PINNACLE

• PHILIPPINES MARKET INSIGHT

AUGUST 2015

FEATURE: FOREIGN DIRECT INVESTMENT IN THE PHILIPPINES

In this issue of VISTA we take a look at Foreign Direct Investment (FDI) in the Philippines and glimpse at some of the data behind the FDI numbers. Direct investment is a category of cross-border investment associated with a foreign entity or individual having control or a significant degree of influence on the management of a local company through investment in debt or equity. In a country's International Investment Position, there are other types of overseas investments such as "Portfolio" investments in Capital Markets, derivatives or government bonds, among others. Nevertheless, our focus in this issue is just FDI.

Most economists would argue FDI benefits a country by providing long term growth, increased employment, sources of capital, global standards of governance, increased competition, and technology transfer. There have been studies of course on some negative impacts of foreign investment such as crowding out effect, balance of payment effects, and social impacts… but to keep it simple our assumption in this issue is that "foreign direct investment and capital *is good* for the economy and good for the Republic of the Philippines"

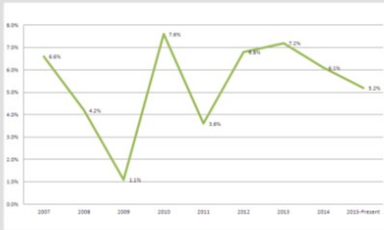
There has been lots of positive news on The Philippines' robust economy, stellar growth compared to its neighbors, and positive outlook. One area Philippines lags far behind and is sort of left standing behind compared to its ASEAN peers is in FDI. In the long run this could impede growth sustainability and so should be monitored and discussed.

CURRENT PHILIPPINES FDI STATISTICS

- **FDI By Type-** In 2014, Net FDI in Philippines was at **6.2 bb USD**. It is important to note though that this is not all new money into the equity of local companies- 54% of the FDI was in the form of debt and 13% was the reinvestment of earnings (return of capital) so not new capital. After debt and reinvestment, this leaves direct equity

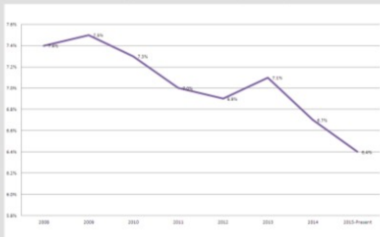
GDP Growth Rate

Source: Philippine Statistics Authority for the 1st Quarter of 2015



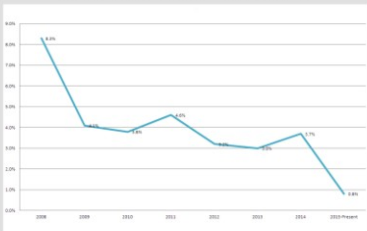
Unemployment Rate

Source: Philippine Statistics Authority as of April 2015



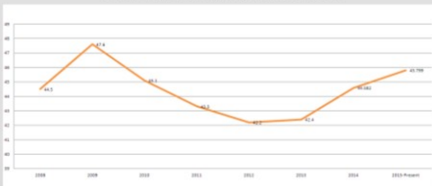
Inflation Rate

Source: Philippine Statistics Authority as of July 2015



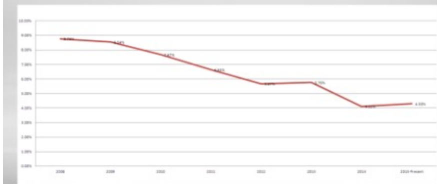
FOREX (US$ to PHP)

Source: Bangko Sentral ng Pilipinas as of July 2015



Bank Interest Rate

Source: Bangko Sentral ng Pilipinas as of July 2015



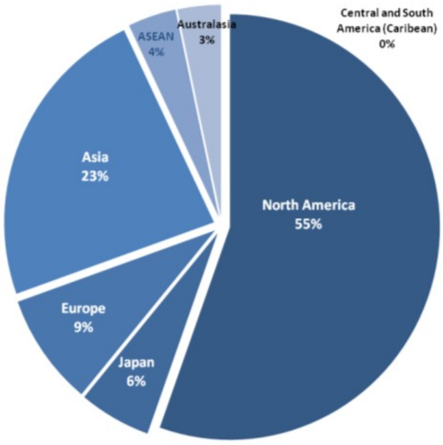
investment at **2.03bb** USD or 33% of total Net FDI. The total stock of direct investment per BSP's International Investment Position classified as a "liability" on the Philippines international accounts is at **59.62bb USD.**

FDI Type	2012	2013	2014	% 2014
Debt	391	2,654	3,347	54%
Reinvestment of Earnings	819	420	819	13%
Equity (Net)	2,006	664	2,035	33%
Totals (mm USD)	**3,215**	**3,737**	**6,201**	

- **FDI By Source** – ***Where is the FDI coming from***?

