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Resisting the Crisis

President Gloria Macapagal-Arroyo
pursues fiscal reforms and pro-business policies
to keep growth alive in the Philippines.

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THE PHILIPPINES

Arroyo's Promise

President Gloria Macapagal-Arroyo has restored fiscal health to the Philippines. Can she steer the country through the global downturn?

By Allen T. Cheng

PHOTOGRAPHS BY PHILIPP ENGELHORN

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HERE IS NEVER A GOOD TIME FOR A CRISIS. But for the Philippines, which has known more than its share of difficulties, the global economic downturn comes at a particularly tricky moment. After decades of failed promise, the country in recent years has registered some of its best economic performances ever as a result of the fiscal reforms and pro-business policies of President Gloria Macapagal-

Arroyo. Now those gains are threatened by the recession in the U.S. and Europe, which has caused the country's exports to plunge and growth to slow sharply.

But Arroyo, who took office eight years ago when the Philippines was on the brink of recession and turned the economy around, is confident that the country can meet the new challenges. Her government is taking advantage of its fiscal reforms, which have dramatically lowered the deficit and the national debt in recent years, to ramp up spending to combat the economic slowdown. The 2009 budget, which Congress approved in January, contains a stimulus package of 300 billion pesos (\$6.4 billion) for infrastructure spending and tax breaks. The president also believes that the Philippines' business-process outsourcing industry, which she has actively promoted, stands to benefit from recessions abroad as hard-pressed American and European companies look to cut costs.

"The important thing now is to work on the global recovery together and to prevent the global crisis from becoming a crisis in the Philippines," Arroyo tells *Institutional Investor* in a recent interview in Hong Kong, where she was attending a meeting of the Clinton Global Initiative. "Reform has been the central pillar of

President Gloria Macapagal-Arroyo believes that increased public spending can protect the Philippines from the global downturn



REDUX

THE PHILIPPINES

our administration. Key among the reforms is the expanded value-added tax, which allowed us to have the revenue to invest in human and physical infrastructure as well as social services.”

Although the country resisted the early stages of the financial crisis, its economy — like most across Asia — is feeling the global slowdown that followed the collapse of Lehman Brothers Holdings in September. Exports dropped by 11.9 percent in November, with shipments to the U.S. — the country’s biggest market — plunging by 18.8 percent. Foreign direct investment, which had surged in recent years, declined 47 percent in the first ten months of 2008, to \$1.42 billion. Remittances from Filipinos working overseas have held up well so far, but they too are likely to be hit by recessions in foreign markets, the International Monetary Fund warned last month.

The government’s budget calls for growth of 3.7 percent to 4.7 percent this year, compared with 4.6 percent in 2008 and a record 7.2 percent in 2007, but economists have been rapidly downgrading their forecasts. The IMF last month predicted that the newly industrialized Asian countries, a group that includes the Philippines, would see their output decline by 3.9 percent this year. “There is no question that growth will slow, given that 60 percent of the nation’s exports are electronics,” says Robert Sears, executive director of the American Chamber of Commerce of the Philippines.

Arroyo is no stranger to crisis, though. She took power in 2001

when the country was reeling from the forced resignation of President Joseph Estrada over corruption allegations and suffering from the global economic downturn sparked by the collapse of technology stocks. By moving steadily to reduce the government deficit and actively courting foreign investment, Arroyo succeeded in bolstering confidence and putting the economy on a robust growth track.

“When President Arroyo took over, she wasn’t dealt the best of hands,” notes Tom Byrne, head of sovereign ratings in Asia for Moody’s Investors Service. “She stabilized the worsening of the budget deficit. They managed to hit their target in the past couple of years.” Moody’s gives the Philippines a relatively low B1 sovereign rating but retains a “positive” outlook.

Neeraj Jain, Philippines country director at the Asian Development Bank in Manila, is equally optimistic. “She has shown fantastic economic management and good economic leadership,” he says. “They have a good road map. They also built up a huge fiscal capacity in the past five years to deploy to face off the global crisis.”

The Philippines can also boast some positive employment news, a stark contrast to the layoffs sweeping the U.S. and Europe. Executives at global banking giant JPMorgan Chase & Co. say they plan to hire an additional 4,000 Filipinos in 2009 for business-process outsourcing, bringing its total employment in the country to 7,000.

