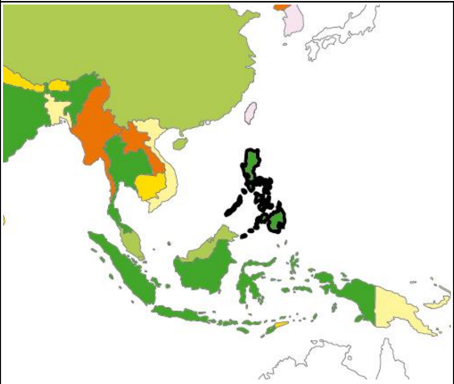
COUNTRY RISK ANALYSIS

The Philippines

CREATING CONFIDENCE IN YOUR EXPORTS



COUNTRY RISK CATEGORY

3/7

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

0 1 2 3 4 5 6 7

EKN'S OUTSTANDING GUARANTEES TO THE COUNTRY

SHORT-TERM TRANSACTIONS: SEK 146 MILLION

MEDIUM AND LONG-TERM TRANSACTIONS: SEK 1486 MILLION

DATE

24 OCTOBER 2014

Reform policies strengthening economy

The Philippine economy has exhibited a positive trend for several years. One key factor is the robust inflow of remittances from Philippine migrant workers. In addition, successful reforms under President Aquino are contributing to strengthening the economy's long-term resistance and growth momentum. The improvement in the public finances frees up scope for much-needed investment in physical and social infrastructure. Ongoing improvements in the governance of the state apparatus and in the investment climate seem to be in the process of producing results in the form of lower corruption, a gradual improvement in the business climate and stronger growth potential. Much remains, however, to be done to tackle the long term structural problems that the country has had to live with for a long time. Continuity in the reform process needed cannot be taken for granted beyond the presidential elections in 2016. The prospects therefore appear to be slightly more uncertain in the long term. The reform policies are strengthening the country's economy and paving the way for favourable economic growth over the coming years.

THE COUNTRY'S STRENGTHS AND WEAKNESSES

Strengths

- Resilient economy with robust growth that has taken off in conjunction with the reform process
- A good external balance with stable inflows of remittances, a current account surplus, a moderate debt burden and strong international reserves

Weaknesses

- Low public revenue in relation to a large amount of investment needed in deficient infrastructure
- Structural factors contribute to a weak business climate and low investment levels
- Social pressure from a growing population, persistent poverty and underemployment
- High exposure to natural disasters

EKN'S POLICY

EKN has placed the Philippines in country risk category 3. This is in line with the assessment undertaken in collaboration with the other OECD countries. For transactions with banks, each transaction is assessed on its own merits. The same applies to transactions with central government debtors, such as the central bank and the ministry of finance. The policy includes certain restrictions with respect to other public buyers (e.g. other ministries or local governments) and for companies. With respect to other public buyers, EKN normally seeks a guarantee from the sovereign or a bank. EKN's restrictive approach is justified by the difficulty in assessing the ability of these authorities to fulfil contracts entered into. For corporate risks, EKN has a slightly restrictive risk assessment policy for transactions, in light of the deficiencies in the business environment.

WHAT MIGHT CAUSE A CHANGE IN THE COUNTRY POLICY?

The policy may be made less restrictive in the event of

- Sustained reforms that strengthen the investment climate and the economy's growth momentum.
- A further strengthening of the government's revenue base and public finances

The policy may be made more restrictive in the event of

- A realignment of financial policies that undermines the advances achieved under Aquino's reforms and makes the public finances significantly worse
- The emergence of serious economic imbalances that threaten the country's financial and macro-economic stability

EKN'S EXPOSURE AND EXPERIENCE

EKN's exposure totals SEK 1.9 billion, with guarantees accounting for SEK 1.6 billion and the remainder made up of offers. The telecom sector is dominant, but in recent years, demand has increased in the mining and construction sectors. EKN has mostly positive experience. Certain delays have however, been noted in recent years. These are concentrated to the mining sector. In some cases, EKN has been involved in rescheduling payment plans to prevent claims. There were no indemnifications during the period.

