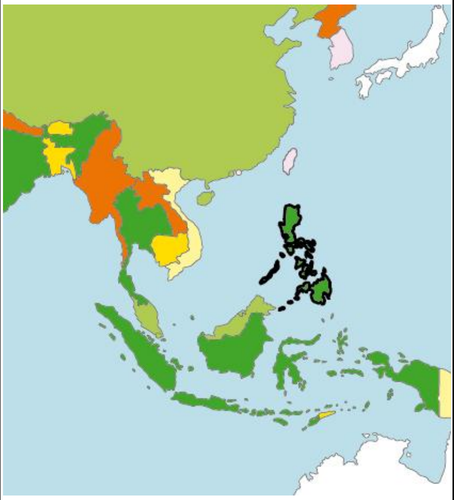
COUNTRY RISK ANALYSIS

Philippines

CREATING CONFIDENCE IN YOUR EXPORTS



COUNTRY RISK CATEGORY

3/7

The country risk categories range from 0 to 7. The lower number the better the credit rating of the country.

0 1 2 3 4 5 6 7

EKN'S OUTSTANDING GUARANTEES ON THE COUNTRY

Short-term transactions: SEK 2 million

Medium and long-term transactions: SEK 1,595 million

EKN'S POLICY

Sovereign risks: Standard risk assessment

Other public risks: Restrictive risk assessment

Bank risks: Standard risk assessment

Corporate risks: Restrictive risk assessment.

See also "EKN'S POLICY" section

DATE

24/10/2013

The positive trend continues

The trend continues to be positive with a favourable political and economic situation. The reform-oriented Aquino administration has brought political stabilisation. The economy shows robust growth and macro stability despite the global financial turmoil of recent years. Contributory factors are stable currency inflows from labour exports, moderate external debt, relatively low exposure to volatile capital and sizeable international reserves. Aquino has had some success in his efforts to improve the governance of the state apparatus and the budget. Consequently, government finances, which have long been a vulnerability factor, are expected to gradually strengthen. We are beginning to see scope for investment in the neglected infrastructure and reforms to strengthen the weak business climate have been initiated. Much remains to be done in order to tackle the country's long standing structural weaknesses. The continuity that is needed in the reform process cannot be taken for granted beyond the presidential elections in 2016. Consequently, the outlook appears somewhat more uncertain in the long term, although the ongoing reform policy is strengthening the country's economy.

STRENGTHS

- Resilient economy with robust growth
- Sound external balance, with a current account surplus, moderate debt burden and strong international reserves
- Relatively sound banking system

WEAKNESSES

- Public finances, given low levels of government income in relation to investment needs
- Structural factors are contributing to a difficult business climate and low investment levels
- Social pressure from a growing population, persistent poverty and underemployment rates

POLITICS

Reform-oriented administration strengthens the country's prospects

Under the reform-oriented President Aquino (2010-2016), political stabilisation has set in and the reform climate has improved. With less than three years left in power, the President's position is strong. Economic growth has been markedly strong in recent years. Aquino can to some extent claim to have delivered on his campaign promises of an improved and less corrupt state administration. Backed by strong opinion poll figures, Aquino's support coalition strengthened its position in both chambers of Congress in the mid-term elections earlier in the year. This means that the administration's scope for pushing through more reform proposals in the normally slow parliamentary process has improved for the period ahead. However, holding together the coalition is expected to become more challenging as the 2016 presidential election approaches. To manage this and avoid being marginalised, Aquino must retain his popularity. The government's focus is therefore expected to move increasingly towards the important employment and poverty issues.

