

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Research Update:

Ratings On The Republic Of The Philippines Affirmed At 'BBB/A-2'; Outlook Stable

Overview

- The Republic of the Philippines has a strong external position, reflecting rising foreign exchange reserves and low external debt. It remains a low-income sovereign with vulnerabilities in its institutional and governance framework.
- We are affirming our 'BBB' long-term and 'A-2' short-term sovereign credit ratings on the Philippines. We are also affirming our 'axA/axA-2' ASEAN regional scale rating on the Philippines.
- The stable outlook reflects our expectation that the key economic fiscal, external, and monetary credit measures for Philippines will continue to improve.

Rating Action

On April 21, 2016, Standard & Poor's Ratings Services affirmed its 'BBB' long-term and 'A-2' short-term sovereign credit ratings on the Republic of the Philippines. The outlook is stable. In addition, we affirmed our 'axA/axA-2' ASEAN regional scale rating on the Philippines.

Rationale

The ratings on the Philippines reflect our assessment of the country's strong external position, which features rising foreign exchange reserves and low and declining external debt. These strengths are offset by the Philippines' low income and a developing institutional and governance framework that can hamper policy responsiveness.

The Philippines has a low income but comparatively diversified economy; we estimate real GDP per capita will rise by 4.4% to about US\$3,000 in 2016, from 4.1% in 2015. We project real GDP per capita will average 4.6% over 2017-2019, reflecting the modest outlooks for the Philippines' trading partners. High household consumption, investment, and exports (mainly of electronics, commodities, and services) continue to support economic activity. These strengths will likely be underpinned by strong household and company balance sheets, sound growth in jobs and income, inward remittance flows, and an adequately performing financial system.

Uncertain conditions in export markets and inadequate infrastructure mainly in transportation and energy are the main downside risks to our growth outlook. Without the closure of infrastructure gaps and improvements in the business

climate through regulatory reforms, the Philippines may not achieve lower-middle-income status in 2017, where per capita GDP exceeds US\$3,000.

We believe the government's fiscal and economic development plans also provide useful policy anchors while keeping the inflationary environment favorable. The government continues to make progress in fiscal consolidation, with fiscal deficits averaging below 0.5% of GDP over the past three years. We forecast its fiscal deficits to average 1% over 2016-2019. We estimate the deficits will allow the net general government debt burden to continue to decline from its peak of 28% of GDP in 2010. That said, while the institutional and governance settings of the Philippines are broadly effective and improving, an ability to develop and implement swift policy responses--including during this presidential election year--is uncertain.

Our affirmation of the ratings is premised on the new administration after the May 2016 elections having a strong mandate to continue to pursue orthodox fiscal, economic, and development policies.

With the Philippines' fiscal settings remaining sound, its external metrics are strong. The current account is likely to remain in surplus (averaging 3.7% of GDP annually to 2019), reflecting robust services exports (including mainly tourism, healthcare, maritime, and business process outsourcing), large remittance inflows, and lower oil prices. Competitive unit labor costs relative to peers' (such as Thailand and Indonesia) and a large young, educated, and flexible labor market imply further strength in services exports over the next five years. Participation in free trade agreements could provide further upside to the Philippines' export earnings.

We expect the Philippines to remain in a net external creditor position, demonstrated by its net external debt (the ratio of gross external debt less official reserves and financial sector external assets to current account receipts [CARs]) averaging about -19% over 2016-2019. (A negative number indicates net external lending.) External liquidity (measured by the ratio of gross external financing needs to current account receipts and useable reserves) will also remain a sound 64.7% on average over the period. We do not envisage a marked deterioration in the Philippines' external financing from a shift in foreign direct investments or portfolio equity investments, or from a reduction in disbursements from donors.

Other factors that mitigate risks associated with the Philippines' international liabilities include a very low reliance on external savings by its bank and company sectors, as well as the low and mainly long-term nature of the government's external borrowings.

Philippine banks benefit from being mainly deposit funded, with high liquidity and limited linkages to global markets. The strengthened oversight of the financial sector by the Bangko Sentral ng Pilipinas (BSP) combined with modest growth in private sector debt and real estate prices have also contributed to improved system stability in recent years. However, the Philippines' low income level and limited legal protection to the regulator heighten credit

risks. Our Bank Industry Credit Risk Assessment for the Philippines is '7' (with '1' being the highest assessment and '10' being the lowest).

We regard the BSP's ability to support sustainable economic growth while attenuating economic or financial shocks to be broadly neutral to our ratings. This reflects the central bank's sound record in keeping inflation low and its history of independence. We believe the BSP's new monetary policy measures (implemented primarily through a term deposit auction facility and supported by reforms to the reverse repo auction mechanism) will improve the effectiveness of monetary policy transmission.