COUNTRY ANALYST

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DISCLAIMER

POLITICS

Rate of reform likely to be slowed down in the run-up to the 2016 elections

The reform climate has improved under President Aquino (2010-2016). With strong popular support and a majority in the congress, the administration has successfully driven forward the reform process. Growth in the economy has strengthened and Aquino can be deemed to have delivered on his promises of improved and less corrupt public administration. It has however proven more difficult to deal with underemployment and poverty. In part as a result of the criticism of deficiencies in disaster relief after Super Typhoon Haiyan and a scandal involving embezzlement of public funds, the president's popularity is beginning to wane, albeit starting from a high level. With less than two years left with Aquino in power, there is a risk that the political twists and turns surrounding the scandal and the impending presidential and congressional elections in May 2016 will increasingly divert the congress's focus from the reform agenda. Maintained his popularity would increase Aquino's chances of keeping the reform efforts on track as long as possible, which is likely to slow down in the latter half of 2015 anyway.

One central challenge is increasing the economy's capacity to generate employment opportunities. Poverty and underemployment fell for the first time in several years in 2013, but 25 per cent of the population still suffer from them. This is in spite of strong growth over the past decade. With a growing, young population, the labour force is growing by over one million people per year. The flourishing services export sector is creating too few jobs and the manufacturing industry is stagnant. Difficulties in attracting foreign investment and in freeing up potential in areas such as the mining sector stem from a weak investment climate and a security situation that is difficult in some instances. Aquino has made important progress in the peace process with Muslim separatists in the poor, but resource-rich, southern parts of the country. There are however many pitfalls along the way to a lasting peace. In addition, powerful vested interests among 40 or so families within the powerful elite often stand in the way of progress in the form of economic and legal reforms. The fact that ten per cent of the population are seeking livelihood opportunities abroad serves as an economic safety valve for tensions in society. Perseverance in the reform process beyond Aquino is required to solve the structural problems the country has had to live with for a long time. As a result, the prospects are more uncertain in the long-term perspective. The somewhat unpredictable political system is expected to generate a new president who may slow down the rate of reform, but not significantly realign policies.

Increasing tensions in the South China Sea are a security concern. Disruptions in the key trade routes or an escalation of the thus far limited confrontations with China would have negative consequences on the country's growing exports to China.

ECONOMY

Reforms boosting growth potential

The Philippines has become one of the more rapid-growing economies in the region. For 2014-2015, GDP growth is expected to come in at around 6 per cent per year (7.2% in 2013). The mild slowdown is due in part to the after-effects of Super Typhoon Haiyan's impact on the country in the autumn of 2013. Moreover, signs of rising inflation pressure and overheating tendencies in industries such as the property sector have induced the central bank to tighten its monetary policies. Crowding in ports, on roads and in airports, as well as warnings of increasing power shortages in the region surrounding Manila in the future, indicate that the infrastructure bottlenecks are now putting the brakes on GDP growth, which, according to the IMF, will have trouble continuing to exceed 6 per cent.

The country's prospects are strengthened by the fact that the historically weak public finances are improving. In relation to GDP, the consolidated public debt has been nearly cut in half in ten years and is expected to fall below 50 per cent this year. In addition, the country's debt profile has been improved by extending the terms of the debt and raising financing in domestic currency. However, the country has one of the lowest public revenue levels among comparable economies in the region. A reform programme is under way to improve governance of the state apparatus, raise the efficiency of tax collection and public expenditure and overhaul parts of the tax system. Revenues have gradually begun to rise. The government is expected to stand by its plan to keep budget deficits below two per cent of GDP by 2016. The public finances are expected to gradually continue getting stronger in the coming years.

GDP GROWTH AND INVESTMENT (% OF GDP)

Source: IMF

The progress made with the public finances makes way for public investments. Investment in education and healthcare is increasing, as well as investment in the deficient infrastructure. The country's target is to double infrastructure expenditure to five per cent of GDP by 2016. In addition, the country is planning to attract private capital to public-private partnerships (PPP) where the state provides certain guarantees of protection from regulatory risks and serves as co-financier. There is a range of potential projects equal to nine per cent of GDP. The PPP initiative has had trouble getting off the ground, but the number of projects is gradually rising. Overall, these policies support Aquino's plan to raise growth to seven or eight per cent in the long term.

The reforms have also begun to take aim at other parts of the investment climate. Poor investment climate has resulted in the country having lower investment levels than other major economies in the region for a long time. The financial and business sphere is dominated by a number of families and their conglomerates. In addition, foreign investment is heavily

restricted in several sectors, by the constitution in some cases. The situation inhibits dynamics and the economy's competitiveness. The reform agenda therefore includes drafting competition legislation, which the country currently lacks, and reducing restrictions on foreign investment where such is possible without changing the constitution. These structures are however deeply rooted, which is why improvements can only occur gradually.
Overall, the economy has shown resilience in several periods of global financial turbulence over the past five-six years. One key stabilising factor is the inflow of remittances from Philippine migrant workers. The advances under Aquino contribute to strengthening the economy's resistance and long-term growth, which paves the way for solid economic growth in the coming years.

