Mizuho Flash: Philippines

Economics & Strategy | Asia ex-Japan

December 04 2024 | Tan Jing Yi | Market Economist

MIZUHO

Ratings Outlook Revision Insufficient For PHP Boost

In a Nutshell: S&P Ratings upgraded its outlook on Philippines to positive from 'Stable' to 'Positive'. Insofar that this is typically a precursor for a credit rating upgrade within the next one or two years, we think this is premature, if not ill-timed. Especially as the fiscal balance is unlikely to see rapid consolidation back to pre-pandemic sub-3%. What's more, prospects for significant narrowing of current account deficit are challenged amid mounting trade headwinds. Not to mention, elevated geo-political risks. Point being, an economic improvement that truly warrants an upgrade is a tall order. And a subpar PHP may be reflecting our circumspection.

Background

On 26 November 2024, S&P Global Ratings revised its outlook on the Philippines to positive from stable, but kept the long-term sovereign credit rating on the Philippines at 'BBB+'. The improved outlook was on the back of strong economic recovery in the last two years, which S&P noted should facilitate a reduction in the general government deficit, while external position remains a credit strength reflecting rising FX reserves and low external debt. Nonetheless, S&P also noted that fiscal balances will take several years to recover to pre-pandemic levels given the eroded fiscal headroom, and that current account deficits will persist but at modest levels in coming years.

S&P further indicated that it **may raise the ratings if:**

a) expectations of current account deficits tapering over the forecast period are realised such that buffers in the Philippines' narrow net external asset position[1] is maintained; and
b) the government achieves more rapid fiscal consolidation.

Officials were upbeat on the announcement. BSP said that S&P's outlook revision indicates a "possible upgrade to an 'A-' rating within 24 months", while Finance Secretary Recto said the government had a comprehensive "Road to A initiative"[2] to ensure more upgrades soon. For reference, S&P upgraded Philippines outlook to 'Positive' on 28 April 2018, and upgraded Philippines credit rating to 'BBB+' (from 'BBB') about one year later on 30 April 2019.

Philippines Credit Ratings since 2011

<table>
<tr><th></th><th></th><th>2011</th><th>2012</th><th>2013</th><th>2014-16</th><th>2017-18</th><th>2019-24</th><th></th><th></th></tr>
<tr><td rowspan="3">Investment Grade (IG)</td><td>BBB+</td><td></td><td></td><td></td><td></td><td></td><td>S&P</td><td>Baa1</td><td rowspan="3">Investment Grade (IG)</td></tr>
<tr><td>BBB</td><td></td><td></td><td></td><td>S&P | Moody's</td><td>S&P | Fitch | Moody's</td><td>Fitch | Moody's</td><td>Baa2</td></tr>
<tr><td>BBB-</td><td></td><td></td><td>S&P | Fitch | Moody's</td><td>Fitch</td><td></td><td></td><td>Baa3</td></tr>
<tr><td rowspan="2">Non-IG</td><td>BB+</td><td>Fitch</td><td>S&P | Fitch | Moody's</td><td></td><td></td><td></td><td></td><td>Ba1</td><td rowspan="2">Non-IG</td></tr>
<tr><td>BB</td><td>S&P | Moody's</td><td></td><td></td><td></td><td></td><td></td><td>Ba2</td></tr>
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1 S&P defines 'narrow net external debt' as the stock of foreign and local currency public- and private-sector borrowings from nonresidents minus official reserves minus public-sector liquid claims on nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities.
2 For avoidance of doubt, there have been no official details on this initiative.