The source of FDI varies each year. Generally USA, Japan, Australia and Hong Kong are at the top of the list every year with guest appearances by other countries throughout the investment cycle. For 2014, Asia (including China) is at 23%, Europe at 9% and surprisingly ASEAN with all of the talk of cross border investment transactions and integration is at 4% barely topping off Australasia at 3%.

FDI- Equity By Region



FDI- Equity Top 10 Countries

Equity By Country	2012	2013	2014	% 2014	3 year
USA	554	(653)	1,175	58%	23%
Hong Kong	655	(86)	394	19%	20%
Japan	146	438	118	6%	15%
Australia	242	3	71	3%	7%
Taiwan (ROC)	0	4	50	2%	1%
Thailand	8	(4)	45	2%	1%
China	0	6	41	2%	1%
Singapore	(35)	(138)	34	2%	-3%
Guam (Marianas Is.)	0	0	10	0%	0%
South Korea (ROK)	4	2	5	0%	0%
Totals (mm USD)	**1,574**	**(427)**	**1,942**		

The top ten countries for the last three years are presented to the left with the USA leading. While South Korea contributes greatly to tourism and dominates foreign "visits", this does not translate into FDI at a mere 5mm USD... Guam seems sort of an anomaly.

FDI- Equity ASEAN

For ASEAN cross border FDI, the numbers paint a gloomy picture. In 2014 Singapore and Thailand were the only ASEAN nations on the radar screen and Singapore only after 2 years of negative Net FDI. These numbers should be monitored as a KPI to assess impact of ASEAN integration.

Equity ASEAN By Country	2012	2013	2014	% 2014	3 year
Brunei Darussalam	0	0	0	0%	0%
Cambodia (Kampuchea)	-	(0)	-	0%	0%
Indonesia	0	0	-	0%	-2%
Lao PDR	-	-	-	0%	0%
Malaysia	(35)	100	-	0%	-262%
Myanmar (Burma)	-	-	-	0%	0%
Singapore	(35)	(138)	34	43%	564%
Thailand	8	(4)	45	57%	-200%
Viet Nam	-	-	-	0%	0%
Totals (mm USD)	**-62**	**-42**	**79**		

Source: Bangko Sentral ng Pilipinas (BSP)

FDI By Industry: *Where does the FDI go*? Manufacturing is the main beneficiary of Philippines FDI followed by Finance and Insurance. Several studies and articles have indicated that FDI in the Philippines is driven by the services sector which makes sense with the sustained growth of the BPO sector. However, we don't see that standing out in the official BSP numbers unless there are data classifications issues to peel back or unless BPO exists as a subset of financial services.

Low labour and overhead costs help drive FDI in manufacturing and other off shoring BPO type sectors. This investment though can be hampered by high electricity costs, restrictive regulations, difficulty of doing business, and a cumbersome tax regime.

The Real Estate sector at 8% is below ASEAN peers but Philippines has very restrictive ownership policies which will continue to impede any investment in this sector until foreign ownership policies change.

FDI by Industry (mm USD)	2012	2013	2014	% 2014	3 year
Financial and Insurance	-200	-377	1321	65%	16%
Manufacturing	1770	216	209	10%	47%
Mining	34	44	159	8%	5%
Real Estate Activities	164	70	154	8%	8%
Wholesale and Retail Trade	202	24	99	5%	7%
Transport and Storage	4	21	90	4%	2%
Accommodation and Food Services	3	7	18	1%	1%
Information and Communication	20	5	13	1%	1%
Construction	9	2	6	0%	0%
Agricultural	9	17	5	0%	1%
Arts Entertainment and recreation	4	167	0	0%	4%
Water Supply	-2	461	-24	-1%	**9%**
Electricity	-14	-27	-58	-3%	-2%
Others	1	34	44	2%	2%
Totals (mm USD)	**2006**	**664**	**2035**		

Source: Bangko Sentral ng Pilipinas (BSP)

Various Philippines Investment promotion agencies carry statics on approved FDI investment and infrastructure projects approved or pending. This data could give an indication of "future" FDI figures and growth. For this issue of Vista we did not explore these leading indicator numbers.