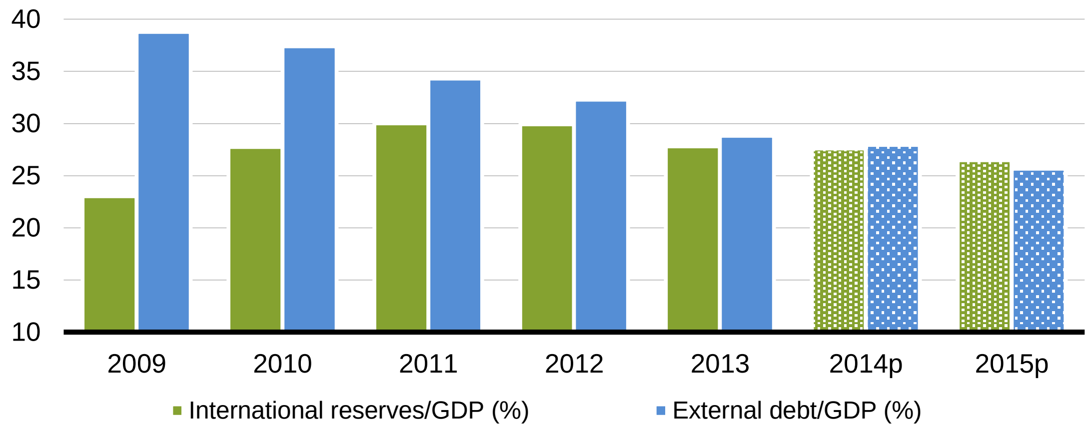
BALANCE OF PAYMENTS AND DEBT ISSUES

Strong international reserves and moderate debt burden

The current account balance has run a surplus since 2003. The surplus is expected to be sustained in the coming years, but gradually decline. The structural trade deficit is, however, growing. This is a result of an increase in domestic demand, but also because the export industry has been unable to take advantage of the growth in China and India to the same extent as other economies in the region. Instead, service and labour exports have grown and now make up 45 per cent of currency earnings. These earnings strengthen the currency, which further undermines the competitiveness of the manufacturing industry. The country has established a leading position in exports of services in the outsourcing industry. The inflows of remittances from labour exports are diversified both in terms of geography and occupations, which makes them robust currency earnings.

Capital inflows are periodically dominated by volatile portfolio flows. Normalisation of US monetary policies will probably slow down the extent slightly in the future, and increased volatility in capital flows may be expected considering the increased divergence in the monetary policies of the G3 countries. However, historically low levels of direct investment are expected to increase gradually in light of ongoing improvements to the business climate. The private corporate sector's increasing external debt is still moderate. The stabilisation of the public finances has lowered the external debt burden significantly since the mid-2000s and it is now at manageable levels.

EXTERNAL DEBT AND INTERNATIONAL RESERVES (%)



Sources: IMF and Bangko Sentral ng Pilipinas

The country's international reserves are strong in spite of the periods of global financial turbulence of the past years. The international reserves cover 95 per cent of the total external debt or more than three times the debt due within one year. Given the current account surpluses and a floating currency regime, the reserves are considered a solid buffer against any increased volatility in capital flows in the future. Overall, the country's external position is solid and the risk of serious external imbalances is considered limited.

CURRENCY POLICY

Periodic capital outflows counterbalancing underlying pressure on a stronger currency

The peso is floating with periodic intervention by the central bank. The inflation target (currently three to five per cent) serves as the anchor of the monetary policy. The flexibility of the currency reduces its external vulnerability. The current account surpluses create underlying pressure for a stronger currency. The risk of currency turbulence stems from the periodically large capital inflows and how they are affected by external factors. Capital inflows may be expected to be lower and more volatile in light of gradually rising interest rates in the US. The development of the particularly expansionary monetary policies pursued by the G3 countries is a factor of uncertainty in this context. These factors counteract the underlying trend of strengthening of the currency's value. In the baseline scenario for the coming years, the currency is expected to remain around its current levels or perhaps undergo moderate weakening.

