HOME GUARANTY CORPORATION

MACRO ECONOMIC REPORT

2007-2008

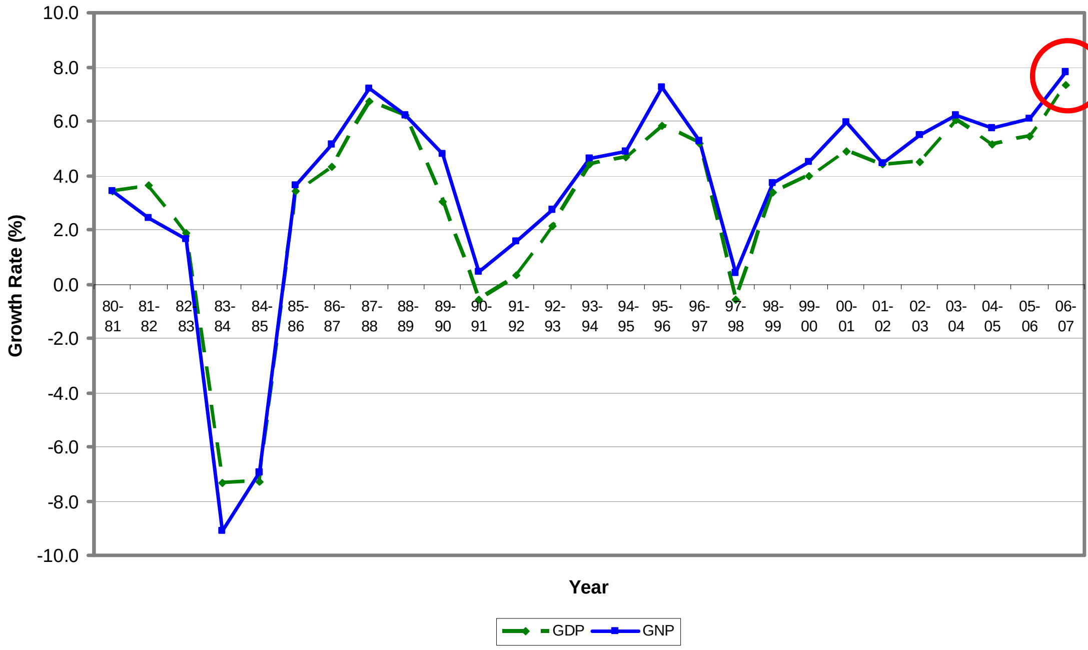
FIRST QUARTER

HOME GUARANTY CORPORATION
MACRO-ECONOMIC REPORT (2007-2008)[1]

GENERAL OBSERVATIONS

The Philippines demonstrated continued economic expansion in 2007. In fact, the country posted robust growth of 7.4% in Gross Domestic Product (GDP) and 7.8% in Gross National Product (GNP)[2], the highest in more than 20 years (Figure 1). A continuation of these economic gains through 2008 is expected, but will not be as promising.

Figure 1. GDP and GNP Growth Rates, Philippines: 1980-2007.

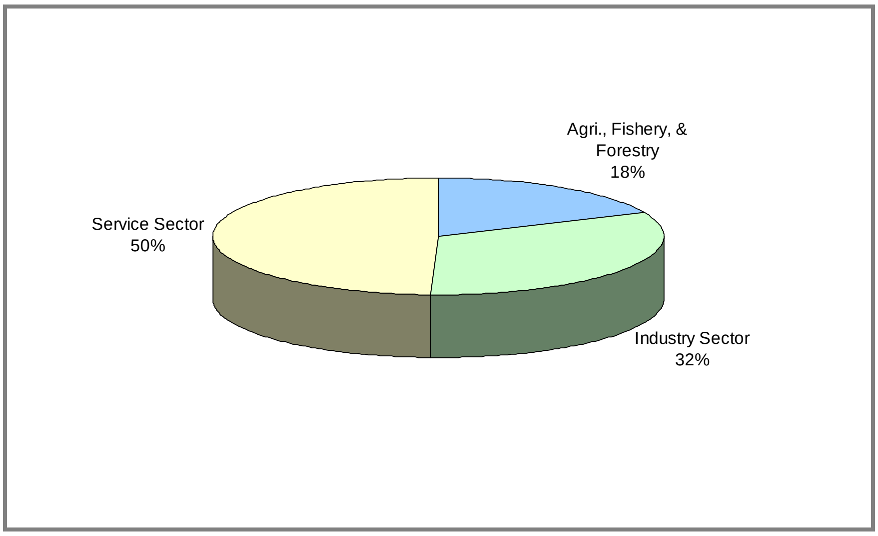


Source of basic data: National Statistical Coordination Board (NSCB)

[1] Presented by HGC President Gonzalo Benjamin A. Bongolan during the HGC Research Team Quarterly Presentation held on May 7, 2008 at the HGC Deck.
[2] As of January 2008 at constant 1985 prices, Economic and Social Statistics Office, National Statistical Coordination Board.

