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Philippines Business Forecast Report Q2 2014

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Abstracts

Core Views

Despite the fact that the Philippine economy likely slowed in Q413 as a result of Typhoon Yolanda's devastating impact on the Visayas, we believe momentum remains solidly positive heading into 2014. Informing our sanguine medium-term view on the Philippine economy is the country's manageable credit-to-GDP ratio, as well as ongoing political stability and prudent monetary and fiscal policies.

Headline inflation in the Philippines jumped to 4.1% year-on-year (y-o-y) in December 2013, as food prices soared following the impact of Typhoon Yolanda in November 2013. While we do not believe that the Bangko Sentral ng Pilipinas (BSP) will look to address such event-driven price increases with monetary policy adjustments, we nevertheless retain our expectations for the central bank to hike its benchmark interest rate by a total of 50 basis points (bps) towards the latter part of the year.

The Philippines is set to pass into law its fourth straight on-time budget, once again marking the increased policy-making efficacy of the government since Benigno Aquino III took office in 2010. Notably, the 2014 budget will drop the controversial Priority Development Assistance Fund (PDAF), a pork barrel-spending program that was recently ruled unconstitutional by the Supreme Court. While the move will have a minimal effect on the overall fiscal health of the country, it nevertheless is a positive step forward in terms of anti-corruption efforts as well as efficiency in fund allocation. We expect the Philippines' 2013 and 2014 budget deficits to come in at approximately 1.9% of GDP, down from our previous forecasts of 2.2% and 2.0%, respectively.

Major Forecast Changes

We have upgraded our 2014 real GDP growth forecast to 6.3% (from 6.0% previously),

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and also see scope for the economy’s long-term trend growth rate to increase as long as the aforementioned factors remain in play.

In light of continued strong economic growth, as well as planned utility price hikes, we are upgrading our 2014 average inflation forecast to 4.0% from 3.5% previously, with our end-year forecast likewise getting a bump to 4.5% from 4.0% previously. Given the peso’s huge appreciation in real effective terms over the past eight years, a further correction in the near term is not outside the realm of possibility. Likewise, sentiment towards EM currencies in general remains tepid at best, and our expectations for a resurgent US dollar over the coming year suggest little upside potential for the peso in 2014. As a result, we have downgraded our end-2014 target on the peso to PHP44.70/US$ from PHP42.00/US$ previously.

Key Risks To Outlook

The Philippines remains at risk of substantial hot money outflows in the event of acute global credit or financial market stresses. Growth slowdowns in oth China and Japan, to which the Philippines is heavily exposed in both investment and trade terms, could undermine the country’s strong domestic growth story should they be more severe than expected.

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aforementioned factors remain in play.

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Table: Em ergi ng Markets , Real GDP Growt h, %

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