Despite robust growth over the past decade (5.1 per cent p.a. 2003-2012), poverty and under-employment rates have barely moved since 2006 and both represent approx. 28 per cent of the population. With a growing population, two-thirds of which are under 35, the labour force is growing by more than one million a year. The thriving service export sector is creating too few jobs and the manufacturing industry is stagnating due to a weak investment climate. The influential Catholic Church opposes family planning initiatives and is an outspoken opponent of Aquino's efforts to unlock the potential of the mining sector. In addition, the vested interests of 40 or so families within the powerful elite often stand in the way of progress in terms of economic and legal reforms. Although some progress has been achieved under Aquino, stable solutions remain elusive in the persistent conflicts with left-wing guerrillas and Muslim separatists in the south. This is inhibiting tourism and investment. Overall, Aquino's policies are strengthening the country's economic governance. This provides a foundation for good economic growth in the medium term. However, it is doubtful whether Aquino, during his remaining three years in power, will be able to make more far-reaching reforms to tackle the structural problems the country has lived with for a long time. Consequently, the outlook is somewhat more uncertain beyond 2016.

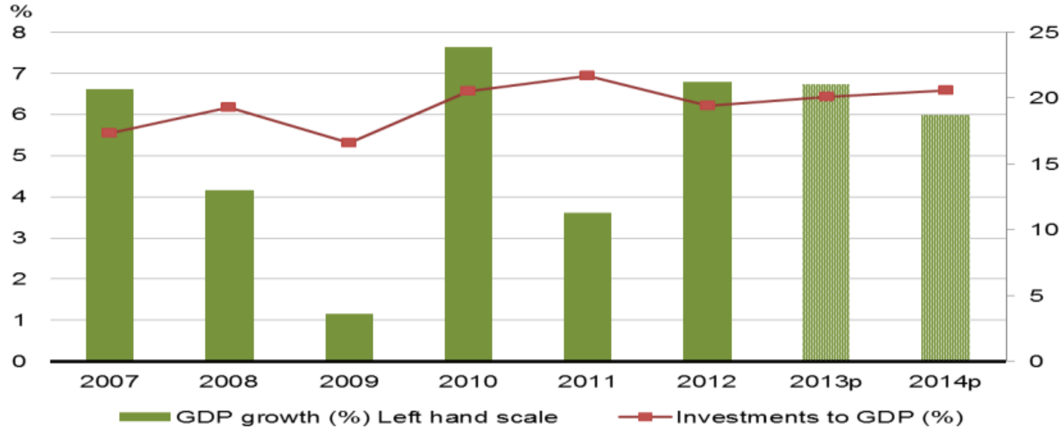
ECONOMY

Growth exceeds expectations

Growth reached an impressive 7.6 per cent in the first half of 2013 (6.8 per cent in 2012). Domestic demand was boosted by an expansionary economic policy with increased infrastructure investments and low interest rates. The current high rate of growth is probably not sustainable and there is some risk of overheating. However, there are no signs of economic imbalances yet. The high activity in the construction sector is a possible concern, although the pace of credit growth is not alarming and inflation pressure remains low. Economic policy is complicated by the presence of significant and at times volatile capital inflows and the uncertainty about what will happen to the flows when interest rates start to rise in the West. The base line scenario for the next few years is a return to more sustainable, but still robust growth levels of 5 to 6 per cent.

The economy has shown resilience during the global financial crisis of 2009 and the subsequent episodes of financial turmoil. The critical stabilising factor is the robust inflow of remittances from the 10 million Filipino nationals working abroad. The inflow amounts to almost 9 per cent of GDP and is stimulating the service and construction sectors as well as driving domestic consumption, which accounts for over 70 per cent of GDP. Consequently, this inflow is one of the main pillars of the economy's together with agriculture, a growing outsourcing industry and the electronics exports.

GDP GROWTH (%)



Investment levels have started to rise and growth of 5 to 6 per cent is sustainable in the long term. Data: IMF

An ongoing improvement of the historically weak public finances is strengthening resilience. Looking at comparable economies in the region, the country has one of the lowest public revenue levels. A reform programme is in progress to improve the governance of the state apparatus, the efficiency of tax collection and public expenditure and to review parts of the tax system. The targets in the government's consolidation plan for the period up to 2016 are to increase revenue to 18 per cent of GDP (14 per cent in 2012) and to limit the annual budget deficit to 2 per cent of GDP. The progress made so far is starting to create some fiscal space for investments without compromising these targets. In addition, the debt profile has been improved by increasing funding in domestic currency and maturity extensions. Government debt in relation to GDP has almost halved in ten years and is expected to fall below 50 per cent within a year or so. There is much to suggest that public finances will continue to strengthen in the next few years.