Largely, the services sector, which accounted for 50 percent of the country's 2007 GDP of ₱3.6 trillion[3] (Figure 2), catapulted this growth. The sector's aggressive investments in the business process outsourcing (BPO) industry contributed to this. The housing and real estate industry is expected to benefit from this expansion in the services sector.

Figure 2. GDP Percent Distribution (at constant 1985 prices), Philippines: 2007.



Source of basic data: NSCB

Despite the domestic political upheavals, there is an absence of local threats unique to the housing sector. However, external factors that threaten the local economy persist, such as the looming U.S. recession, the sharp increases in food and oil prices, and the resulting inflationary pressures on other commodities.

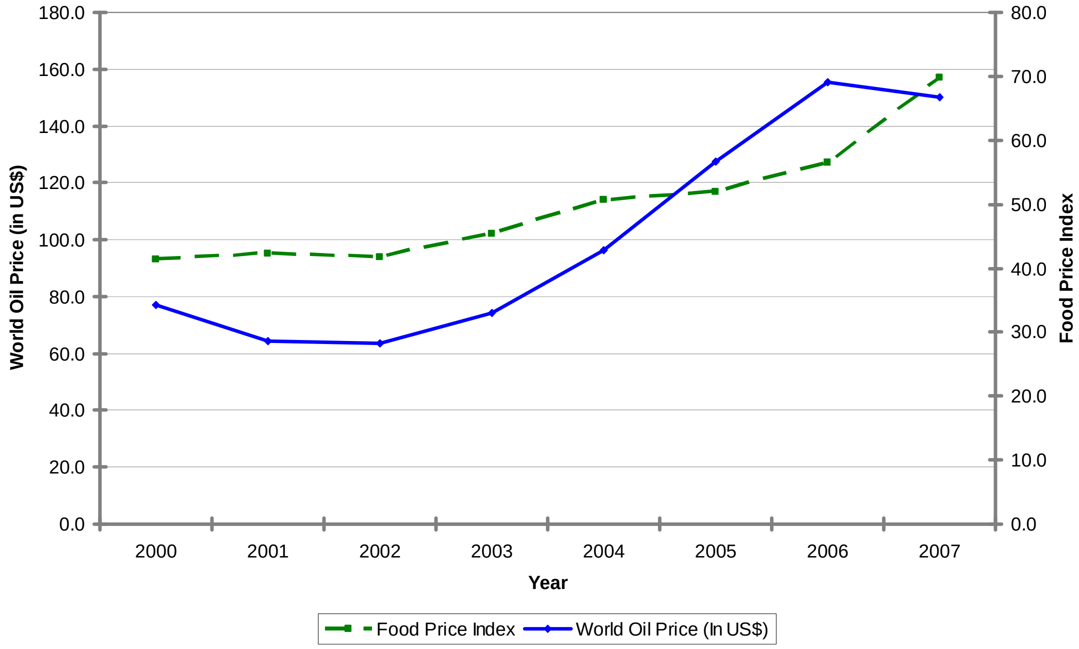
The U.S. economy is undergoing a period of dangerous uncertainty. The imminent recession brings into fore the reality of slowing demand. Now, it depends on how the American leadership will respond.

Usually, during an election year like 2008, the U.S. economy is boosted by expansionary economic policy. But the Federal government cannot boost it so much because of imbalances. The U.S. cannot further gamble by lowering the federal interest rates as this would down-grade the dollar and precipitate capital flight in favor of oil, metals and euro investments. This predicament of the U.S. economy is evidently having a material impact on that country's near-term prospects.

[3] At current prices, NSCB.