<u>Philippines' Current Credit Rating compared with regional peers</u>

	S&P	Fitch	Moody's	
AAA	SG, AU	SG, AU	SG, AU	Aaa
AA+	TW			Aa1
AA	KR	TW	KR	Aa2
AA-		KR	TW	Aa3
A+	CH	CH	CH	A1
A				A2
A-	MY		MY	A3
BBB+	TH, PH	TH, MY	TH	Baa1
BBB	ID	PH, ID	PH, ID	Baa2
BBB-	IN	IN	IN	Baa3
BB+	VN	VN		Ba1
BB			VN	Ba2

Investment Grade (AAA to BBB- / Aaa to Baa3)

Non-investment Grade ("Junk") (BB+ to BB / Ba1 to Ba2)

Legend	
AU	Australia
CH	China
ID	Indonesia
IN	India
KR	South Korea
MY	Malaysia
PH	Philippines
SG	Singapore
TH	Thailand
TW	Taiwan
VN	Vietnam

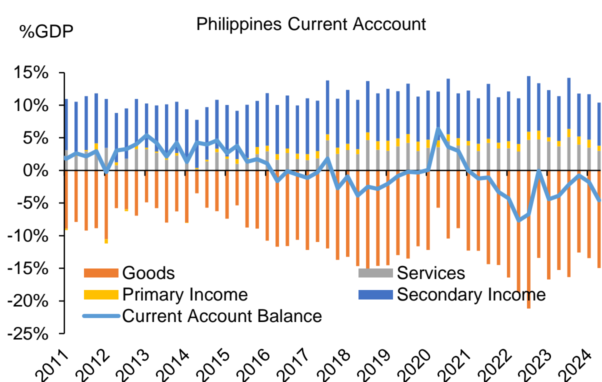
On balance, we think that a ratings upgrade would not be imminent, at least in the one to two years, as we think it would be a high bar for Philippines to meet the two pre-requisites for the ratings upgrade. The lack of any durable PHP boost on the announcement may suggest that we are not alone in having these sentiments.

Current Account & Net External Position

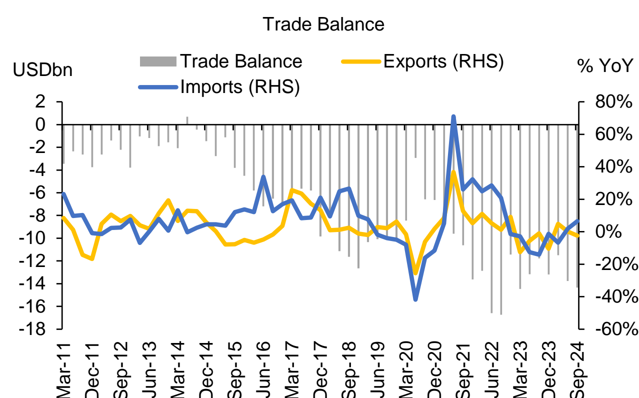
<u>First</u>, we think that Philippines' current account deficit will only narrow modestly and may not be sufficient to ensure that Philippines' narrow net external asset position is maintained.

Admittedly, the widening of services surplus on higher tourism revenue have helped to narrow the overall current account deficit. Notably, services surplus averaged 3.3% of GDP in 1H'24. While on-par with an average services surplus of 3.5% of GDP in 2019, total tourism recovery in 1H'24 have only recovered to ~69% of 1H'19 levels. This suggests that tourists are spending more post-pandemic on average, and that tourism recovery still has further room to grow. Meanwhile, remittances growth remains stable.

However, our relatively circumspect view mainly comes from downside risks to a large trade balance and possible fading tailwinds to the electronics recovery, especially amid uncertainties of adverse US-China trade conflict and Philippines' position along the supply chain. In particular, we are of the view that downside risks would more than offset any improvement to services surplus. Notably, goods deficit (as % of GDP) has been widening for the past two quarters and we are not expecting a significant narrowing of current account deficit in Q3 given that trade data for Q3 suggests a deteriorating trade balance while there is no marked improvement to tourist arrivals in Q3. Overall, we expect current account deficit to print at around 2.4% of GDP in 2024 (2023: 2.7%), compared to S&P's 2.0% estimate.

