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THE PHILIPPINE ECONOMY AND THE PHILIPPINE STOCK MARKET*

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I will discuss in this paper the character of the Philippine economy, the erratic performance of the economy in the past and the dramatic turnabout since the imposition of martial law. Towards the end, I will discuss the nature of and the current situation in the Philippine stock market.

THE NATIONAL ECONOMY

On September 21, 1972, President Ferdinand Marcos imposed martial law in the Philippines. It was an unprecedented move and it effectively concentrated the legislative and executive powers of government on one man - The President. Congress was suspended and then abolished. Since then the President has ruled the Philippines by decree.

The martial law proclamation was made at a time when conditions in the Philippines had deteriorated to a serious degree. The political situation was explosive. Law and order were at extremely low levels. The population was discontented and the economy was close to stagnation.

Since then, despite serious misgivings during the early months of martial law, the Philippines has staged a dramatic recovery: the political situation has stabilized, the over-all climate has improved substantially, the economy is buoyant and the country is more confident of its future.

To some extent, the gains made by the economy these past months were due to good luck. There were no natural calamities during the period and there were unexpectedly high prices for the Philippine's major exports.

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To a larger extent, however, the gains achieved by the country were due to the greater efficiency and greater effectiveness of the government. Unburdened of the need for political compromise and the need to accommodate the vested interests of the rich and the politically powerful, the government has been able to push its program of management and reform at a much faster rate, with greater direction and purpose than any previous governments in the past.

In the final analysis, it is the quality of the governing body which determines the fortunes of nations. And in the Philippine situation today, it will be the ability of the Marcos Administration in managing the country and its resources which will determine the future of the Philippines.

During the 1960s the economy had performed erratically. The rate of growth was sluggish - an average of 4.5% annually. Credit conditions were generally tight and the external sector was chronically deficit. Unemployment levels remained high. The Philippine peso was devalued twice by a cumulative 237%.

Marked improvement was evident as of the end of 1972. Gross National Product stood at P55,895 million and per capita income was P1,396.00. (At 1967 constant prices, GNP was P35,682 million and per capita income was P890.00.)

While the share of agriculture in the GNP has been diminishing (Philippine economy is based on agriculture), the agricultural sector at present still accounts for 1/3 of the GNP, 2/3 of total exports, and 1/2 of total employment. The rate of growth in agriculture has been 3.3% per year in the past 10 years.

Notwithstanding government support and despite the fertile soil and large areas planted to rice, the country has traditionally been a rice importer. On the other hand, sugar, coconut products, and logs are 3 of the 4 major exports accounting for about 53% of total exports in 1972 - sugar comprised 18%; coconut products, 20%; and logs, 15%.

Because of government efforts toward industrialization, manufacturing has had a progressively increasing share of total GNP, from 9.1% in 1946 to 21.4% in 1972. The growth rate of manufacturing has been 6.0% over the past 10 years. The concentration of manufacturing industries in the country, however, has been on light, import-substituting, finishing assembly-type firms. There is at present a lack of more basic intermediate goods-type industries.

The mining sector has been the leading growth sector in the economy in recent years. In the past 5 years, the growth rate of the mining sector averaged 14% annually. Its share of GNP has increased from 1.5% in 1967 to 2.4% in 1972. The basic mining product of the country is copper concentrates. As of 1970, the Philippines was the largest producer of primary copper in Asia and the 7th largest in the Free World with a share of about 3%. For the past 10 years, copper exports have grown from a low of 2.8% in 1961 to 17% of total exports today, ranking it as the fourth major export of the country.

The country's external sector has chronically been deficit. Over the past 13 years, the export sector has grown at an average annual rate of 8.1%, while imports have grown at 8.6% annually. The manufacturing sector of the economy is highly dependent on imports of capital goods, equipment, and raw materials while about 90% of the total import bill is accounted for by imports of capital and investment goods.

The rate of unemployment has remained at relatively high levels. While the visibly unemployed is estimated at 5.4% of the labor force of 14.0 million, there is also a large segment which is underemployed estimated to be about 10.3%.