The world has already seen steady increases in world prices of oil and food commodities in the last seven years (Figure 3). Although oil prices slightly tapered off after surpassing the US$75 per barrel mark in the summer of 2006, which continued to slide to US$60 per barrel by the early part of 2007[4], it gained momentum in October 2007 to post new record highs up to the present.

Figure 3. World Oil Price and Food Price Index: 2000-2007.



Source of basic data:http://www.eia.doe.gov/oiaf/ieo/excel/figure_35data.xls, and http://www.fao.org/worldfoodsituation/FoodPricesIndex, accessed 13 May2008.

In the same manner, prices of major food commodities such as grains and vegetable oils in the world market have reach historic highs as well. Higher energy prices, growing demand for alternative energy sources, rising incomes in developing countries, the weakening dollar, and the impact of climate change have collectively pushed prices up. The low cumulative investment in agriculture has also left us with a capacity that is unable to meet the growing demand of the world's population.

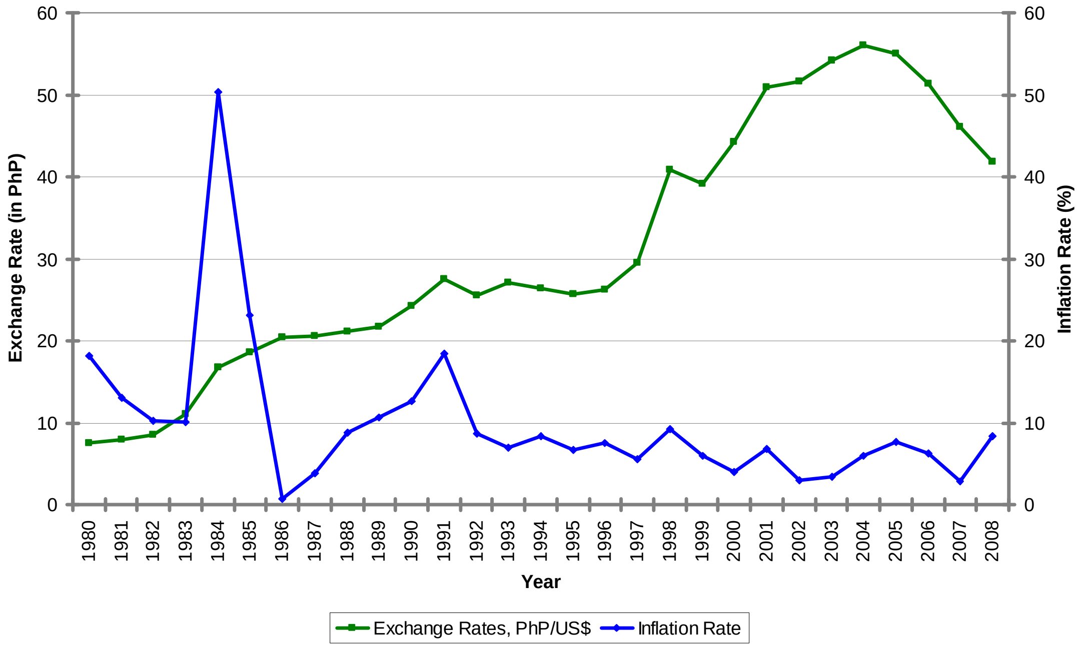
The price increases of commodities described above will surely result in commodities and money markets hitting an air pocket. Consequently, fears of inflationary pressures across the globe and the country have triggered monetary tightening. This, in turn, signals an increase of interest rates above the recent levels in order to suppress the effects of previous expansionary monetary policy.

[4] http://en.wikipedia.org/wiki/Oil_price_increases_of_2004-2006, accessed 13 May 2008.

From 2007 until the early part of 2008, the peso demonstrated a relatively remarkable appreciation against the dollar, while the inflation rate had a sharp upturn (Figure 4).

Generally, the trend exhibited by the exchange and inflation rates is good for borrowers, but banks, especially thrift banks, will realize small margins or a drop in income. In fact, Union Bank on May 6, 2006, as well as most other banks, have already reported a drop in income.

Figure 4. Peso-U.S. Dollar Exchange Rate: 1980-2008.



Source of basic data: Philippine Institute for Development Studies (PIDS) and Bangko Sentral ng Pilipinas (BSP)

Further, import prices have gone down at the expense of exporters. Likewise, the strengthening of the peso has eroded the value of the remittances of overseas Filipino workers (OFWs), though they will still continue to send money back home.

