Recent Statements Suggest Philippine Officials Looking To Advance Economic Agenda

Recent statement from senior Philippine government officials suggest elements of President Rodrigo Duterte's administration are attempting to advance its economic agenda, particularly its ambitious infrastructure plan, and have identified and secured funding. These initiatives are necessary for the Philippine economy to grow and accommodate its expanding middle class, and will provide local companies the necessary infrastructure to prosper long-term.

- On 7 April, Philippine Finance Secretary Carlos Dominguez announced Manila's intent to implement a tax amnesty program similar to Indonesia's, which collected over USD 10 billion, to help fund the country's ambitious spending plans, according to Bloomberg.

- On 31 March, the Philippine budget secretary revealed that feasibility studies for infrastructure projects spanning the island of Mindanao were underway, with the government hoping these projects would commence later this year, according to Business World, a daily Philippine business publication.

- Also in late March, the government's socioeconomic planning secretary announced over USD 8 billion in funding from Tokyo to finance three railway projects, according to The Philippine Star. Earlier that month, the Philippine undersecretary for trade declared that Chinese officials agreed to provide approximately USD 3 billion for three infrastructure projects, according to The Philippine Daily Inquirer.

Philippine President's Recent Statements Destabilize Détente with Beijing

Philippine President Rodrigo Duterte's statement on 6 April that he would order Filipino troops to occupy and fortify the islands Manila claims in the South China Sea—almost certainly a rebuke to Beijing—underscores Duterte's mercurial nature and jeopardizes the rapprochement between the two countries, to include Beijing's attendant financial support for infrastructure projects. Duterte made the remarks while visiting a western Philippine island, according to the Wall Street Journal.

- Duterte cast aside an international court ruling from July rejecting Beijing's claims to the islands and instead has advocated for a bilateral solution, much to Beijing's pleasure. Relations have since warmed between the two countries, which Duterte has leveraged for Manila's financial gain.

The Duterte administration's infrastructure initiatives are central to its economic agenda and represent a marked departure from previous administration's inadequate investments. Over the next five years, the government expects to spend over Philippine Peso (PHP) 8 trillion, or USD 160 billion,[1] according to the Philippine Daily Inquirer.

[1] This implies a conversion rate of 50 PHP/USD.

- As of 2012, road transport accounted for 98% of passenger traffic and 58% of cargo traffic, but a large segment of the road network remains in poor condition and intermodal integration generally is weak, according to the Asian Development Bank (ADB). The ADB assessed the quality of these roads as inferior to nearly all neighboring countries.

- Traffic in Manila is clogged throughout the day with cars, buses, jeepneys—extended jeeps that serve as minibuses—and local versions of the rickshaw. The congested Manila streets can be attributed to a growing middle class that increasingly owns vehicles and insufficient rail transport, among other factors, according to The Economist.

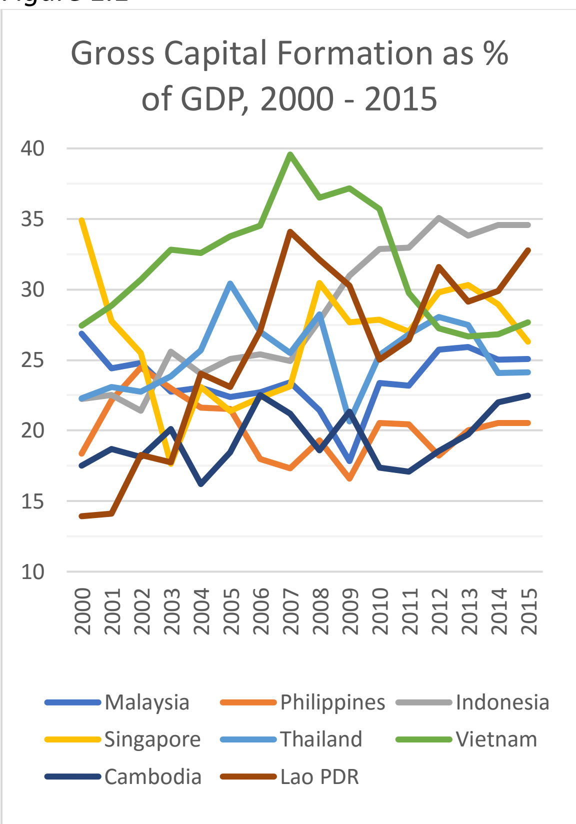
- The Philippines has one of the slowest internet speeds in the world, according to content delivery network provider Akamai. Anecdotally, few public locations in Manila offer internet—Starbucks is a rare provider—and service at two mid-range hotels was intermittent.

The Philippines' poor infrastructure largely can be attributed to the dearth of investment over the previous decades, which was insufficient to meet the country's growth. The country's investment allocation also significantly lagged its peers.

- From 2000-2014, Manila's average infrastructure spending as a percent of GDP was 2.5%, according to an IMF working paper. In comparison, in 2017, the government expects to spend 5.3% of GDP on infrastructure, according to the country's budget secretary, as reported in Business World.