In our opinion, a deeper and more diversified financial and capital market would further improve the effectiveness of policy transmission and facilitate improved credit metrics.

Outlook

The stable outlook balances the Philippines' strong external position, which features its rising foreign exchange reserves and low external debt, against its low income and developing institutional and governance framework over the next 18 months.

We may raise the ratings if continued fiscal improvements under the new administration boost investment and economic growth prospects, or if changes in governance and the policy environment lead us to a better assessment of institutional and governance effectiveness.

We may lower the ratings if, under the new administration, the reform agenda stalls or if there is a reversal of the recent gains in the Philippines' fiscal or external positions.

Key Statistics

Table 1

Republic of the Philippines - Selected Indicators										
ECONOMIC INDICATORS (%)	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Nominal GDP (bil. LC)	9,003.5	9,708.3	10,561.1	11,542.3	12,642.7	13,285.2	14,309.3	15,450.0	16,681.6	18,011.4
Nominal GDP (bil. \$)	199.6	224.1	250.1	271.9	284.8	292.0	299.9	321.0	348.7	376.5
GDP per capita (000s \$)	2.2	2.4	2.6	2.8	2.9	2.9	2.9	3.1	3.3	3.5
Real GDP growth	7.6	3.7	6.7	7.1	6.1	5.8	6.0	6.3	6.3	6.3
Real GDP per capita growth	5.8	1.3	4.8	5.2	4.3	4.0	4.4	4.7	4.5	4.5
Real investment growth	19.1	(1.9)	10.8	12.2	6.8	14.0	16.0	16.8	17.2	10.1
Investment/GDP	20.5	20.5	18.2	20.0	20.9	20.2	20.9	23.6	25.8	27.6
Savings/GDP	24.1	23.0	21.0	24.2	24.7	23.1	25.4	27.6	29.3	30.6
Exports/GDP	34.8	32.0	30.8	28.0	28.7	27.9	27.4	26.8	26.1	25.5

Table 1

Republic of the Philippines - Selected Indicators (cont.)										
ECONOMIC INDICATORS (%)	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Real exports growth	21.0	(2.5)	8.6	(1)	11.3	5.5	5.0	5.7	6.1	6.3
Unemployment rate	7.4	7.0	7.0	7.1	6.8	6.3	6.0	5.7	7.1	7.1
EXTERNAL INDICATORS (%)										
Current account balance/GDP	3.6	2.5	2.8	4.2	3.8	2.9	4.5	4.0	3.5	3.0
Current account balance/CARs	9.1	6.7	7.3	11.6	10.0	8.0	12.1	10.7	9.4	8.0
Trade balance/GDP	(8.4)	(9.1)	(7.6)	(6.5)	(6.1)	(7.4)	(6.7)	(7.5)	(8.4)	(9.1)
Net FDI/GDP	(0.8)	(0.2)	(0.4)	0.0	(0.4)	0.0	(0.8)	(0.8)	(0.8)	(0.8)
Net portfolio equity inflow/GDP	2.5	1.6	1.3	0.4	(1)	(1.6)	(1.5)	(1.5)	(1.5)	(1.5)
Gross external financing needs/CARs plus usable reserves	68.0	65.5	60.6	58.7	61.5	63.2	61.2	63.4	65.3	67.1
Narrow net external debt/CARs	(3.8)	(11.2)	(12.7)	(15.5)	(20.1)	(21.7)	(20.8)	(19.1)	(18.8)	(18.9)
Net external liabilities/CARs	37.0	27.4	42.8	36.8	38.0	33.3	24.6	16.8	8.1	(0.4)
Short-term external debt by remaining maturity/CARs	14.1	20.1	15.9	20.6	19.0	19.0	18.1	16.8	15.8	14.5
Reserves/CAPs (months)	7.2	9.4	10.3	11.6	10.3	9.9	10.0	9.1	8.3	7.7
FISCAL INDICATORS (% , General government)										
Balance/GDP	(2.7)	(1.1)	(1.2)	(0.4)	0.4	(0.8)	(1)	(1)	(1)	(1)
Change in debt/GDP	(4.2)	2.3	2.5	2.1	0.6	0.8	1.0	1.0	1.0	1.0
Primary balance/GDP	0.6	1.7	1.8	2.4	2.9	1.5	1.1	0.9	0.8	0.7
Revenue/GDP	19.3	20.2	20.8	21.4	21.7	21.7	21.8	21.8	21.8	21.8
Expenditures/GDP	22.0	21.3	22.0	21.8	21.3	22.5	22.8	22.8	22.8	22.8
Interest /revenues	16.9	14.2	14.2	13.1	11.7	10.8	9.4	8.6	8.2	7.8
Debt/GDP	42.2	41.4	40.6	39.2	36.4	35.4	33.9	32.4	31.0	29.7
Debt/Revenue	218.6	205.0	194.9	183.5	167.7	163.3	155.5	148.6	142.3	136.3
Net debt/GDP	27.6	27.2	22.7	22.7	20.4	20.2	19.8	19.3	18.9	18.5
Liquid assets/GDP	14.6	14.2	17.9	16.5	16.0	15.2	14.1	13.1	12.1	11.2
MONETARY INDICATORS (%)										
CPI growth	3.8	4.6	3.2	3.0	4.1	1.4	2.5	2.4	2.4	2.4
GDP deflator growth	4.2	4.0	2.0	2.1	3.2	(0.7)	1.6	1.6	1.6	1.6
Exchange rate, year-end (LC/\$)	43.9	43.9	41.2	44.4	44.6	47.2	48.0	47.8	47.8	47.8
Banks' claims on resident non-gov't sector growth	13.1	18.5	14.4	14.4	18.3	14.0	15.0	15.0	15.0	15.0
Banks' claims on resident non-gov't sector/GDP	35.0	38.4	40.4	42.3	45.7	49.6	52.9	56.4	60.0	63.9
Foreign currency share of residents' bank deposits	21.5	19.9	18.1	15.2	16.8	16.7	16.7	16.7	16.7	16.7

