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PHILIPPINES
AT A GLANCE
Government: Republic
Population: 76 million
Population growth: 2%
Life expectancy: 66 years
Literacy: 94%
GDP per capita: SUS2,600
Currency: Peso
Industrial products: Textiles, chemicals, electronics assembly, petroleum refining
Agriculture: Rice, coconut, sugar, fish

LIKE all other South East Asian market, the Philippines has had its share of the problems that have befallen all our markets. The Philippine peso has tremendously lost value compared with the beginning of 1997. When the peso reached a low of 35.57 to the SUS, the loss in value represented 34%. If we use history as our guide, the two past devaluation-depreciation episodes teach us that it takes almost two years before exchange rates return to trend levels. By my estimation, rates will probably return to trend at around PHP30 to the SUS by end-1998.

The liquidity and interest-rate uncertainty brought about by the currency depreciation has led to a return of high levels of interest. The benchmark treasury-bill rate has taken a roller-coaster ride, as have the interbank, Bangko Sentral ng Pilipinas (BSP) lending and borrowing, and Philippine Interbank Offered rates.

By most indications, the high interest-rate regime is here to stay, until probably the third quarter of 1998. The level of interest has historically been the policy lever most resorted to by government when it wishes to control changes in the exchange rate. High levels of interest are a deterrent to capital flight and facilitate an inward flow of portfolio capital. They also make life more difficult for speculators by increasing the cost of borrowing for currency speculation. This also makes the interest rate a notoriously difficult variable to predict.

The bright spot is that inflation will most likely be controlled. The government has already decided to let go of both the exchange rate and interest rates, keeping only inflation as the sturdy nominal anchor on which its monetary policy is based.

It must be noted that the politico-economic decision by government to keep prices low will favour the consuming public. But the trade-off will be one involving a transfer of income from producers to end-users. Margins will thin out along the value chain since input costs will be rising, but the pass-through mechanism to final prices will be controlled. Aside from the demand management or macroeconomic policy levers such as money supply growth and interest-rate adjustments, the government has been and will remain active in its direct price control and monitoring activities.

Officials have begun talking of a cutback in the public investment program. If we are to take the proposed budget of the department of public works and highways of PHP46.952 billion as a proxy for construction spending and assume a 10% cutback, then that reduces to a PHP4.7 billion drop. To the extent that private construction spending positively responds to government construction
activity, that PHP4.7 billion represents the minimum in forgone overall construction spending. In the oil industry alone, reports have it that some PHP50 billion in planned investments for the next two years will be deferred.

Following textbook strategy when it comes to situations like this, the government can be expected to at least pursue further trade liberalisation, particularly of raw materials or production inputs. Aside from the long-term benefit to the economy as a whole, access to imports at world prices will ease the inflationary pressure somewhat. Directly import-competing business will therefore feel the heat sooner, but not necessarily niche players who may actually benefit by being able to import at relatively lower prices.

Industries that either generate or save foreign exchange, through exporting or substituting for imports, will be at an advantage. Aside from a favourable economic picture, government policy will tend to provide a conducive environment due to the foreign-exchange gains.

However, a dampener to the potential gains from the depreciation of the peso is that most of our neighbours have also floated their currencies. The government has been highlighting the fact that the peso has not depreciated as sharply as other regional currencies as proof of a fundamentally sound economy. Yet that may eventually lead to our disadvantage because this also translates to a less competitive currency.

The Philippine Institute of Development Studies has already identified eight industries which may be the most adversely affected by the programmed reduction in tariffs to between zero and 5% by the year 2004 under the Common Effective Preferential Tariff scheme of the ASEAN Free Trade Area. These are flat glass, motor vehicles, radio and television sets, rubber products, hardboard and particleboard, meat processing, chocolate bars and food products. Allied and supplier industries to these will most likely be affected as well.

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On the other hand, there are 23 identified export winners, which will likely receive government support over and above what they are now receiving. These are: electronics, garments and textiles, furniture, motor vehicles and components, oleochemicals (coconuts), petrochemicals, iron and steel products, seaweeds and carrageenan, fertilisers, copper products, decorative crafts (basketwork, holiday decors, jewellery and ceramics), fresh fruits, marine products, footwear and leather goods, processed foods, industrial tree plantation and rubber products, marble, IT services, construction services, professional services, biotechnology, education, health and medical services.

In a situation where the prices of tradable goods (import-competing and export-oriented) are higher relative to those for non-tradable (goods not exposed to international trade and competition), producers of tradable can benefit most if they are able to lessen dependence on tradable inputs and maximize sourcing of inputs of non-tradable. Also, those involved in non-tradable need not worry about increased competition and liberalisation. Of course, those directly import-competing will have a difficult time, especially if that company has been used to high levels of protection in the past.

According to a 1995 study by the Philippine Institute for Development Studies, the most highly protected manufacturing sectors are tobacco, metal furniture and fixtures, printing and publishing, petroleum refineries, iron and steel, and fabricated metal products. These would face relatively more difficulties under a liberalised environment than the least protected, or better prepared, industries: wearing apparel, footwear, non-metal furniture and fixtures, leather, wood, industrial chemicals, food, beverages, other chemicals, products of coal and petrol.

Construction activities will most likely be maintained by the government and also the private sector, considering that the performance of the sector as a whole is not as sensitive to financial and currency movements as it is to over-all economic growth, rise in per-capita incomes and confidence in the economy.

On a quarterly basis and in current price terms, construction as an industry is a steady 5-6% of GNP while as an expenditure item, it is 10-11%. Theoretically, the difference is the added value generated by construction-related industries but not being recognised or booked by the construction industry. We also see a trend for the simple correlation of growth rates that shows construction growing by double the rate of GNP growth. If we abide by government growth targets of 6-6.5% growth in real GNP for 1998, then construction can be expected to grow 12-13%, a little slower than present rates but still at trend levels.

There is a threat of a slowdown and harder times for the economy as a whole. But from a longer-term perspective, the difficulties posed by the changed environment are what we will be facing anyway, as globalisation and liberalisation of the economy impose a higher degree of discipline in consumption and efficiency in production. These are but the costs of widening opportunities for generation of income and wealth. The awakening was rather rude, but the day can still be saved.