“India may be No. 1 in terms of providing back-office support

Arroyo: Fiscal Reform Holds the Key to Growth

President Gloria Macapagal-Arroyo helped steer the Philippines out of an economic slump in 2001 to its best growth ever, in 2007, by strengthening the country’s public finances and reducing debt. Global turmoil slowed the economy in 2008 and poses an even bigger threat this year, but the president aims to maintain growth by increasing spending. During a recent visit to Hong Kong, Arroyo, 61, discussed her priorities with *Institutional Investor* Asia Bureau Chief Allen T. Cheng.

Institutional Investor: What has the Philippines done right under your presidency to promote growth, and what is your strategy to maintain it in a global recession?

Arroyo: Reform has been the central pillar of our administration. Key among the reforms is the expanded value-added tax, which allowed us to have the revenue to invest in human and physical infrastructure as well as social services. We did this before we even had a hint the world would go into global economic crisis. We have been

working on balancing the budget, developing new industries such as business-process outsourcing, expanding our trade relations and diver-

sifying our exports and export markets. All of these will serve us well during this global economic crisis.

Are you afraid remittances will slow because of global contagion?

The bulk of our expatriates are in the Middle East and Asia, which are fairly resilient in the face of the downturn in the U.S. and Europe. And our workers are increasingly becoming skilled workers. So the higher the skill, the higher the income and the higher the remittance. But also we — the central bank together with the Department of Labor — have embarked on a financial literacy program that provides expatriates and their families information on how to leverage their remittances to earn more income.

How did the Philippines manage to avoid the toxic assets that hurt banks in the U.S. and Europe?

Since the Asian financial crisis, we have had the special-purpose asset vehicle law. Lately, we had the formation of a credit information bureau, and then we had the restructuring of housing loans. These have helped clean up the

financial system. And the central bank has used its regulatory and supervisory power to improve banking practices and corporate governance, and to make the banks align their accounting practices with international standards. They have enhanced risk management and bank capitalization. **Last spring there was a major rice crisis that almost derailed the Philippines’ growth plans. What did you do to contain the crisis, and do you think the rice crisis challenge is over?**

We started by ensuring stable supplies. Very early on, when our secretary of Agriculture told me there would be a shortage, he said we should procure early, which we did. And then when we had a supply, we had to ensure distribution, and we enlisted the support of civic and church groups, local governments. Then third, we went after price manipulators and conniving officials. Now we see, with uncertainty in the world, with climate change — you never know how much the harvest will be every year — and with so much speculation moving from subprime into commodities, the new global economics makes it important for us to be self-sufficient in rice. Hopefully, we can achieve it in five years.

The Asian Development Bank says the Philippines isn’t doing enough to encourage industrial development and infrastructure investment.

Well, infrastructure investment is indeed the backbone of a modern nation. That is why in the Philippines’ long-term development plan, we are increasing infrastructure expenditures, from 1.8 percent of GDP when we started in 2001 to 4.5 percent in 2010. This is part of the 1.7 trillion pesos (\$36 billion) we are planning to spend on human and physical infrastructure, which means billions in ports, roads and bridges and in education, health care and training. We began the plan in 2006, and the money will be spent through 2010.

Your critics have launched various impeachment campaigns against you, alleging that you and your family are corrupt. Why are there all these allegations?

It’s hardball politics. It’s a fact of life in the Philippines, and I don’t like it. We have two Philippines. The economy has been doing well, and the political system continues to be very bad. That is why after working on economic reforms I called for fundamental political reforms, so we can not only have more transparency and accountability, but also less destructive politics.



Trade and Industry Secretary Peter Favila says the government is determined to assist foreign investors

for global companies, but it's important to diversify and not concentrate risk," says Barry Marshall, head of JPMorgan's customer care center in the Philippines. "The level of English is fantastic here. They speak American English."

The country's banks are also in relatively good health. Some 4 percent of all loans are nonperforming, down from 17.3 percent in 2001, when Arroyo took office. Banks came into compliance with Basel II requirements in 2008 and boast an average capital adequacy ratio of 15.5 percent. "Philippine banks are basically quite conservative," asserts central bank governor Amando Tetangco. "They are still domestically oriented. They generate deposits, the bulk of which are in pesos, and they extend loans, again in pesos."