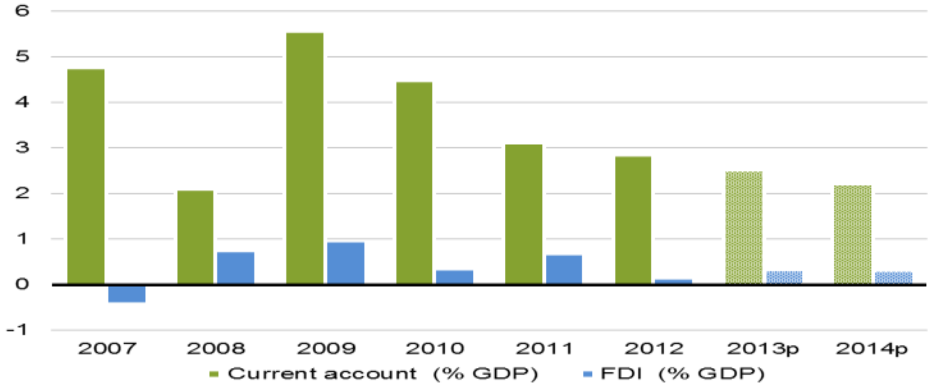
A number of structural weaknesses put a drag on the growth potential. This is one of the reasons why the country has had lower investment levels than other major economies in the region for such a long time. Aquino's plan for eventually increasing the growth rate to 7 to 8 per cent includes a number of initiatives aimed at remedying some of these weaknesses. Investments in the seriously lagging infrastructure are increasing by means of higher public spending and attracting private capital. This will take place in Public Private Partnership (PPP) projects, for which the state provides partial funding and certain guarantees against regulatory risks. The projects have started to get underway, but the size of the investments is still modest. The government has also begun to focus on improving the weak business environment, an area in which the country trails Indonesia, Vietnam, Bangladesh and India in the World Bank rankings. The country's finance and industry is dominated by a number of families and their conglomerates. In addition, opportunities for foreign investment are heavily restricted in a large number of sectors by the Constitution and other factors. All in all, the situation is inhibiting dynamics and competitive pressure in the economy. It is less evident what the administration can achieve in the matter of these deep-rooted structures. Although the reform policy is expected to move in a positive direction, an even more vigorous reform agenda is needed in order to firmly increase the long-term sustainable growth level.

BALANCE OF PAYMENTS AND DEBT ISSUES

Continuing current account surplus gives strong international reserves

The current account balance has been in surplus since 2003. The surplus has shown a decline for a few years, but is expected to remain at levels of around 1 to 2 per cent of GDP in the period ahead. It is the structural trade deficit that is showing growth. This is due to rising domestic demand, but is also a result of the export industry's failure to capitalise on China's and India's growth to the same extent as other regional economies. Cyclical electronics exports, which account for almost 60 per cent of exports, appear to be in structural decline. In addition, exploitation of the country's significant mineral resources is being impeded by the investment climate. Instead, exports of services and labour have grown and now account for 45 per cent of currency earnings. These earnings are strengthening the currency, thereby further eroding the competitiveness of the manufacturing industry. The country has established a leading position in the services export in the Business Processes Outsourcing industry. At the same time the labour exports are crucial to the current account surplus. These remittances inflows are diversified both geographically and in terms of occupational categories, making them a robust currency earner.