COMPARISON AMONG ASEAN

So back to our theme that *FDI "is good" for the economy, but the Philippines needs to catch up.* In June, many papers carried the following or similar quote… "THE PHILIPPINES has emerged anew among top foreign direct investment (FDI) destinations in East Asia, beating global and regional growth rates but value of inflows still paled against those of comparable Southeast Asian peers, [the United Nations Conference on Trade and Development (UNCTAD) said in its World Investment Report 2015 released in June.]" Yes, FDI growth was strong but the reality is that the Philippines is at the bottom of the ranking on FDI and needs to be mindful of its ranking so that weaknesses can be identified and addressed. Here are some of the rankings and indicators relating to foreign investment:

- **FDI in ASEAN -** Philippines is at the bottom of the ranking on FDI in ASEAN

Country	Net FDI	FDI%
Singapore	67,523	51%
Indonesia	22,580	17%
Thailand	12,566	10%
Malaysia	10,799	8%
Vietnam	9,200	7%
Philippines	**6,201**	**5%**
Cambodia	1,730	1%
Myanmar	946	1%
Laos	721	1%
Total (mm USD)	**132,266**	*Source: UNCTAD*

- **Regulatory Restrictiveness -**The Philippines ranks the lowest in ASEAN and almost the world on the Regulatory Restrictiveness Index produced by The Organization of Economic Cooperation and Development (OECD). As of June 2014, the Philippines has the most restrictive environment for foreign investment in Southeast Asia and tied China on the world scale.

Country	2014 Rank	FDI RRI
Philippines	**1**	**0.42**
Myanmar	3	0.36
Indonesia *	5	0.32
Thailand	7	0.28
Lao PDR	8	0.27
Vietnam	11	0.23
Malaysia	12	0.23
Cambodia	42	0.04
Singapore	45	0.03

- **Ease of Doing Businesses** – Philippines ranks low on the World Bank Group's Ease of Doing Businesses Index. This is a ranking of economies based on their ease of doing business. Higher ranking means the "regulatory environment is more conducive to the starting and operation of a local firm".

Country	2015 Rank
Singapore	1
Hong Kong SAR, China	3
Malaysia	18
Taiwan, China	19
Thailand	26
Vietnam	78
China *	90
Philippines	**95**
Indonesia *	114
Cambodia	135
Lao PDR	148

Source: World Bank Group

- **Corruption Perceptions Index** – Philippine has improved its ranking 3 or 4 notches the last two years on perceived corruption and has edged up to a respectable position among its ASEAN peers but of course with room to improve. The CPI 2014 Score relates to the degree to which corruption is perceived to exist among public officials and politicians by business people and country analysts. Score ranges between 100 (highly clean) and 0 (highly corrupt). With a ranking of 174 countries.

Country Rank	Country / Territory	CPI 2014 Score
7	Singapore	84
15	Japan	76
17	Hong Kong	74
17	United States	74
35	Taiwan	61
43	Korea (South)	55
50	Malaysia	52
85	**Philippines**	**38**
85	Thailand	38
100	China	36
107	Indonesia	34
119	Vietnam	31
145	Laos	25
156	Cambodia	21
156	Myanmar	21

Source: Transparency International

- **Country Credit Ratings-** Philippines has had several positive upgrades in its credit ratings and now rests in the middle of its Asian peers and is "Investment grade." Investors look at the credit ratings as a key measure of risk and rely on the ratings in determining country risk and investment selection.

Country	S&P		Moody's		Fitch		TE	
Singapore	AAA	stable	Aaa	stable	AAA	stable	98	stable
Hong Kong	AAA	stable	Aa1	stable	AA+	stable	94	stable
Japan	AA-	negative	A1	stable	A	stable	82	negative
Taiwan	AA-	stable	Aa3	stable	A+	stable	81	stable
China	AA-	stable	Aa3	stable	A+	stable	79	stable
Malaysia	A-	stable	A3	positive	A-	stable	66	stable
Thailand	BBB+	stable	Baa1	stable	BBB+	stable	62	stable
Philippines	**BBB**	**stable**	**Baa2**	**stable**	**BBB-**	**stable**	**52**	**stable**
Indonesia	BB+	positive	Baa3	stable	BBB-	stable	46	stable
Cambodia			B2	stable			30	stable
Vietnam	BB-	stable	B1	stable	BB-	stable	30	stable

Source: Trading Economics

There are of course many other measures and KPI we can look at both qualitative (i.e. political stability, sentiments etc.) and quantitative (i.e. tariff rates, demographics, macro fundamentals, currency risk, market performance etc). Our glimpse into a few of these benchmarks though will allow us to monitor the impact of financial policies, changes to ownership and of course ASEAN integration.

