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CascadeAsia Advisors

Exclusive Analysis: Philippines Market Update

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- **The Philippines leads Southeast Asia's rebound in Q4**
- **Inflation picks up to a three-month high in January**
- **The BSP keeps an eye on the money**
- **The PSEi advances but appears overbought**

The Philippines leads Southeast Asia's rebound in Q4

The Philippines led Southeast Asia in a year-end rebound, reporting 6.8% growth y/y for Q4 2012 and beating consensus expectations of 6.4%. Full year growth in 2012 was recorded at 6.6%, which is a sharp acceleration from 3.9% in 2011. Strong domestic activity, led by private consumption and investment activity, particularly in the construction sector, underpinned much of this growth. Exports also performed well, albeit from a low base in 2011, rising by 9.1% y/y, up from 6.7% in Q3.

For 2012 as a whole, government spending rose by 11.8%, albeit from a low base in 2011 when growth was just 1%. As we noted in our 2013 outlook, we expect the government spending trend to continue through H1. Of course, the downside risk remains very real. Bottlenecks in PPP projects and mining reforms will be delayed even further. The mining sector in particular disappointed in Q4, with a 5.3% decline y/y. We also expect consumption to receive a bump from remittances this year as global demand recovers. Cash remittances from overseas Filipino workers rose by 7.6% y/y to $1.9bn.

Inflation picks up to a three-month high in January

Philippine inflation picked up to a three-month high in January, in line with Cascade Asia's price expectations. The National Statistics Office reported that consumer prices rose 3% y/y, up from 2.9% y/y for December. Core inflation, however, was 3.6%. We have been expecting the rise as higher taxes boosted the prices of alcoholic beverages and tobacco following the Sin Tax Bill. Alcoholic beverages and tobacco costs rose 17.3% from a year earlier, compared with a 5.1% gain in December. Faster-than-expected

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annual change in indices of clothing, footwear, healthcare, communication, recreation, and other miscellaneous goods and services also added to the change. Housing and fuel climbed at a steady 3.6%.

The news limits the BSP's scope the reduce interest rates further. In line with our expectations, the BSP held its benchmark rate at a record low last month while cutting rates on special deposit accounts to help curb capital inflows that boosted the peso and drove the PSEi up. The BSP also cut its forecast for price gains this year to 3% from 3.1%.

The BSP keeps an eye on the money

The Philippine peso completed a second weekly decline and 5-yr bonds rose on speculation the central bank will step up efforts to curb capital inflows. The BSP is currently looking into how it can counter excessive capital flows that result from the improving economy. Ideas currently being considered are to loosen FX rules to encourage outflows and prop up measures to discourage carry trades involving Philippine fixed income assets. These moves are not entirely out of sync in other regions such as Indonesia, Thailand and South Korea which have been attracting record flows in FDI as well as portfolio investment in recent years.

An additional possibility that we are not ruling out is another reduction in the special deposit accounts. Last December, the BSP announced limits on banks' currency forward positions and banned overseas funds from keeping money in its special deposit accounts in July. On January 24, it reduced the rate it pays on PHP 1.72mn (US$42bn) in the accounts from 3.5% to 3%.

The PSEi advances but appears overbought

The PSEi advanced again this week, gaining 2.2%, up 8.7% YTD. The market reached a new record closing earlier in the week at 6,470.67. Global markets also managed to keep up with their respective advances. But the PSEi looks increasingly overbought as monthly reads on the RSI are at levels that have historically triggered corrective drives. Nevertheless, foreign fund inflows remained significant throughout the week. Investors also sought to consolidate gains in the run up to the Chinese New Year this weekend. With the lunar holiday and the subsequent closure of many Asian markets next week, look for trading activity to dip off slightly.

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