CURRENT ACCOUNT BALANCE AND FDI (% OF GDP)

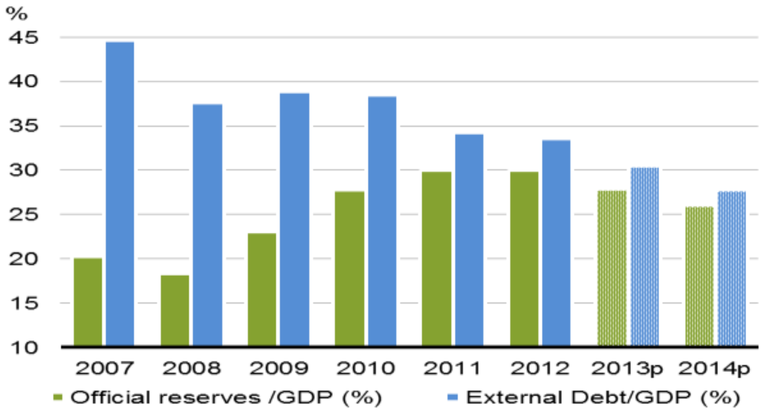


The current account surplus has been maintained, while foreign direct investments remain modest. Data: IMF, Bangko Sentral ng Pilipinas and forecasts based on the IMF and a number of commercial banks and analysis institutes.

The country's international reserves continue to strengthen despite several episodes of global financial turmoil since 2008. The business climate means that foreign direct investments remain low and concentrated in the services and property sectors. Exposure to sometimes volatile flows of portfolio capital has increased in recent years. The majority is invested in equities, while the proportion of foreign ownership of government bonds in local currency remains limited (15 per cent). International reserves cover over 90 per cent of the total external debt, or four times the debt due within one year. In view of the country's otherwise sound macro fundamentals, the reserves, together with a flexible currency, should provide a good buffer ahead of the pending adjustment of the G3 countries' exceptionally expansionary monetary policies.

The private sector's external debt is increasing, but is still moderate. With the stabilisation of the public finances, the external debt burden has declined since the mid-2000s and is now at manageable levels. Overall, the country's external position is sound. The international reserves appear robust and in our view the risk of more serious external imbalances are limited.

DEBT BURDEN AND INTERNATIONAL RESERVES (% OF GDP)



The external debt burden continues to decline and international reserves now cover over 90 per cent of the debt. Data: IMF and forecast based on a number of commercial banks and analysis institutes.

CURRENCY POLICY

Peso relatively spared from currency instability

The peso is floating, albeit with occasional intervention from the central bank. The monetary policy is anchored around the inflation target (3 to 5 per cent). The flexibility of the exchange rate reduces the external vulnerability. The trend towards stabilisation of the public finances and in the political sphere means that the risk of currency instability is mainly attributable to external factors. During the financial crisis of 2009, the currency fell by 15 per cent, after which it started to strengthen. During the financial turmoil in 2013, which has affected a number of emerging markets, the peso has been relatively spared with only a limited depreciation taking place. The monetary policies of the G3 countries are creating some uncertainty about future developments. The baseline scenario for the currency in the next few years is a moderate strengthening in line with the appreciation pressures created by current account surpluses and occasionally large capital inflows.

With relatively liberalised capital flows and the country's international integration, the transfer risk for private sector transaction is considered to be limited. The peso is convertible for current account transactions, i.e., current trade in goods and services. However, the currency is not fully convertible. The currency may not be transferred outside the country and a system of capital controls is in place, with documentation and authorisation requirements for currency conversion. EKN does not have any experience in guaranteeing transactions in local currency.

FINANCIAL SECTOR

Loans to the private sector increasing

The financial system is dominated by the banks, whose assets represent 77 per cent of the financial sector and correspond to 76 per cent of GDP. In recent years, other parts of the financial sector have expanded, particularly the equity and bond markets, with the state actively promoting their development. In a long-term perspective, the deepening of the financial markets is positive and reduces the economy's reliance on the banking sector, although it also means increased complexity in macro-prudential supervision.

