



Manny Mogato
Correspondent

manuel.mogato@thomsonreuters.com
+63 2 841 8900

RISKS TO WATCH

THE PHILIPPINES

Five months into power, Philippine President Benigno Aquino III continues to face many old problems: a large budget deficit, endemic corruption, widespread poverty, poor infrastructure and long-running insurgencies.

GOVERNMENT EFFECTIVENESS

Aquino, son of two heroes of the Philippines' democracy movement, won the presidency at elections in May 2010 after campaigning as a man who would fight corruption, respect human rights and deliver honest and transparent government. His win was due at least in part to the family name - he was not a candidate until his mother's death in August 2009 sparked an outpouring of emotion and a push for change after two administrations dogged by allegations of corruption and mismanagement.

There is an enormous weight of public expectation for him to deliver despite a lacklustre career before he won office. There are concerns he lacks the political nous to take on entrenched interests and push his agenda through Congress, where allegiances are loose and personalities matter more than political beliefs.

Aquino was seen to have failed his first major test, when the bungled handling of a deadly bus hijacking in August exposed inadequacies in government and security forces. He ignored calls to sack senior officials held responsible for the poorly organised rescue attempt, who included some close allies, in contrast to his action in July to sack the chief weather forecaster over an incorrect typhoon forecast. In late November, the deputy tourism minister quit after a new tourism logo was found to be similar to a Polish campaign.

There are doubts about Aquino's ability to push through with his plan to investigate his predecessor, Gloria Macapagal Arroyo, and he has run into obstacles in a court system and bureaucracy dominated by appointments made by Arroyo. Three executive orders have already been challenged in the Supreme Court, including one to set up commission to investigate the Arroyo administration.

The court has ruled twice against Aquino. First, it stopped the lower house of Congress from starting an impeachment process against the head of an anti-corruption agency, an Arroyo ally.

The court has also ordered the reinstatement of an Arroyo appointee who was removed by Aquino, opening the way for challenges by others dismissed by the new president. An angry Aquino said the ruling "could precipitate a clash with another separate, co-equal branch of government"

In November, he had to withdraw a directive granting amnesty to hundreds of soldiers and police officers linked to three failed coup attempts against Arroyo because it had flaws.

Aquino maintains widespread popular support, but Arroyo remains politically powerful despite being electorally unpopular. She won a seat in the lower house of Congress in the May elections from where she could marshal opposition.



What to watch:

- Competing interests among Aquino's supporters, including his family and relatives. There is talk that rival factions are already creating administrative gridlock, which could thwart the reform agenda.
- Aquino has to move past the rhetoric of the campaign and the criticisms of Arroyo and start delivering on policy and his legislative agenda. Inaction may erode his support.
- Aquino will need to **build working relations within the court system**, which he wants to reform, to support his plans to investigate Arroyo and officials in several unresolved high-profile corruption and rights abuses cases.

FISCAL CHALLENGES

The Philippines, Asia's largest sovereign issuer of offshore debt, is set to post a second successive record budget deficit in nominal terms this year, largely because state revenues remain weak despite a major sales tax reform in 2005. The deficit in the first 10 months of the year was 270.3 billion pesos (\$6.1 billion), about 83 percent of the full year target of 325 billion pesos. The **government has kept the budget in check in recent months** largely by limiting spending, but the tighter state spending, after heavy pump-priming by the previous administration and election spending in the first half of the year, was a factor in a third-quarter contraction in growth.

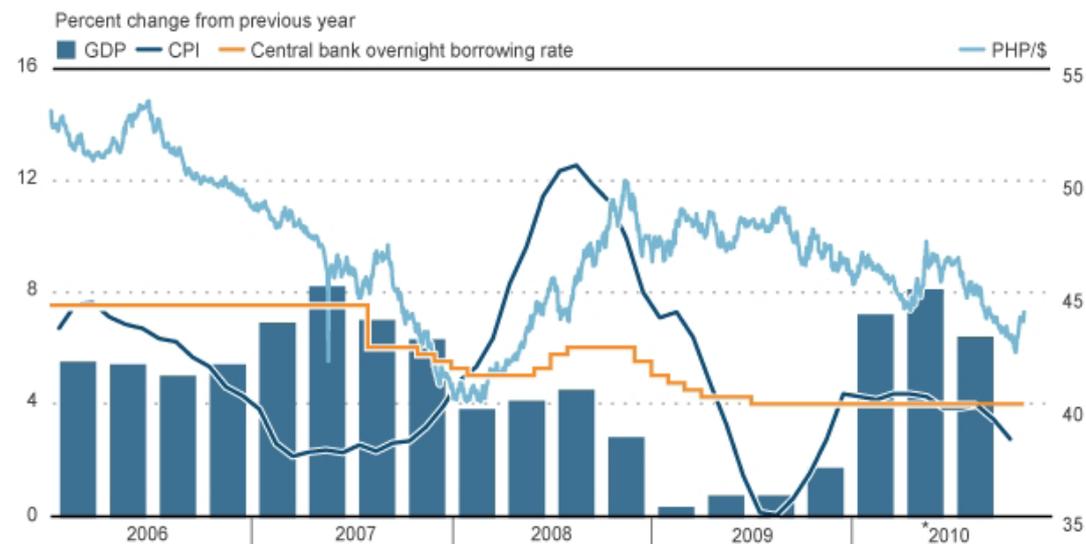
Former Philippine first lady Imelda Marcos sings a song with a local band as she entertains her supporters during a victory party in front of her house in Batac town, Ilocos Norte province, north of Manila.
REUTERS/Romeo Ranoco