In part as a result of the relatively free capital flows and the country's international integration, the transfer risk is considered limited. The peso is convertible for current account transactions, i.e. ongoing trade in goods and services. However, it 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 licence requirements for converting currency. EKN does not have any experience of guaranteeing transactions in local currency.

FINANCIAL SECTOR

Increased lending and liberalisation of banking sector

The financial system is dominated by the banks, even though the other parts of the financial sector have expanded in recent years. Especially the equity and bond markets, where the state has actively promoted this trend. The strengthening and diversification of the financial markets is positive in the long term, but also results in greater complexity in macro-economic supervision.

The banking system is dominated by around 20 domestic private banks, with the five largest accounting for around 60 per cent of the banking system's assets. In addition, there are three state-owned banks, a handful of foreign subsidiary banks and around 650 small regional institutions. The system exhibits certain structural weaknesses. The majority of the system's assets (equivalent to 85 per cent of GDP) are held in government bonds and other liquid assets. Loans to the private sector are at a relatively low 35 per cent of GDP. Powerful family-owned conglomerates control 60 per cent of the banking system. This contributes to concentration risks and makes it difficult for the authorities tasked with banking supervision to intervene in problem banks. One of the government's priorities is therefore to bring changes to the central bank act aimed to strengthen supervision. A sweeping liberalisation reform was adopted in 2014. The reform abolishes many restrictions on the ability of foreign banks to make acquisitions and establishments. Both wholly-owned subsidiaries and branches can now get full banking rights. 60 per cent of the banking system will however still be controlled by domestic parties. Overall, the reforms could contribute to a long-term improvement in the banking system.

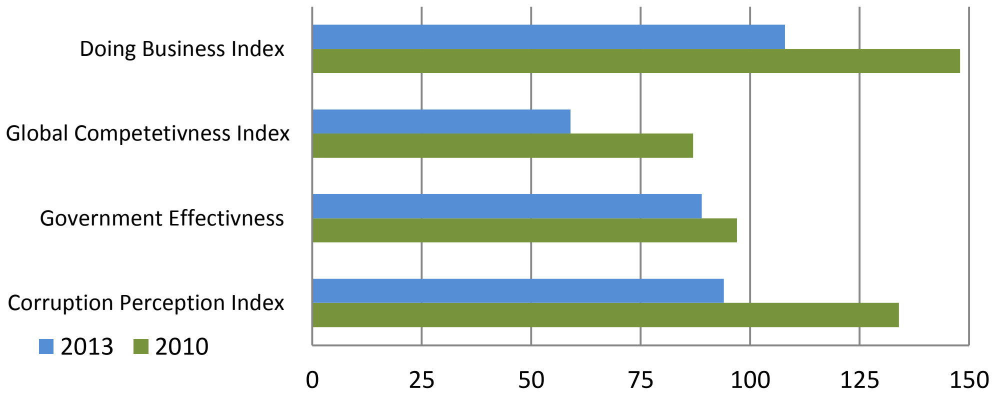
The growth rate of loans to the private sector has taken off since a couple years ago and is now at around 20 per cent on an annual basis. This trend is considered positive, since the debt in the economy as a whole is moderate. Incipient risks can however be seen. In particular, loans to the property sector (currently 22 per cent of the stock of loans) are increasing. In addition, debt is beginning to be high in parts of the property sector. The central bank has tightened supervision and regulations in these areas in order to curb the build-up of financial imbalances. Non-performing loans have been reduced to just over two per cent of the stock of loans. Capital adequacy requirements under Basel III were introduced in the beginning of 2014. The system's liquidity is good and there is little exposure to foreign financing. The banking system is therefore considered relatively well-equipped. From EKN's perspective, the risk assessment is made easier by the fact that IFRS accounting has been implemented and most major banks have external credit ratings. The majority of the ten largest banks should be acceptable.

BUSINESS ENVIRONMENT

Business climate improving

As a result of the reform efforts underway, the business environment, which is still difficult, is in the process of improving. This trend is reflected in multiple international indices that measure corruption, efficiency of public administration, the business environment and overall competitiveness.

BUSINESS ENVIRONMENT



The Philippines is climbing in international indices for the business environment, corruption etc. Ranking (lower value = better position). Sources: World Bank, IFC, Transparency International, World Economic Forum

The regulatory environment is characterised on the one hand by the fact that the authorities have a statutory obligation to include a consultation process when developing new regulations. This tends to be positive for transparency in the regulatory process. On the other hand, implementation is characterised by influence, exercised by the business elite and politicians, over the actions of the authorities. Corruption is widespread, which creates uncertainty surrounding the stability of the ground rules. The reforms in the state apparatus have however contributed to a gradual improvement in the corruption situation.