The banking system is relatively sound. The system is dominated by 18 domestic private banks, which account for two-thirds of the system's assets, while the five largest account for just under half. Foreign and state-owned banks account for just over 12 per cent each. In addition, there are about 650 smaller banks. Gradual reforms have strengthened the system. The number of banks continues to decline. Non-performing loans have been reduced to 3 per cent of the loan portfolio (27 per cent in 2003). Although this is on the high side, the phasing-in of capital requirements under Basel III by 2014 will help ensure good capitalisation. The system's liquidity is good and exposure to external funding is low. Credit expansion has increased since 2011 and lending to the property sector now accounts for about 18 per cent of the loan portfolio. In response, the central bank has tightened supervision and regulation in this area to curb the build-up of financial imbalances. As long as the the credit expansion does not get out of hand the trend is positive, as the debt in the economy is moderate.

The main weaknesses are structural. Foreign banks have limited establishment opportunities. Powerful family-owned conglomerates, which also dominate the corporate sector, control 60 per cent of the system. This contributes to concentration risks and complicates banking supervision and interventions in the case of problem banks. From EKN's perspective, risk assessments have been facilitated by the introduction of IFRS reporting standards and the fact that most large banks have external credit ratings. The majority of the ten largest banks should be acceptable.

BUSINESS ENVIRONMENT

Ongoing reforms to improve the business environment

The business and credit environment could be described as difficult. However reforms are in progress that suggests that improvements can be expected over the medium term. On the one hand, the regulatory environment is characterised by the statutory obligation of the authorities to include a consultation process when drafting new regulations, which tends to have a positive effect on transparency in the regulatory process. On the other hand, the implementation is affected by the influence of the business elite and politicians on the authorities' actions. Corruption is also widespread, which creates some uncertainty about the stability of the ground rules.

The operational environment for the mining industry is difficult. The administration is trying to promote the mining industry, which is controversial because of resistance to foreign extraction as well as social and environmental issues. It is not unknown for local authorities to introduce new taxes and charges. In addition, the security situation is difficult and mines are sometimes targets for left-wing guerrillas who operate in rural areas. In the Fraser Institute's survey of the operational environment for mining companies, the country was ranked in 50th place (out of 58 countries in 2012). EKN always assesses mining transactions from an environmental and a social perspective.

Sweden has a bilateral investment treaty with the Philippines and the country has acceded to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. This is positive for EKN’s ability to cover corporate investments under EKN's investment guarantees.

The financial disclosure of listed and large companies is generally adequate. Reporting largely in line with IFRS and audit requirements was introduced for these types of companies in 2005 *(Philippine Financial Reporting Standards).* In 2010, simplified financial reporting standards based on international practice were also introduced for SME companies *(PFRS for SMEs)*. A number of local auditing firms are affiliated with the major global audit companies.

Despite a Western-oriented legal system with an independent judiciary, there may be questions about the efficiency and impartiality of courts, such as in civil cases when domestic influential interests are set against foreign interests. The ability of foreign creditors to declare a company bankrupt has historically been circumscribed by the law. In the World Bank's ranking in the area of resolving insolvency, the country occupies 163th place (out of 183). On a positive note the regulatory framework for insolvency and corporate restructuring is undergoing improvements. A new law *(the Financial Rehabilitation and Insolvency Act, FRIA)* came into force in 2010. However, the process of implementing the new regulations appear to be lagging behind. Once the framework is in place, the new act is expected to strengthen the position of foreign creditors, as it is said to be partly based on international practice. The ability to establish movable assets as collateral exists, but the collateral must be realised through distraint and public auction, and there is no central register for asset encumbrance and collateral. However, the government has recently announced that such a register will established by 2015.