Therefore, a slowdown in economic performance, a monetary consolidation, and a slight up-tick in prices are all in the offing. Investors will wait and see. Nonetheless, a continued growth in socialized low- to medium-cost housing is expected.

SELECTED ECONOMIC INDICATORS

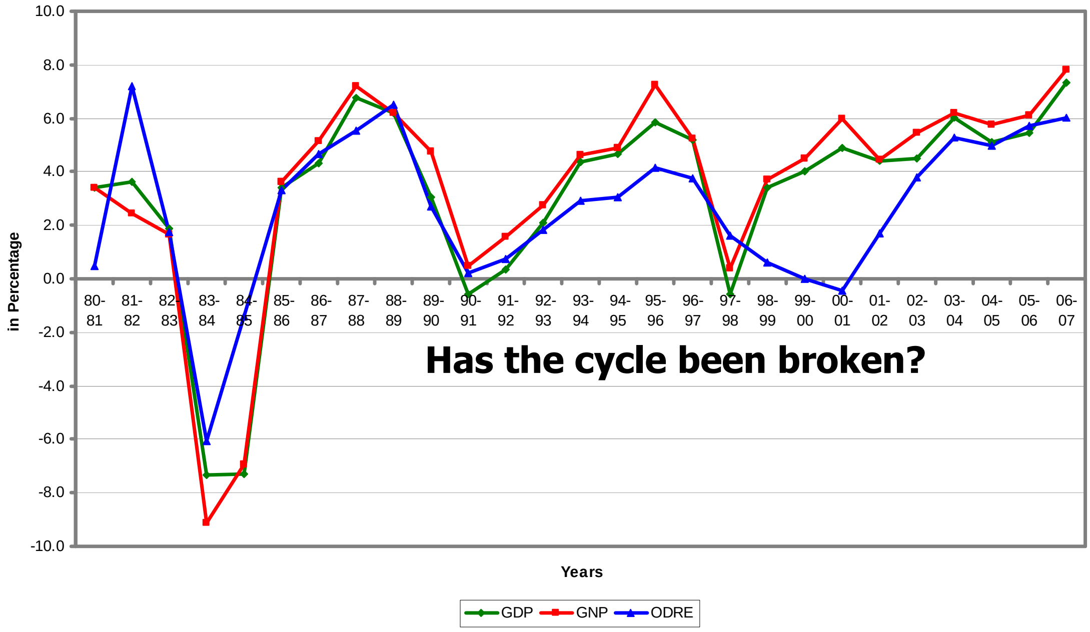
Growth in Real GNP, GDP and the Ownership of Dwellings and Real Estate (ODRE)

If we go by cycles, growth may be slowing down but the economy has been able to sustain positive growth (Figure 5). A contraction in economic activity is unlikely. It seems the cycle has been broken, and fortunately, the poor have managed to cope with the effects of this devastating cycle of severe fluctuations in income.

Sustaining this growth can lead to an above average estimate of slightly between 4.0 and 6.0 percent growth rate in real estate and dwellings. It is important to note that the housing agencies alone have a lot of unused housing inventories and there is no point in producing more at this time.

The above average growth of real estate and housing since 2002 is unsustainable from a historical standpoint. Thus, these sectors might experience a slow down considering that it has registered only a 3.0 percent historical average growth rate for the past 20 years.

Figure 5. Growth in Real GNP, GDP and ODRE, Philippines: 1980-2007.