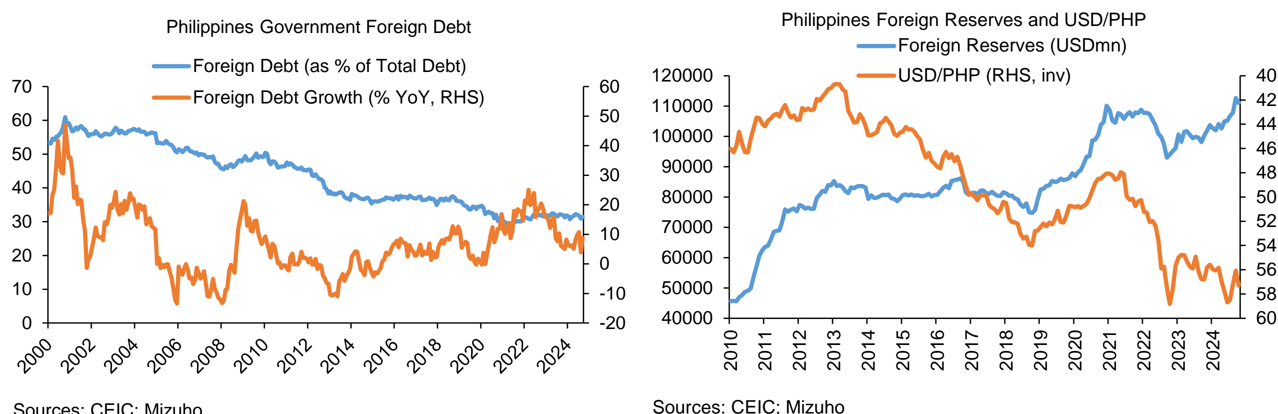


Source: CEIC; Mizuho Bank



Sources: CEIC; Mizuho

The modest narrowing of current account deficit may mean that net external debt position may deteriorate. This is in addition to heightened uncertainty in recent weeks which have prompted intervention in the FX market and would likely see a corresponding fall in foreign reserves in November. With Trump 2.0 policies shaping up, the end of heightened FX volatility may not be near. Nonetheless, smaller proportion of foreign debt[3] (as % of total debt) is encouraging.



Fiscal Consolidation

What's more, we are circumspect that the pace of fiscal consolidation would be faster-than-expected. In particular, S&P noted that restoring the fiscal and debt settings to pre-pandemic levels over the next 12-24 months will be challenging. If achieving pre-pandemic levels is the criteria for "rapid" fiscal consolidation, it is unlikely to be met. Afterall, the fiscal deficit targets set out in the Medium-term Fiscal Framework (MTFF) is above the 2016-2019 average fiscal deficit. In addition, our current assessment for Budget 2025 that there are risks of fiscal slippages on higher-than-expected expenditures.

	Actual		**MTFF Targets**				
	'16-'19 avg	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
Fiscal Deficit (% of GDP)	2.7%	6.2%	5.6%	5.3%	4.7%	4.1%	3.7%

*2018-2019 average due to data availability.

The Senate approved Budget 2025 of PHP6.352tn on 26 November, but the fiscal deficit target of 5.3% in 2025 is premised on lower disbursements than budgeted (specifically PHP6.182tn). While we believe the government is committed to achieve the fiscal deficit target, we are of the view that upcoming midterm elections due May 2025 adds material risk to higher expenditures given higher stakes as the **elections will be closely contested one** between two political dynasties.

In addition, we think that revenue upside remains modest. Budget 2025 is targeting a fiscal revenue growth of 8.8% YoY, which appears a reasonable estimate given that it is higher than 2023 revenues growth of 7.9% YoY but lower than 2016-2019 average growth of 10.5% YoY. While the passing of the Digital Services Tax bill could also help buffer coffers, it would not be much relative to the increase in budget, especially as clarity on other tax reforms (e.g. Mining Fiscal regime) remain scant. In addition, while the CREATE MORE Bill could possibly increase the tax base by attracting more investments and businesses, provisions to decrease corporate taxes, among others, may offset the increase in tax revenue.

All said, the revised outlook is certainly encouraging, and not entirely groundless. But the high bar for an upgrade implies that the PHP bull may be found wanting.

[3] Foreign Debt refers to the foreign borrowings or liabilities (loans and securities) sourced in the international financial markets.

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