MOODY'S
INVESTORS SERVICE

Rating Action: Moody's upgrades Philippines to Baa3, revises outlook to positive

Global Credit Research - 03 Oct 2013

Singapore, October 03, 2013 -- Moody's Investors Service has today upgraded the rating of the Government of the Philippines by one notch to Baa3 from Ba1.

At the same time, Moody's has assigned a positive outlook to the rating.

The rating action concludes the review for upgrade announced on 25 July 2013.

The factors that prompted the review remain intact, namely the sustainability of the country's 1) robust economic performance; 2) ongoing fiscal and debt consolidation; and 3) political stability and improved governance.

In addition, the stability of the Philippines' funding conditions -- during the recent bout of market volatility in emerging markets -- points to the country's relative lack of vulnerability to external financial shocks, such as those arising from anticipated tapering by the US Federal Reserve of its quantitative easing policy.

In a related rating action, Moody's has upgraded the government's foreign currency shelf rating to (P)Baa3 and the ratings for the liabilities of the country's central bank, Bangko Sentral ng Pilipinas (BSP), to Baa3. These have also been assigned a positive outlook.

RATINGS RATIONALE

RATIONALE FOR THE UPGRADE

The Philippines' economic performance has entered a structural shift to higher growth, accompanied by low inflation. Real GDP expanded by 6.8% in 2012 and 7.6% year-on-year in the first half of 2013. These levels are among the fastest rates of growth in Asia-Pacific and across emerging markets globally. At the same time, CPI inflation remains well anchored and is currently below the central bank's target range.

The new growth path is being reinforced in part by improved fiscal management. Revenue growth has accommodated sizeable increases in infrastructure and social spending, although revenue generation remains weak when compared with investment-grade countries overall.

Nevertheless, since 2008, the Philippine government has regularly recorded fiscal deficits that are narrower than the Baa3-rated median. Primary surpluses recorded in eight of the past 10 years will likely continue over the five-year medium-term horizon, allowing for further consolidation of the government's debt burden. Yet, government debt as measured against GDP will remain higher than most similarly rated peers.

Over the past few months, the prospects of Fed tapering had only a muted effect on funding conditions for the Philippines. An underlying shift in the government's funding profile has contributed to the country's resilience to such external financial shocks. Although the Philippine government is the largest sovereign issuer of US dollar-denominated securities in the Asia-Pacific based on total debt outstanding, it is now much more reliant on domestic sources of financing. The government's improved ability to fund itself onshore reflects both the country's healthy external payments position and the ample liquidity in its banking system, which is also the only system worldwide deemed by Moody's to have a positive outlook.

In addition, the Aquino administration has maintained its popularity among voters, which in turn supports the further institutionalization of reforms for good governance. This situation has in turn been reflected in improving third-party assessments of institutional quality and international competitiveness.

The Philippines will maintain a current account surplus, which has been bolstered by remittance inflows from overseas Filipinos and services exports, particularly from the business process outsourcing sector. These flows are likely to remain strong, if not strengthen, over the outlook horizon. The Philippines' external strengths are reflected in the falling external debt to GDP ratio and the ample stock of gross international reserves, which now exceeds the country's total external debt.

Moody's has also raised the Philippines' long-term foreign currency (FC) bond ceiling to Baa1 from Baa2 as well as its long-term FC deposit ceiling to Baa3 from Ba1.

In addition, Moody's has raised the short-term FC bond ceiling to P-2 from P-3, while changing the short-term FC deposit ceiling to P-3 from "Not Prime." These ceilings act as a cap on the ratings that can be assigned to the FC obligations of other entities domiciled in the country.

The Philippines' local currency (LC) bond and deposit ceilings remain unchanged at A2.

RATIONALE FOR THE POSITIVE OUTLOOK

The positive outlook for the Baa3 rating reflects the expectation of continued economic outperformance by the Philippines relative to peers, which, in turn, would further support debt consolidation and associated improvements in debt affordability and sustainability. Moreover, sustained political stability points to better prospects for reform over the second half of the current presidential administration.

WHAT COULD CHANGE THE RATING UP/DOWN

Continued improvements in the country's main debt metrics and growth dynamics will support further upgrades.

In view of the currently positive outlook on the Philippines' sovereign rating, a downward rating movement is unlikely over the short term.

However, the emergence of macroeconomic instability -- which leads to a substantial deterioration in fiscal/debt metrics, a rise in debt-servicing costs, and/or an erosion of the country's external payments position -- could exert downward pressure on the rating.

GDP per capita (PPP basis, US$): 4,412 (2012 Actual) (also known as Per Capita Income)

Real GDP growth (% change): 6.8% (2012 Actual) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 2.9% (2012 Actual)

Gen. Gov. Financial Balance/GDP: -2.4% (2012 Actual) (also known as Fiscal Balance)

Current Account Balance/GDP: 2.9% (2012 Actual) (also known as External Balance)

External debt/GDP: 32.3% (2012 Actual)

Level of economic development: Moderate level of economic resilience

Default history: At least one default event (on bonds and/or loans) has been recorded since 1983.

On 01 October 2013, a rating committee was called to discuss the rating of the Philippines, Government of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have materially increased. The issuer's institutional strength/framework has materially strengthened. The issuer's fiscal or financial strength, including its debt profile, has materially strengthened. The systemic risk in which the issuer operates has not materially changed. The issuer's susceptibility to event risks has not materially changed. An analysis of this issuer, relative to its peers, indicates that a repositioning of its rating would be appropriate.

The principal methodology used in these ratings was Sovereign Bond Ratings published in September 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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