- The Philippines since 2000 consistently has trailed its regional counterparts in overall gross capital formation as percent of GDP, which is a broader term that encompasses infrastructure, according to the World Bank. Whereas the Philippines' gross capital formation averaged 20.2% of GDP from 2000-2015, its counterparts in Southeast Asia averaged 25.8%, excluding Myanmar.[2]

Figure 1.1



Data is from the World Bank. "Gross capital formation" previously was referred to as "gross domestic investment."

[2] The World Bank did not include data for Myanmar.

Philippine President Duterte must prioritize his investment agenda if it is to be implemented. The budget secretary on 31 March acknowledged that Duterte had not been focused on infrastructure development, although he stated the president now was behind these efforts, according to Business World.

- Since taking office in June, the president has focused primarily on countering illegal drugs, a central theme of his campaign. His anti-drug efforts are confrontational and have led to approximately 7,000 deaths, according to Business Insider Australia.

- Duterte's proposal to appoint the heads of the country's local municipalities, referred to as barangays, also has sparked controversy, with some perceiving it as undermining democracy, according to GMA News Online, a Philippine news organization. Such proposals might embolden opposition parties and detract from Duterte's ability to implement his investment agenda.

- With any infrastructure spending, corruption and the siphoning of funds will scuttle the benefits. It will be incumbent on the Duterte administration to impose safeguards that limit this possibility.

The vibrancy of the Philippine people and the country's resources suggest that execution of the administration's investment plan will position the country to be an economic leader in Southeast Asia. The country's high growth rate despite insufficient investment—in 2016, GDP grew 6.9%, surpassing expectations and besting many regional counterparts—is a testament to the potential of this country and its people.

- The Philippines has a population of almost 104 million, making it Southeast Asia's second largest nation, behind Indonesia. Furthermore, 50% of the population is under 25 years of age, with only Cambodia and Laos having younger populations, according to Population Pyramid.

- The country is rich in natural resources—to include the contested islands in the South China Sea, which have vast oil and gas reserves, according to Reuters—and in 2016 its metal deposits yielded almost PHP 102 billion, or approximately USD 2 billion, according to the Philippine Mines and Geosciences Bureau.

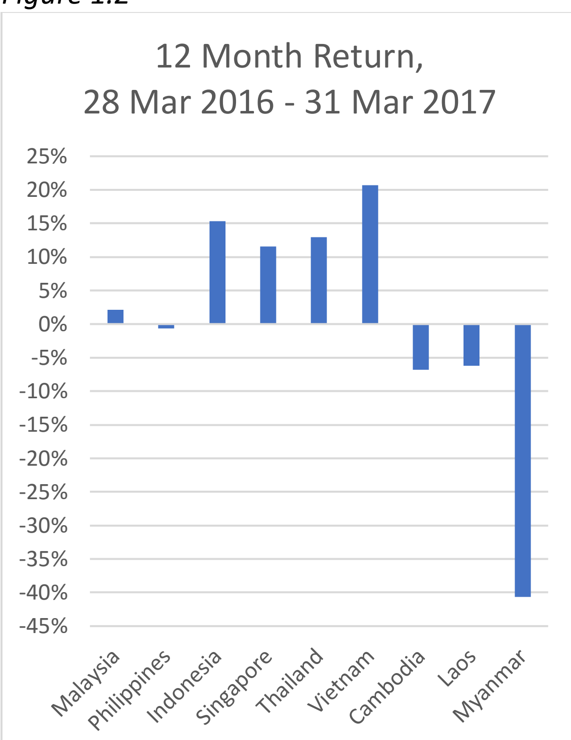
- The country's idyllic landscape presents opportunities to expand its tourism industry, although Manila needs to undertake several reforms to reach its potential. The World Economic Forum's 2017 report on tourism ranked the Philippines 79th, behind Vietnam (67), Indonesia (42), Thailand (34), Malaysia (26), and Singapore (13).

- In late March, Fitch Ratings affirmed Manila's sovereign credit rating at investment grade BBB- and indicated the agency could upgrade the country's rating within the next two years, according to the Manila Standard. Fitch identified Manila's sustained current account surplus, its high level of international reserves, and low and declining external debt as factors in its decision.

Philippine companies probably would benefit greatly from significant infrastructure spending, which for many companies could improve supply chain efficiency, increase trade, and generate new business opportunities. These benefits should translate into increased profitability for Philippine firms, and thus generate positive market returns.

- The Philippine Stock Exchange (PSE) index has trailed its regional peers over the past twelve months, declining 0.66%, while the major indices in Indonesia, Malaysia, Singapore, Thailand, and Vietnam averaged a 12.5% gain.[3]

Figure 1.2



Return data compiled from the Wall Street Journal, Investing.com, and respective exchange websites.

- At least a few Infrastructure-related companies that trade on the PSE should benefit from increased investment spending, depending on whether they are selected for projects. However, foreign-funded initiatives, particularly those funded by Beijing, probably would employ foreign workers and materials, thus mitigating gains to Philippine industrial companies.

- Firms with a country-wide presence, or tourism-related companies outside of large cities, also could benefit from improved transportation infrastructure, due to enhanced accessibility and decreased travel times.

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[3] As of 31 March 2017.