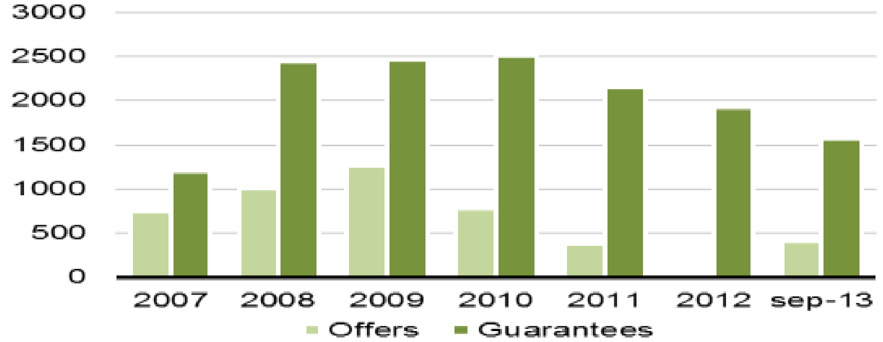
The Aquino administration is also promoting a number of other reforms to improve the business environment such as the drafting of a competition law, which the country currently lacks. The reforms in the state apparatus have contributed to what appears to be a gradual improvement in the corruption situation. In Transparency International's Corruption Perceptions Index, the country has climbed from 134th place (out of 183) in 2010 to 105th place in 2013. Overall, the business environment appears difficult, although the present administration's efforts to improve it point in a positive direction.

EKN'S EXPOSURE

Telecom dominates the exposure.

The telecom sector accounts for two-thirds of the total exposure of SEK 2 billion. Just under a quarter relates to one infrastructure project guaranteed by the state. EKN's exposure to the mining sector as well as the transport and logistics sector is increasing. Together, transactions in these sectors represent just over SEK 185 million. Continuing interest in risk coverage in these sectors and in telecom is expected.

EXPOSURE AT 31 DECEMBER (MSEK)



Exposure has declined since the 2008-2009 financial crisis. The mining sector and the transport sector dominate the increase in offers.

PAYMENT EXPERIENCE

Over the past ten years, EKN has issued guarantees totalling SEK 4.4 billion. Just over 75 per cent of this volume relates to telecom, while 17 per cent of the guarantees have the state as debtor. Deliveries of mining and construction equipment, as well as vehicles to private debtors, account for 5 per cent of the guarantees issued. Some payment arrears have been noted in recent years. These have been concentrated to the mining sector. In some individual cases, EKN has contributed to a rescheduling of payment plans to prevent loss. There are no losses to report from the period.

Reports from other export credit agencies also indicate generally good payment experience. Only a few commercial claims have been reported in recent years. Reported experiences regarding reconstructions point to protracted litigation and the fact that even with large borrowers, strong loan documentation and established collateral, it is not always possible to count on enforcing collateral rights.

EKN'S POLICY

Upgrade in June 2013

EKN upgraded the Philippines to country risk category three from four in June 2013. This was in line with the assessment made in collaboration with other OECD countries. This means that the country's risk classification has returned to the favourable position it occupied in the early 2000s. The country escaped the worst effects of the Asian crisis of 1998. However, a steady deterioration in public finances and external debt in the subsequent years resulted in successive downgrades to country risk category five, where the country was placed in 2003. As the risk situation gradually improved, the country was upgraded back to country risk category four in 2008 and the present category three in June 2013. In the years before the upgrade, EKN gradually eased its policy regarding sovereign risks and bank risks.

For transactions with banks, EKN does not have any specific restrictions; instead, each transaction is assessed on its own merits. This applies whether the transaction has a short credit term (under one year) or a longer term. The same applies to transactions with central government debtors, such as the central bank or finance ministry.

The policy includes certain restrictions on other public purchasers (sub-sovereigns such as other ministries or local governments) as well as companies. Regarding transactions with other public buyers EKN normally requires government or bank guarantees. EKN's restrictive approach is motivated by the difficulty in assessing the authorities' ability to fulfil current contracts.

For corporate risks, EKN applies a somewhat restrictive risk assessment of transactions, with particular consideration of the quality of the financial information. This is due to the difficult business environment.