The population of the Philippines is estimated to be 40.0 million with an average annual growth rate of 3%. Over 75% of the population is under 25 years of age and the median age is 18 years. The literacy rate of the population of 10 years old and above is 84%. Over 30% of the entire population attends formal schooling every year and about 14% are in college. Of the labor force of 14.0 million about 7% are professionals and technicians.

The country has a vast amount of natural resources, a large portion of which still remains untapped. Over half of the Philippine land area is composed of forests, of which about 88% is considered productive. The country also has large reservoirs of marine life with about 33 fishing grounds known to be rich in commercial species.

The country's wealth of mineral resources is especially impressive. There are 20 known minerals in the country. Of these, the largest reserves are those of copper, gold and nickel. Known ore reserves of copper amount to 1.8 billion short tons with an average copper content of 0.631% worth $20.5 billion at current prices. The known gold ore reserves are worth $80.0 billion at current prices.

The financial system of the Philippines is fairly well-developed. The system is composed of the banking institutions and other non-bank financial institutions together with the money market and the stock market.

In the center of the financial system is the Central Bank, which prescribes monetary policies and administers the banking and credit system of the country.

The banking sector in the country is composed of commercial banks, which is the largest sub-group in the system, savings banks, rural banks and development banks. As of 1972, there were 39 commercial banks (33 private, 2 government, 4 foreign) with 700 branches around the country. Their total deposits amounted to P11.3 billion with total resources of P20.0 billion and total net worth of P1.8 billion. The other types of banks had total resources of P6.0 billion as of year-end 1972.

The biggest non-bank financial group in the country is the insurance companies. As of year-end 1972, there were 156 private insurance companies in the Philippines. Total assets of the industry as of year-end 1971 was P2.3 billion and total premiums in 1971 amounted to P375.0 million.

Another group of non-bank financial institutions are the investment houses. While they were intended primarily to provide long-term debt and equity financing through the underwriting and distribution of primary issues, the bulk of their operations have been concentrated on short-term debt financing because of the lack of an active capital market in non-mining issues.

As of 1973, there were 11 investment houses with total resources of about P1.3 billion.

The growth of bank and non-bank financial institutions have been impressive - commercial banks grew at a rate of 18% per annum over the past 5 years and savings banks by 22%. They have been instrumental in mobilizing savings in the country. The rate of gross domestic savings has grown from 13% of GNP in 1950 to 20% in 1970. Despite the relatively high rates of savings, however, the Philippines had to resort to borrowings in the past. In 1965-1969, borrowings comprised 8.5% of net capital formation.

In the three years immediately preceding martial law, the Philippine economy was faced with a host of problems: 1) extraordinary pressures on its international reserves, which resulted in a de-facto devaluation of the peso; 2) contractionary monetary policies designed to remove excess liquidity in the economy, which resulted in the slowdown of economic activity and an increase in interest rates; 3) uncontrolled inflationary tendencies in 1970-1972 which saw prices go up by an average of 18% per year; 4) heavy floods in July-August 1972 which resulted in substantial losses to agricultural production and infrastructure; 5) an increase in the volume and intensity of social protest and discontent.

In 1970, the Philippine peso was allowed to float freely from its official rate. In a de-facto devaluation, the value of the peso depreciated from P3.90/$1 to P6.75/$1. The floating of the peso was intended to relieve the extraordinary pressures that had built up on the peso. These pressures were due to heavy borrowings in the past which the economy had resorted to in order to compensate for the country's perennial trade deficit. In the 60's, the country's trade deficit had country amounted to $744.0 million while the country's international reserve level was $125.0 million.

The devaluation was also intended to make imports more expensive as the excessive expansion in money supply in 1969 when it went up by 19%, had resulted in some of the excessive liquidity in the economy leaking into the import sector, thus increasing the country's trade deficit.

Together with the devaluation of the peso, other measures were adopted in 1970. Monetary and credit conditions were made more restrictive. An intensive drive to encourage exports was launched and the government restrained its spending. For that year, the economy showed a real rate of growth of only 5%. The inflationary pressures consequent to the devaluation brought prices up by 17% while the tight money policies pushed up interest rates from a low of 6% in January to a high of 16% in August.

As a result of the economic measures adopted in 1970, however, the country was able to restructure its outstanding obligations.