THE DAUGHTER OF POPULAR POLITICIAN Diosdado Macapagal, Arroyo first moved into Malacanang Palace at age 14, when her father, known by his nickname "the Incorruptible," won election as president in 1961. Born to a peasant family, Macapagal enacted land reforms that helped poor farmers, boosted growth by floating the peso and changed the national independence day from July 4 — a legacy of U.S. colonial rule — to June 12, the date the Philippines declared independence from Spain in 1898. He lost his bid for reelection four years later to Ferdinand Marcos, whose embrace of authoritarianism stunted the Philippines politically and economically for the next two decades.

Arroyo spent two years at Georgetown Uni-

versity's Edmund A. Walsh School of Foreign Service in the 1960s, where she got to know classmate and future U.S. president Bill Clinton, before graduating with a BA in economics in 1968 from Assumption College in Manila. She earned a doctorate in economics from the University of the Philippines in 1985, became a professor and later chaired the economics department at Assumption.

Arroyo entered politics in 1987 at the invitation of then-president Corazón Aquino, becoming an assistant secretary and later undersecretary at the Department of Trade and Industry. She won a Senate seat in 1992 and in 1998 was elected vice president under Estrada, succeeding him on his resignation.

The president's background is critical for a country that has trailed economically for decades. In the 1960s per capita income was \$612 in the Philippines, well ahead of Thailand's \$329 and Indonesia's \$196 and just behind Malaysia's \$784, according to the Asian Development Bank. But the Philippines was mired in corruption and political turmoil during the Marcos era and beyond, while most of its neighbors powered ahead. As a result, the country's per capita income stood at \$3,400 in 2008, well behind Thailand's (\$8,700) and Malaysia's (\$15,700), according to the U.S. Central Intelligence Agency. China, which had an average annual income of just \$100 in the 1960s, has leapfrogged ahead to \$6,100.

The key to reviving growth has been Arroyo's success in getting control of the government budget. Initially, her administration focused on cutting spending growth and boosting revenues by setting targets for tax collectors.

In 2006, Arroyo overcame the opposition of many wealthy Filipinos and pushed through Congress an increase in the value-added tax, to 12 percent from 10 percent. "This allowed a lot of resources to come in and helped us fund a lot of the social services and infrastructure expansion and cut our debt-to-GDP ratio," Finance Secretary Margarito (Gary) Teves tells *II* in an interview in his Manila office. The government deficit was 1 percent of GDP in 2008, down from a peak of 5.3 percent in 2002, and the national debt had declined to 57 percent of GDP at the end of last year, from 76 percent in 2004. The government's medium-term plan calls

for balancing the budget in 2010 and reducing the debt to 43 percent of GDP that year, but the stimulus spending will delay that target, Teves concedes, without specifying a new date.

The new budget calls for the deficit to increase by P27 billion, to P102 billion, or 1.2 percent of GDP, this year. The P1.4 trillion budget, up nearly 16 percent from 2008, contains a near-tripling of infrastructure spending, to P260 billion, and will finance many projects already under way, including 32 airports, 28 power plants, 27 seaports and nine railways. "The spending is targeted — it is not just spending for the sake of spending," notes Arroyo.

Arroyo is also ramping up investment in agriculture in a bid to make the country self-sufficient in rice. She drafted the program in response to a global rice shortage last year that saw wholesale rice prices more than double, to P40 a kilogram, inflation surge to a high of 12.4 percent and fights erupt as hundreds of thousands of people queued up for scarce supplies of the staple. The Philippines, whose population of 91 million is growing by 2 percent a year, imported 2 million tons of rice in 2007, roughly 10 percent of its consumption and 7 percent of the global trade in rice.

The government's program aims to more than double investment in agriculture, to P50 billion a year for five years, with spending focused on building rural roads, irrigation canals and regional warehouses to store rice, says Agricultural Secretary Arthur Yap. "Since the time of martial law [under Marcos], this is the first time we had such a large-scale investment in agriculture," he points out.

Former Agriculture secretary Salvador (Sonny) Escudero, who advised Yap and Arroyo on the program, says, "If implemented properly, the president's program can make the Philippines self-sufficient in many agricultural products, especially rice." More than 50 percent of the population lives in rural areas, and creating jobs there will slow the migration of people into urban slums, he notes.

Many Filipinos have long migrated overseas for work, of course. Currently, some 8 million workers live abroad, and they send \$1.4 billion a month back to the Philippines. Remittances account for 11 percent of GDP and are a major reason foreign exchange reserves reached a high of \$36 billion in November, compared with \$15.6 billion in