The operating environment is difficult for the mining industry. The administration is attempting to promote the mining industry, which is controversial given the resistance to foreign extraction as well as social and environmental issues. It is not uncommon for local authorities to institute new taxes and fees. In addition, the security situation is difficult and mines are periodically targets of the left-wing guerrillas operating on the countryside. EKN always assesses mining transactions from an environmental and social perspective.

The financial transparency of listed companies, large companies and public sector companies is generally adequate. Reporting and auditing requirements similar to IFRS were adopted for these types of companies in 2005 (*Philippine Financial Reporting Standards*). In 2010, a simplified accounting standard was introduced on the basis of international practice for SMEs (PFRS for SME). A series of local auditing companies are associated with the major global auditing firms.

In spite of a western-oriented legal system with an independent judiciary, there are questions concerning the efficiency and impartiality of the courts, such as in disputes where influential domestic interests face off against foreign interests. The ability of foreign lenders to put a company in bankruptcy has previously been restricted by the law. The regulatory framework for company restructuring and insolvency is however undergoing improvements. A new law (*the Financial Rehabilitation and Insolvency Act*, FRIA) entered into force in 2010. This law is partially based on international practice and is expected to contribute to strengthening the position of foreign creditors. Implementation of the new framework seems to be lagging behind a bit. The positive development of the country's business climate is also reflected in the World Bank's ranking of insolvency procedures, with the country climbing to 100th place (from 163rd in 2012, out of 189 places). It is possible to establish collateral in current assets, but the collateral must be realised via execution and a public auction and there is no central register of mortgages and collateral. The government has announced that such a register will be established no later than in 2015.

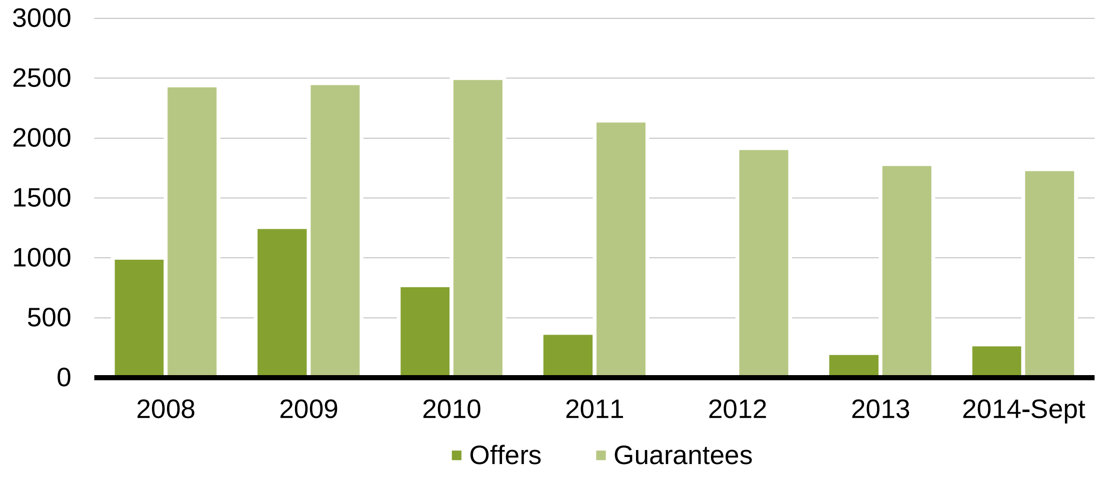
Overall, the business environment appears to be somewhat difficult and is not considered to fully reach the quality expected, to be in line with EKN's favourable country risk categorisation. However, the current administration's efforts to improve the business environment point in a clearly positive direction.

EKN'S EXPOSURE

Dominance of telecom transactions in exposure subsiding

EKN's exposure totals SEK 1.9 billion, with guarantees accounting for SEK 1.6 billion and the remainder made up of offers issued. Over half of the exposure is comprised of telecom transactions. One-fifth is for an infrastructure project guaranteed by the state. EKN's exposure to the mining sector, the construction sector and the transport sector has increased in recent years. Together, transactions from these sectors account for SEK 350 million. Some interest for guarantees in these sectors is expected to persist in the future.