The economy showed some signs of recovery in 1971, as the 1970 package of economic measures infused new vigor into the economy. Real growth of GNP was measured at 6.5%. Construction was the leading sector during the year, as the value added by construction to net domestic product increased by 17% vs. a 17% decline in 1970. However, because of the lingering effects of the 1970 devaluation, prices continued to advance rapidly. For the year, prices went up by an average of 20%; interest rates continued to remain high during the year, averaging 13% for 91-day treasury bills.

In 1972, the economy failed to sustain the tentative recovery of 1971. The increasingly uncertain socio-political situation hampered economic activity during the first half of the year. The floods in July-August which inundated the central areas of Luzon had devastating effects on agriculture and infrastructure, a combined damage estimated at over P2.0 billion. For the year, GNP grew by a low 4.3%. The agricultural sector during the period showed virtually no growth.

Interest rates remained high and interbank one-day call money reached highs of 22% during the year.

Prices continued to climb, despite efforts of the Price Control Council to check price increases. During the period, the consumer price index went up by another 16.5%.

Through the past 3 years, the efforts of the government to reverse the traditional export deficit failed to yield the desired results. In 1970, despite a 21% increase in value of exports from the previous year's level, the trade sector still had a deficit of \$25.0 million. In 1971, due to lower commodity prices, exports increased by only 6.5%, and the yearly trade deficit went up to \$34.0 million. In 1972, the value of exports declined by 3% and the trade deficit amounted to \$122.0 million.

Despite the continuing deficit in trade, the country's international reserve position continued to improve during the period, although the improvement was due to a large extent to Central Bank borrowings. From a level of \$126.0 million in early January, foreign exchange reserves of the country totaled \$282.0 million as of 1972.

Since the imposition of martial law, the economy has staged a dramatic turnabout. For the first 6 months of this year, the GNP in real terms, increased by 8% over the GNP of the previous 6 months. The manufacturing sector advanced by 14%, while agriculture gained by 9.3%.

The external sector's performance during the period was outstanding. Due to unexpectedly high prices in the country's major exports, export receipts for the first half of 1973 were 55% higher than those earned during the first half of 1972. The trade sector achieved a surplus of $259.0 million during the first half of the year. In the non-trade sector, invisible receipts posted gains of $168.0 million, a 30% increase over the total for the first half of the last year. The total surplus in the balance of payments as of the end of June was $424.0 million, the highest in the country's history.

The level of international reserves, likewise improved remarkably. From a 1972 year-end level of $282.0 million, the international reserve level had reached $648.0 million at the end of June — an unprecedented level.

The trend was sustained during the 3rd quarter of this year. As of August 31, 1973, the trade surplus had reached $315.0 million. The balance of payments surplus was $612.0 million.

Because of the high level of export proceeds, money supply expanded during the period by 5% over the 1972 year-end level and interest rates stabilized at much lower levels than the previous year. During the period, the interbank one-day call rates hit lows of 2% vs. highs of 22% in 1972. Treasury Bills averaged 9% vs. 12% last year.

Despite the high level of liquidity in the economy, prices advanced only by 6% during the period as the Price Control Council effectively clamped down on prices of prime commodities.

Indicative also of the expansive mood of the economy, gross domestic capital formation expanded by 13.1% during the period against a 2.6% increase in 1972.

The fiscal position of the government was likewise much better during the first half of this year. For fiscal year 1973, the government achieved an operating surplus of P1,200.0 million vs. a deficit of P1,100.0 million for 1972. The government's better working balances were due to: 1) a number of tax amnesties proclaimed by the government which resulted in extraordinary government revenues of P800.0 million; 2) better tax administration and collection efforts. Because of the liquidity of the government, a factor which had been influential in raising interest rates in the past 3 years, was eliminated. In the past, because it was unable to borrow substantially from abroad and from the Central Bank of the Philippines, the government, to finance its deficit, had to compete with the private sector in the use of loanable funds in the country.

The improvement in the over-all climate and in the economy during the year was also apparent from other angles:

1. The stock market during the first half of this year turned in its best performance to date. Volumes in terms of pesos increased by 500% from P209.0 million for the same period last year to P1,255.0 million this year. In the market's last boom in 1969, volume for the first half of the year was only P770.0 million. The market indices posted an average gain of 150% during the period.