CONCLUSION: *"No Man is an Island"* -John Donne

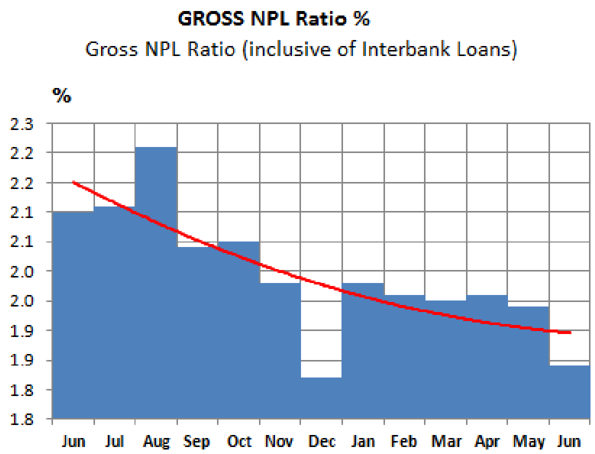
The Philippine economy continues to be stable and has positive fundamentals. Along with the usual suspects, Foreign Direct Investment (FDI) and ASEAN Integration will be drivers of future sustainable growth and so these numbers should be closely monitored. It is critical to understand the factors impacting FDI and take progressive measures to monitor and improve Philippines' rankings in this area.

We are entering the new election cycle so the current administration needs to keep the ship straight and finish strong and the new administration will need to focus on midterm strategies towards improving FDI by taking measures such as easing restrictiveness, improving the ease of doing business, expanding PPP and other critical infrastructure programs, and working with ASEAN and global trading partners to increase cross border flows and investments. This is a tough act to pull off as the administration will also need to keep all other aspects of the economy rolling forward (GDP, unemployment, inflation etc) while also keeping a leery eye on South Sea's geo politics.

MARKET UPDATES

- **Distressed Debt Updates**

The Universal and Commercial Banking sector continues to be robust. (**NPL Ratio 1.82%**) Distress Debt Levels have hit yet another 15 year low with June 2015 distressed debt at 197.15bb PHP (4.15bb USD) and ROPA at 94.8bb PHP (2.10bb USD) down from December levels of 201.2bb (4.47bb USD) and ROPA at 97bb PHP (2.15bb USD).



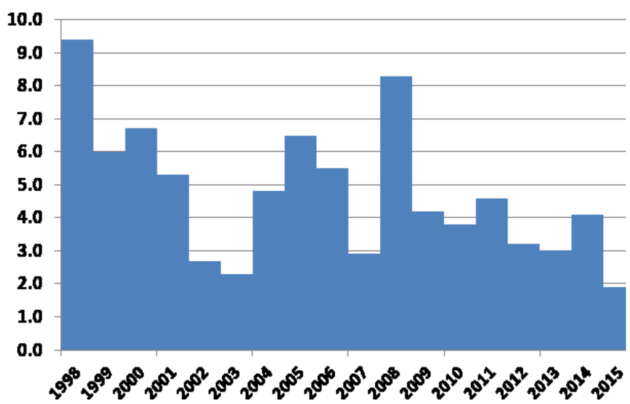
Meanwhile at the Rural Banks (**NPL Ratio 11.92%**) there continues to be the same story and the"*Tale of Two Cities*" with very little improvement in balance sheets. March 2015 levels stand at 26.51bb PHP (589mm USD) up from December levels of 26.465bb PHP (588mm USD). As we have discussed in past Vista issues the high level of NPL in this sector has very little impact on the overall banking sector given the relaive size of the rural bank sector.

- **Foreign Banks**

Since January, the BSP has approved the entry of 5 banks - Japan's Sumitomo Mitsui, South Korea's Shinhan Bank, Taiwan's Cathay United, the Industrial Bank of Korea and most recently Yuanta Bank which is the second Taiwanese bank to obtain approval. There are reportedly two more foreign banks in process for applying for approval and rumor that Japan's Mizuho in talks with SM Group and that PNB Bank/ Insurance has "many" suitors.

- **Inflation Good News!!**

For those who missed the headlines Inflation has hit a new record low with June at 1.1% July at 0.8%



Source: Philippine Statistics Authority (PSA)

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