OFFICIAL COUNTRY DATA AND CREDIT RATINGS

OFFICIAL COUNTRY DATA

Area: 300 km^2 (0.7 times Sweden)

Population: 96.7 million (2012)

Population growth: 1.7 % p.a. (2007-2012)

GDP: USD 250.3 billion, 2012 (Sweden USD 525.7 billion, 2012)

GDP/capita: USD 2,470, 2012 (Sweden USD 56,210, 2012)

CREDIT RATING

	COUNTRY CEILING	SOVEREIGN RATING
Moody's:	Baa1	Baa3
S&P:	BBB	BBB-
Fitch:	BBB	BBB-

COUNTRY ANALYST

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DISCLAIMER

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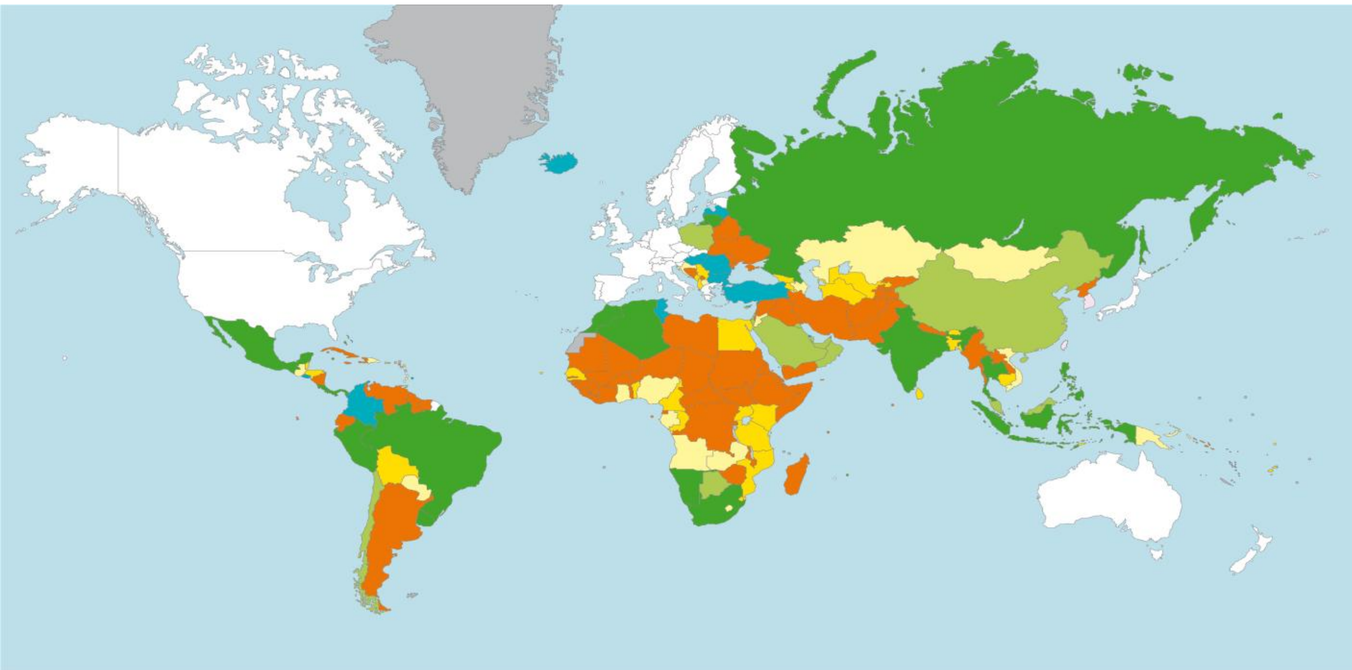
EKN'S VIEW OF THE WORLD



The country risk categories range from 0 to 7.
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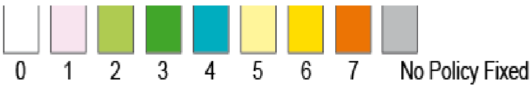

EKN – CREATING CONFIDENCE IN YOUR EXPORTS
EKN is a government agency that supports Swedish exports and the internationalisation of Swedish industry. This we do by offering exporting companies and banks guarantees for payment and financing, together with advice on business structure and risk management. Our services provide an extra level of confidence, increased competitiveness and more opportunities for successful export transactions.

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