2. The inflow of foreign funds was markedly higher this year and the interest of foreign investors in the country was obvious. In the stock market alone, an estimated $35.0 million to date have gone into the market — the first time that foreign funds have gone into local market.

3. Tourism, which had grown at an average rate of 11% in the past 5 years, suddenly boomed this year. From January to September, the number of foreign tourists in the country totaled 122,207, an increase of 23% from the same period last year.

The improvement of the economy this year has been due to several factors, most notably: 1) higher export prices; 2) improvement in the socio-political climate; 3) stronger and more realistic strategies and policies for growth.

One of the major changes in the country's economic policies this year has been a shift towards a more liberal and more favorable attitude toward foreign investments. While the need for foreign capital to help finance the country's development efforts had always been appreciated by Philippine economic planners, in the past the anti-foreign sentiments of a vocal minority had tended to hinder the implementation of effective strategies aimed at attracting foreign capital.

Since the martial law, however, the government has sought to accommodate the interests of foreign investors. This is obvious in the amendment to the local oil exploration law which effectively incorporated all the suggestions and requests of American oil drilling companies. This is even more apparent in a more significant measure adopted last March which guarantees the complete and immediate repatriation of foreign investments, principal and capital gains, as along as these investments are made in preferred areas, specifically export-oriented industries, industries registered with the Philippine Board of Investments and stocks of companies listed in the Philippine Stock Exchanges.

The government has laid down its general objectives for the future. These are: 1) the creation of the proper setting and climate for development; 2) the elimination of bottlenecks which have hampered development efforts in the past; 3) the strengthening and coordination of development policies and strategies; 4) the generation and mobilization of resources for development.

Among the major socio-economic reforms and measures which have been undertaken are: 1) the restoration of peace and order; 2) reorganization and streamlining of the government; 3) promotion of domestic and foreign investments; 4) monetary and financial reforms; 5) the changing of the tax structure.

The thrust of government economic policies being pursued at present are aimed at: 1) increasing the export potential of the economy by increasing the range of agricultural-mineral products as well as by diversifying the product range to include processed and semi-processed goods; 2) encouraging the forward integration of certain industries, especially those where the natural resources of the country are used as basic raw materials; 3) encouraging regional development and dispersal of industries so that investments and economic activity will spill over to the rural and provincial areas and a more balanced domestic market can be developed; 4) improving government fiscal operations; 5) constructing more extensive infrastructure; 6) encouraging greater productivity in the agricultural sector in order to improve incomes in the rural areas and to remove the perennial need to import the country's basic staples; 7) improving the mobilization and allocation of the economy's savings by improving the quality of the country's financial intermediaries.

In quantitative terms, the growth rate targets for the economy for the next 4 years are: GNP - average real growth of 7% annually vs. 5.5% in the past 5 years; agriculture - 5% annually vs. 3.3% average annual growth in the past 5 years; manufacturing - 10% annually vs. 7% in the past 5 years; mining - 18% vs. 14% in the past 5 years; exports - 10% vs. 6% in the past 5 years; imports - 9% vs. 1.4% in the past 5 years. Construction is expected to grow by 42% in 1973 and

10% thereafter. Inflation is expected to average 8% a year.

The growth rate targets seem reasonable. It is not unreasonable to expect that given the proper environment and incentives, these targets will be surpassed.

There have been major shifts and movements in the economy these past 13 months. It is likely that more changes will occur in the coming months.

Whether the economy will eventually achieve the rates of growth it is aiming for, given all the support and momentum, remains to be seen. One thing is certain however - that the Philippines today, as never before in the past, is in a position to achieve a high rate of economic development.

It may be that in the coming years, the strength of the economy may be self-reenforcing. As the economy gets stronger, it may be that investments will accelerate both from that segment of the local economy which today still remains reluctant and from foreign investors who apparently are becoming more convinced. In much the same fashion as in the stock market, confidence should beget confidence and sustained strength should beget more strength.