RISK DATA

Sovereign foreign currency:	
S&P	BB- (stable)
Moody's	Ba3 (stable)
Fitch	BB (stable)
World Governance Indicators:	
Voice & Accountability	45.5
Political Stability	10.8
Govt Effectiveness	50.0
Regulatory Quality	52.4
Rule of Law	35.4
Control of Corruption	27.1
Eurasia Group	
GPRI Score	58
IHS Global Insight	
Country risk	2.72
Sovereign	BB+ (positive)
Economist Intelligence Unit	
Sovereign risk	B
Political risk	CCC
Country risk	B



Philippine Q3 GDP grew 6.5 percent



Source: Philippine National Statistics Office, *revised



The shortfall in revenue, due mainly to a narrow tax base and chronic evasion and corruption, limits the government's ability to spend more on social services and upgrade infrastructure, and so acts as a long-term drag on growth. The government plans to raising tax revenue through better enforcement and a crackdown on evasion and smuggling, before considering any tax increases. The enforcement drive will be given two years to work. However, five months after tax evasion and smuggling complaints began to be filed with the Department of Justice, not a single case has gone to court.

The government has promised a business-friendly environment to support its Public-Private Partnerships (PPP) programme to fund infrastructure and free up money for social spending.

What to watch:

- Without success in improving tax collections, the deficit is unlikely to fall as expected and could widen further.
- The government's moves to dismantle the bureaucratic structures that allow corruption to flourish, seen as a key to strengthening revenues.
- How any new spending in the budget will be funded, and what assumptions the figures are based on. The government was targeting the fastest growth in 35 years in 2011, although it has a more conservative forecast in the budget.
- The lower house has approved the 2011 budget. It is now being scrutinised by the Senate, which Aquino does not control, and it could be changed.
- Markets would like a rise in tax rates and expansion of the tax base to more sustainably support state spending. Until then, the Philippines is likely to remain plagued by fiscal problems.

INTERNAL SECURITY

Security remains poor across the Philippines, which is struggling with two long-running insurgencies by Muslim separatists in the south and Maoist guerrillas as well as a persistent risk of Islamic militancy.

In November, a number of countries including the United States updated travel advisories for the Philippines. Australia said there were reliable reports attacks may be imminent in Manila, but the government said the advisories were unfounded and unfair.

Aquino has promised to restart peace negotiations with rebel groups, saying a secure and sustained peace is needed to foster growth and investment. He created new peace panels to negotiate with Muslims and Maoist guerrillas. Talks with the Moro Islamic Liberation Front, the largest Muslim rebel group, were bogged down on issues such as territory, wealth and power-sharing, although a shaky ceasefire was reestablished in mid-2009. The talks have yet to restart under the new government, and attempts to replace a senior Malaysian facilitator is opposed by the MILF. Maoist guerrillas have expressed a willingness to resume talks with the Aquino government, but rejected his call for a ceasefire for negotiations to prosper. The smaller but deadlier Abu Sayyaf group still presents a problem despite some tactical successes by U.S.-backed Filipino troops.

Aquino has promised to crack down on rights abuses and crime, but private armies remain a feature of rural areas. Also, the slow progress of the Maguindanao massacre trial, where a member of a powerful clan is on trial for the murder of 57 people, has raised concerns from rights and press groups.

What to watch:

- Evidence showing serious attempts to address root causes of armed conflicts to end extortion from businesses, reduce the kidnapping threat to businesspeople and open up resource-rich Mindanao to investment would be positive for markets.
- Fresh approaches by Aquino to re-start talks with Muslim and communist rebel groups, which have so far failed to get off the ground..
- Aquino's appointments to defence and military organisations and plans to increase spending could help keep security forces onside and negate a potentially destabilising force.

KEY DATES

- December 7, 2010
Inflation data for November
- December 10, 2010
October exports data
- January 5, 2011
CPI data for November
- February 10, 2011
Central bank press release on monetary policy stance

RISK DATA

JLT Group	
Strikes, riots & civil unrest	6
Terrorism	7
War & civil war	4
Economic risk	5
Currency risk	5
Sovereign risk	6
Expropriation	6
Contract repudiation risk	6
Legal & regulatory risk	6
Coface	
Country rating	B
Business climate	B
Transparency International	
Corruption Perceptions Index Score	2.4
Rank (of 180)	139
World Bank Doing Business	
Rank (of 183)	144
WEF Global Competitiveness	
Score	3.96
Rank (of 133)	85
Reporters Sans Frontières	
World Press Freedom Index Score	60.00
Rank (of 175)	156

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