▪ Philippines

UOB Economics Projections	2005	2006	2007F	2008F
GDP	5.0	5.4	7.0	6.1
CPI (average, y/y)	7.6	6.2	3.0	4.9
Unemployment (yearly avg)	8.1	7.8	7.9	8.0
Current account (% of GDP)	2.0	4.3	2.7	2.6
Fiscal balance (% of GDP)	-3.0	-1.5	-1.1	-0.2

The Philippines' 3Q GDP growth slowed to 6.6% y/y, versus 1H's stellar 7.3%, due to weak exports on waning US demand for electronics (two-thirds of Philippine exports). Still, with the economy remaining well-supported by a balance of payments surplus and healthy consumption due to record-high remittances, reduced fiscal debt, falling interest rates, low inflation and buoyant financial markets, we are raising our full-year GDP forecast to 7.0% for 2007, and 6.1% for 2008.

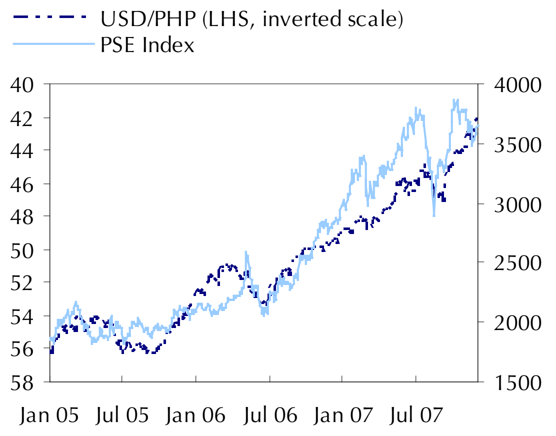
PHP has been the top-performing Asian currency this year, racking up a 17.5% pace of appreciation year-to-date. Despite the peso being a heavily-hit casualty in the Aug credit turmoil, it has since recovered to hit a 7-and-a-half year high of 41.40/USD as of Dec 11, boosted by massive portfolio inflows and overseas Filipino worker (OFW) remittances. We are positive on the peso's fundamentals, expecting healthy fiscal balances and inflationary pressures to push USD/PHP to 38.95 levels by end-2008.

Manageable inflation levels also gave the BSP room to cut rates by 25bp to a 15-year low of 5.50% at its Nov meeting. The BSP still has plenty of flexibility to cut rates in 2008, though a bout of caution could cause the central bank to adopt a wait-and-see attitude in terms of inflation monitoring. We expect the BSP to resume rate cutting in 1Q08 to 5.0%, to reduce pressure on the escalating peso and stimulate investments.

The Peso: A Bull Run with Legs?

The PHP has been the best performing Asian currency, racking up a blistering 17.5% pace of appreciation year-to-date. Despite the peso being a heavily-hit casualty in the recent credit turmoil in Aug, it has since recovered to hit a 7-and-a-half-year high of 41.40/USD as of Dec 11 – boosted by a strong balance-of-payments surplus due to large overseas Filipino worker (OFW) remittances, portfolio investments & a recovery in foreign direct investments. The peso has also been a beneficiary of a rally in Philippines stocks, with the Philippine Composite rising some 23% year-to-date. Still the index is trading at a modest 15x PE ratio, leaving room for further appreciation of the peso ahead.

The PHP & PSE Index
Rebound Sharply from their Aug Correction



Source: CEIC, UOB

Despite the recent uptick in risk aversion, we are raising our forecasts for the USD/PHP to 41.00 for end-2007, to reflect the faster-than-expected pace of appreciation and the seasonal upsurge in remittances for 4Q07. However, we believe the peso's rapid rise will slow in the first quarter of 2008, due to external headwinds such as sluggish US consumer demand weighing on net exports and as remittances decelerate in 2008. However, growing FDI should provide more sustainable support for the peso, being less prone to fluctuations than short term portfolio inflows.

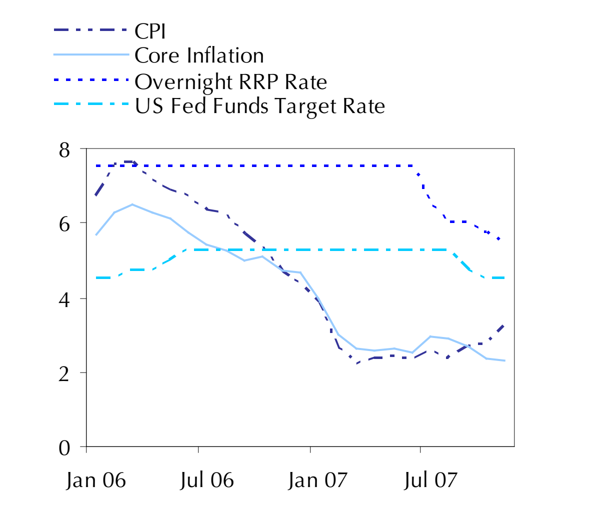
We expect healthy fiscal balances and inflationary pressures to push USD/PHP to 38.95 levels by end-2008. Further privatization plans ahead, such as the estimated US$1.1bn sale of the government's stake in the Philippine National Oil Company (PNOC-EDC) suggests further capital injections to boost balance of payments inflows.