EXPOSURE AT 31 DECEMBER (SEK MILLION)

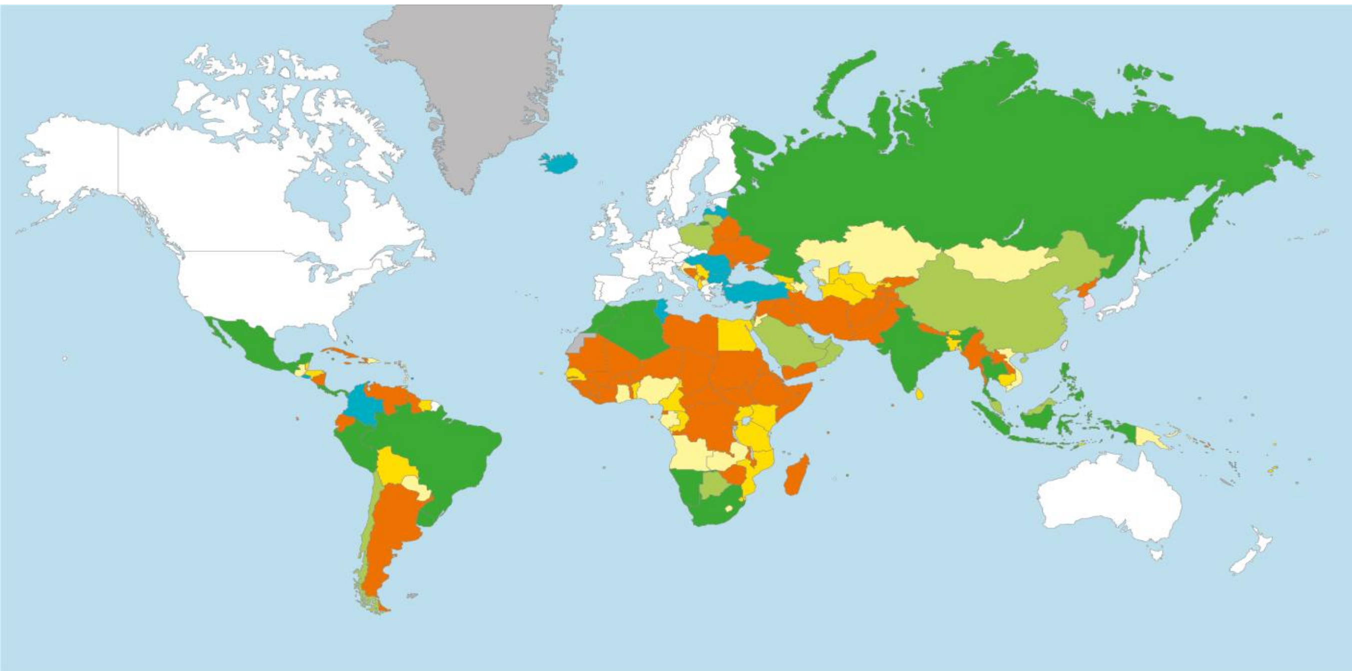


EKN's exposure has waned since 2009, with the mining and construction sectors dominating the increase in offers in recent years.

PAYMENT EXPERIENCE

EKN has issued guarantees for SEK 4.7 billion over the past ten years. Nearly two-thirds of this amount are for telecom transactions. Nearly ten per cent are for deliveries of construction services, mining machinery and vehicles. Private companies are the debtors for the majority of the transactions. The government is the debtor for over 15 per cent. A number of delays have been noted in recent years. They have been concentrated to the mining sector. In individual cases, EKN has been involved in rescheduling payment plans to prevent claims. There were no claims to report from the period. Experiences from other export credit agencies also indicate overall good payment experiences. Experiences previously reported concerning reconstructions indicate lengthy legal proceedings and that one cannot always rely on being able to enforce the rights to collateral even with large lenders, strong loan documentation and established collateral.

COUNTRY DATA	CREDIT RATING (COUNTRY CEILING/SOVEREIGN RISK)	
Area: 300,000 km² (0.7 times Sweden)	**Moody's:**	Baa1/ Baa3 positive
Population: 98.4 million (2013)	**S&P:**	BBB+/ BBB stable
GDP: USD 272 billion in 2013 (Sweden USD 558 billion in 2013)	**Fitch:**	BBB/ BBB- stable
GDP/capita: USD 3,270 in 2013 (Sweden USD 59,130 in 2013)		



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

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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