Table 1

Republic of the Philippines - Selected Indicators (cont.)

ECONOMIC INDICATORS (%)	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Real effective exchange rate growth	4.8	0.7	4.8	4.2	(0.4)	6.6	N/A	N/A	N/A	N/A

Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Republic of the Philippines - Ratings Score Snapshot

Key rating factors	
Institutional assessment	Neutral
Economic assessment	Weakness
External assessment	Strength
Fiscal assessment: flexibility and performance	Neutral
Fiscal assessment: debt burden	Neutral
Monetary assessment	Neutral

Standard & Poor's analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). Section V.B of Standard & Poor's "Sovereign Rating Methodology," published on Dec. 23, 2014, summarizes how the various factors are combined to derive the sovereign foreign currency rating, while section V.C details how the scores are derived. The ratings score snapshot summarizes whether we consider that the individual rating factors listed in our methodology constitute a strength or a weakness to the sovereign credit profile, or whether we consider them to be neutral. The concepts of "strength", "neutral", or "weakness" are absolute, rather than in relation to sovereigns in a given rating category. Therefore, highly rated sovereigns will typically display more strengths, and lower rated sovereigns more weaknesses. In accordance with Standard & Poor's sovereign ratings methodology, a change in assessment of the aforementioned factors does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the assessments.

Related Criteria And Research

Related Criteria

- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Standard & Poor's National And Regional Scale Mapping Tables, Jan. 19, 2016
- National And Regional Scale Credit Ratings, Sept. 22, 2014
- Sovereign Rating Methodology, Dec. 23, 2014
- Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

Sovereign Risk Indicators at <http://spratings.com/sri>

- Asia-Pacific Sovereign Rating Trends, January 2016, Jan. 18, 2016
- Philippines' U.S.-Dollar-Denominated Notes Rated 'BBB', Feb. 16, 2016
- Asia-Pacific Sector Outlook 2Q 2016: Net Negative Bias Inches Up To 9%, April 18, 2016
- Corporate And Government Ratings That Exceed The Sovereign Rating, April 15, 2016
- Asia-Pacific Credit Outlook 2Q 2016: Downgrade Momentum Will Continue, April 12, 2016
- Sovereign Ratings Score Snapshot, April 4, 2016
- Banking Industry Country Risk Assessment Update: March 2016 March 23, 2016
- Emerging Markets Sovereign Debt Report 2016: Borrowing Is Pointing Up This Year, Feb. 29, 2016
- Global Sovereign Debt Report 2016: Borrowing To Drop By 2% To US\$6.7 Trillion, Feb. 29, 2016
- Asia-Pacific Sovereign Debt Report 2016: Borrowing Of US\$2.5 Trillion Is Likely This Year, Feb. 29, 2016
- Sector Review: The Philippines' Supportive Economy Underpins A Stable Outlook For Its Banking Sector In 2016, Feb. 23, 2016

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee agreed that fiscal performance had improved and all other key rating factors were unchanged.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed

Philippines (Republic of the)	
Sovereign Credit Rating	BBB/Stable/A-2
ASEAN Regional Scale	axA/--/axA-2
Senior Unsecured	BBB
Senior Unsecured	axA

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

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