More Rate-Cutting in 2008 Despite Inflationary Pressures

Keen to spur foreign investment and stabilize the accelerating peso, the Philippine central bank Bangko Sentral ng Pilipinas (BSP) reduced the overnight reverse repurchase rate by 25bp for a second month in a row, to a 15-year low of 5.50%, as of 11 Dec. Nov CPI picked up to a 10-month high of 3.2% y/y, compared to the 2.6% average for Jan-Oct. The chief contributors to inflation were food, fuel, light and water commodities.

Nevertheless, the BSP still has the flexibility to cut rates to 5.00% in 2008, though a bout of caution could cause the central bank to adopt a wait-and-see attitude in terms of inflation monitoring. The BSP should stay on the easing cycle to reduce pressure on the escalating peso and stimulate investments. The extension of US rate easing gives the BSP further room to reduce rates. The Philippine economy could also hold off higher inflation as rapid gains in the peso temper imported inflation, while its domestic agricultural output could offset soaring global food prices.

Manageable Inflation Suggests BSP Still has Flexibility to Cut Rates in 2008

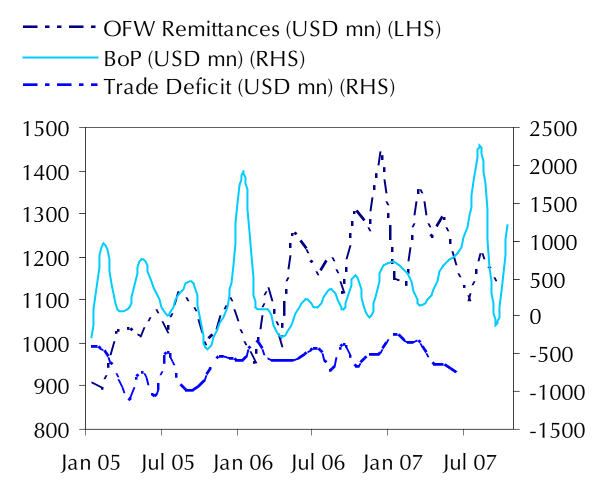


Source: CEIC, UOB

Can Sterling Growth in 08 Be Sustained?

Strong performances in the financial markets were underpinned by sterling economic growth. But 3Q GDP growth slipped below expectations at 6.6% y/y, slowing from the stellar 7.3% in 1H07. Growth was supported by consumer spending and bumper harvests, but let down by weak exports as US demand for electronics waned. Still, we expect the Philippine economy to be on course for its fastest annual growth in 30 years, at a projected 7.0% y/y for 2007. The economy is still well-supported by a balance of payments surplus and healthy consumption fuelled by record remittances, reduced fiscal debt, falling interest rates, low inflation and buoyant financial markets. Going forward into 2008, the economy needs to attract foreign investments and create jobs at home to cut down on the brain drain.

BoP Supported by Strong Remittances Inflows, Despite Trade Deficit



Source: CEIC, UOB

OFW remittances for the first 9 months of 2007 reached US$10.5bn, 15% higher than the same period a year ago. Remittances now account for 12% of GDP, up from 10% last year. Remittances are a major factor why the Philippines ran a record high balance of payments surplus of US$7.8bn for the first 10 months of the year, despite an ongoing trade deficit. We can expect a seasonal surge in remittances in 4Q, in time for the Christmas period, to bolster the peso. But going forward into 2008, remittances are likely to increase at a slower pace, given the higher base and the fact that 60% of remittances come from a slowing US economy. As the greenback eases to new lows against the PHP, OFWs will need to send more dollars to sustain income levels back home. High oil prices in the Mideast have boosted demand for OFWs in that region, but Mideast remittances currently account for only 16% of total inflows.

The Philippines needs to shift its focus to more long-term investments to sustain robust inflows for 2008. Net FDI levels reached US$1.9bn in the first 9 months of 2007, up 22% from a low base in the same period a year ago. Yet, FDI still pales in comparison to investment levels in its regional neighbours, with Indonesia netting about US$8.5bn in the first 9 months and Thailand US$6.2bn despite the latter two countries' reportedly poor investment climates. What is holding investors back is probably the lack of infrastructure and skilled labour, and widespread corruption in the Philippines. Two bomb explosions recently in a luxury shopping mall and in Congress – raise security concerns among investors.

Still, there are positive leading indicators that could point towards more investment ahead. Bank loans grew 6.2% y/y in September, with loans to the services sector leading expansion at 23.7%, while loans to the manufacturing sector finally posted positive growth of 1%, after declining for 7 months. These could be the result of the BSP 'tiering' system introduced last November, to dissuade banks from depositing with the central bank and to stimulate lending and investment. The system was scrapped in July, once loan rates started to show growth. The two back-to-back policy rate cuts in October and November, which bring interest rates to a 15-year low, are also expected to further encourage bank lending and investments going forward.

GDP by Expenditure								
	1Q07	2Q07	3Q07	1Q06	2Q06	3Q06	4Q06	FY06
Private Consumption	5.9	6.0	5.6	5.3	5.4	5.2	5.8	5.5
Government Consumption	9.9	12.4	8.3	7.6	3.3	4.5	9.9	5.7
Investment	6.9	6.8	7.5	0.3	1.5	8.0	1.8	2.1
Exports	9.9	4.2	-4.9	13.0	21.2	9.2	2.3	12.1
Imports	-2.1	-11.2	-6.3	0.7	4.0	1.2	1.4	2.5
GDP	6.9	7.5	6.6	5.7	5.8	5.3	4.8	5.4
Source: CEIC, UOB								