THE STOCK MARKET

For the past 9 months, the Philippine stock market has performed in much the same fashion as the economy. The downtrend of the previous 3 years was completely reversed this year. For the past nine months, the indices gained by an average of 115%. The mining index went up from 1,166 index points in January to 3,655 in September, a gain of 213.5%. The index hit an all-time high level of 4,087 in mid-September. The industrial average advanced from 34.78 in January to 67.18 in September, a gain of 93.2%. The oil average went up by 21.6%.

Volumes likewise expanded dramatically. Average daily volume in 1972 was P2.5 million. For the past 9 months, the average daily volume amounted to P26.0 million. In 1969, when the market reached its then all time high levels, volumes averaged P18.7 million a day.

The improvement in the market this year has apparently been due to: 1) the improvement in the over-all climate in the country; 2) the strong performance of the economy as well as the prospects for increased growth in the future; 3) the high levels of confidence and liquidity in the economy; 4) the high level of copper prices; 5) the inflow of foreign funds.

The one significant change in the Philippine market this year is the inflow of foreign funds. For the first 9 months of this years, there has been an estimated inflow of about $35.0 million worth of foreign investments into the market.

The interest of foreign investors in the local market has apparently been due to: (1) the view that the Philippines under martial law may enjoy higher rates of economic growth; (2) the relatively low price earnings ratios of Philippine stocks; (3) the historically high rates of growth of investment grade companies quoted in the stock exchanges; (4) the relative sophistication of the Philippine stock market together with the existence of regulations designed to protect investors; (5) the complete guarantee of repatriation of investments (principal plus gains) made in quoted issues; (6) the elimination of capital gains tax on gains made in stock investments.

The average PER of investment grade issues in the Philippines over the past 5 years was 8.6 times; the average PER of mining companies was 9 times; while the average PER of industrial issues was 8 times. As of January this year, the average PER of mining companies averaged 5.6 times 1972 earnings while industrial companies averaged 5.2 times. As of September, the average PER of mining companies was about 8.5 times 1973 expected earnings, while the leading industrial companies averaged about 8 times 1973 prospective earnings.

The rate of growth of Philippine companies in the past 15 years has been impressive, specially in the mining sector. The average annual rate of growth of the major mining companies in the country was 35% compounded annually from 1958 to 1972. The average compounded rate of growth of industrial companies on the other hand was at a more modest 15% annually.

There are two stock exchanges in the country: The Manila Stock Exchange which was established in 1927 and the Makati Stock Exchange which was established in 1964. There are at present 44 brokerage houses in Manila and 43 in Makati.

As of 1972, the total capitalization of the market based on the total number of shares outstanding multiplied by their respective par values was P6.0 billion.

There were 133 issues listed on both exchanges in 1972. Of these only 56 were actively traded. Of the actively traded issues, 25 were issues of operating companies and 31 were shares of speculative firms. Of the actively traded operating companies, 20 were mining firms and only 5 were industrial firms.

The Exchanges have central clearing houses to facilitate payment and deliveries of checks and certificates. The exchanges are closely supervised by a government agency - The Securities and Exchange Commission. Patterned after the US SEC, the Philippine SEC was established in 1936 to exercise general regulatory power over business enterprises. Among the SEC's functions is the formulation and implementation of rules and regulations designed to protect investors.

Despite the fundamental values of Philippine stocks early this year, it was only in late March that foreign investments started to flow into the Manila market in fairly substantial amounts. Led by W.I. Carr, which has now established an office in Manila, the foreign funds that have come into the Philippine market are largely British - both from Europe and Hongkong. There have also been some Japanese and Chinese inflows but the big percentage of foreign funds have come from British institutions.

The major change that occurred in March which led to a greater and more steady inflow of foreign funds into the market was the promulgation of Central Bank Circular 365 which categorically guaranteed the complete and immediate repatriation of all foreign investments, principal plus gains, in quoted securities purchased after March 16, 1973. Previous to this circular, repatriation of capital was not immediate.

The attitude of foreign investors toward the Philippine market has grown increasingly favorable. Up to as late as June this year, most foreign investors had shown a reluctance for unquoted securities preferring instead the big relatively high volume quoted issues. In the last two months, a growing number have become interested and have taken positions in over-the-counter issues and the quoted but hardly traded issues, and have indicated their willingness to take positions in primary issues of unquoted companies, despite the obvious risk of possibly being locked-in in these issues for some time.