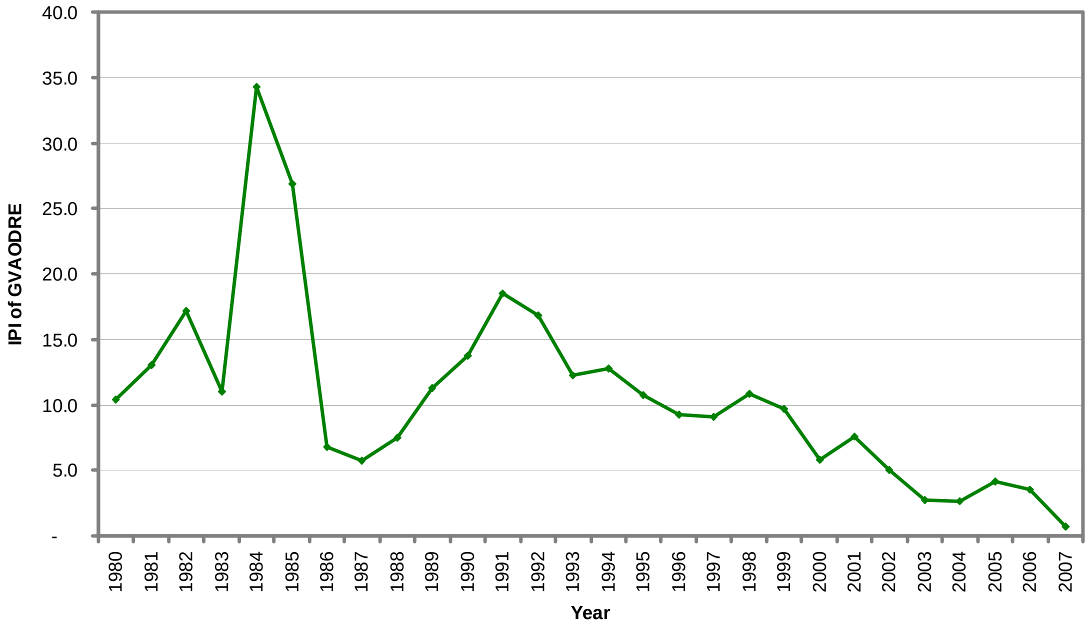
Source of basic data: Economic and Social Statistics Office (ESSO), NSCB

Changes in Implicit Price Index (IPI) of GVAODRE

In the absence of an index for house prices in the Philippines, HGC employs the changes in IPI of the Gross Value Added (GVA) in ODRE as a proxy for house prices.

House prices inflation, as gleaned from the IPI of ODRE presented in the National Accounts (to the extent that this captures house price inflation), is actually falling (Figure 6) since the Ramos years. As such, it would be safe to say that the over-production of the Ramos and Aquino administrations are still here. In fact, HGC still carries the Ramos' legacy of Asset Participation Certificates-funded projects such as Smokey Mountain, Commonwealth, and the like.

Figure 6. Changes in Implicit Price Index of GVAODRE, Philippines: 1980-2007.



Source of basic data: ESSO, NSCB

Velocity of Money vs. Nominal GDP

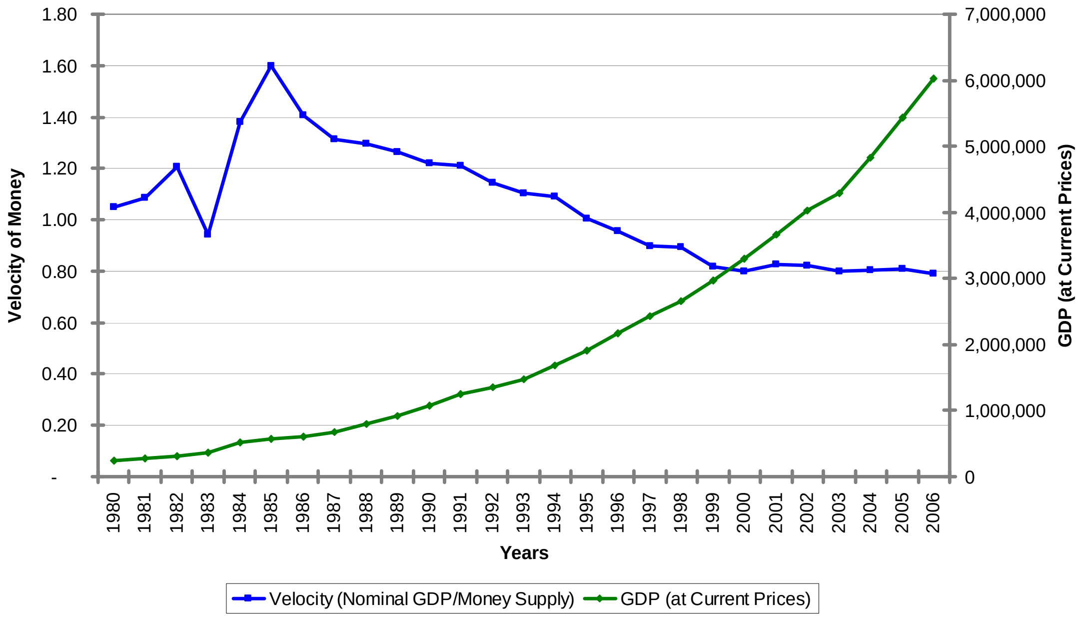
The Philippine economy has been dependent on monetary expansion since the mid-80's. It has been reliant on the financial system's infusion and injection of money and credit creation. But these tend to inflate prices and make incipient inflation more probable.

Expectedly, GDP at current prices, which incorporates inflation, has been increasing. Over-laying the crude measure of money supply against nominal GDP shows that as the velocity of money[5] goes down, money supply increases. Simply, this means that the economy needs more money per unit of output generated.

However, too much money in circulation is unhealthy, especially when it goes to the wrong places such as non-essential consumption and speculative markets. It might burst like a real estate bubble. In response, the monetary authorities have learned their lessons and started stepping on the velocity of money in 2000.

Since 2000, the velocity of money has tapered off at around 1.0 (Figure 7). This illustrates the effort of Philippine monetary authorities to reign in growth in money supply and liquidity. The latest effort of the Bangko Sentral ng Pilipinas (BSP) is to offer special deposit accounts at off-market rates, as a way of reining in this liquidity. As a result, monetary expansion has bee kept in check.

Figure 7. Velocity of Money and GDP, Philippines: 1980-2007.



Source of basic data: NSCB, BSP

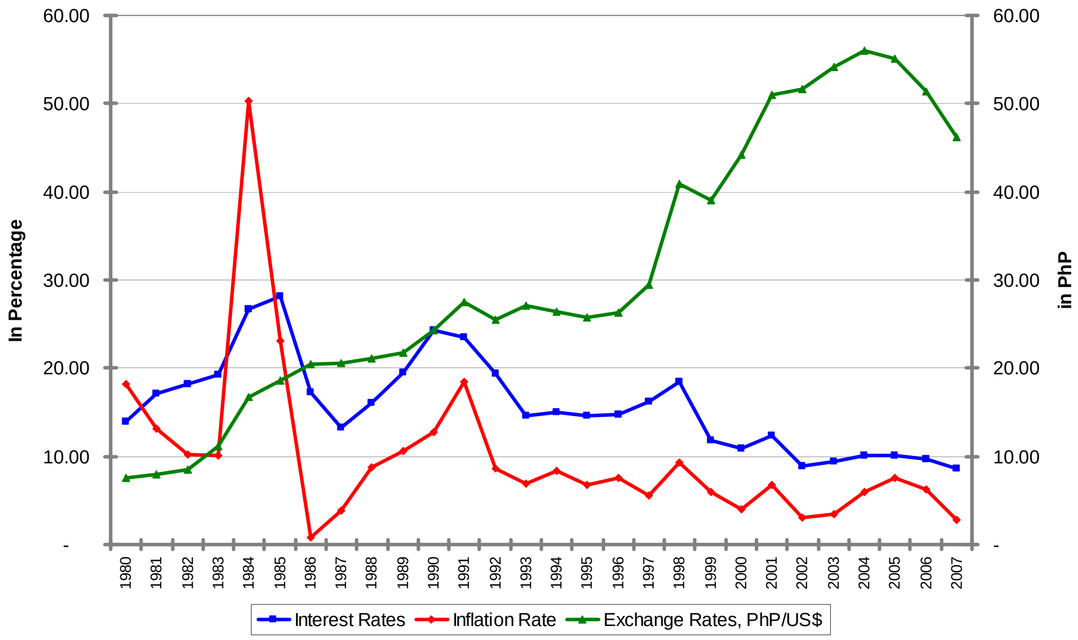
[5] The speed at which money changes hands to support a certain level of economic activity.

Inflation Rate, Exchange Rate & Interest Rate

There is almost a one-to-one correlation between inflation rate, exchange rate and interest rate (Figure 8). The financial market still looks at inflation as its anchor. Some time in the late 90s, the Philippines let go of its exchange rates. Then, the rates started to soar, reaching as high as ₱56.00 to the dollar in 2004.

The question for policy makers now is whether to increase interest rates or not. But there is pressure for them to do so. The Philippines will probably increase interest rates while the peso weakens due to high inflation rate. High interest rates support the peso and will support the authorities' anti-inflation drive. So most likely rates will go up. But the HGC is not yet liquid to take advantage of the increase in interest rates. Shelter agencies with extra liquidity should look into fixed income investments.

Figure 8. Inflation Rate, Exchange Rate & Interest Rate, Philippines: 1980-2007.



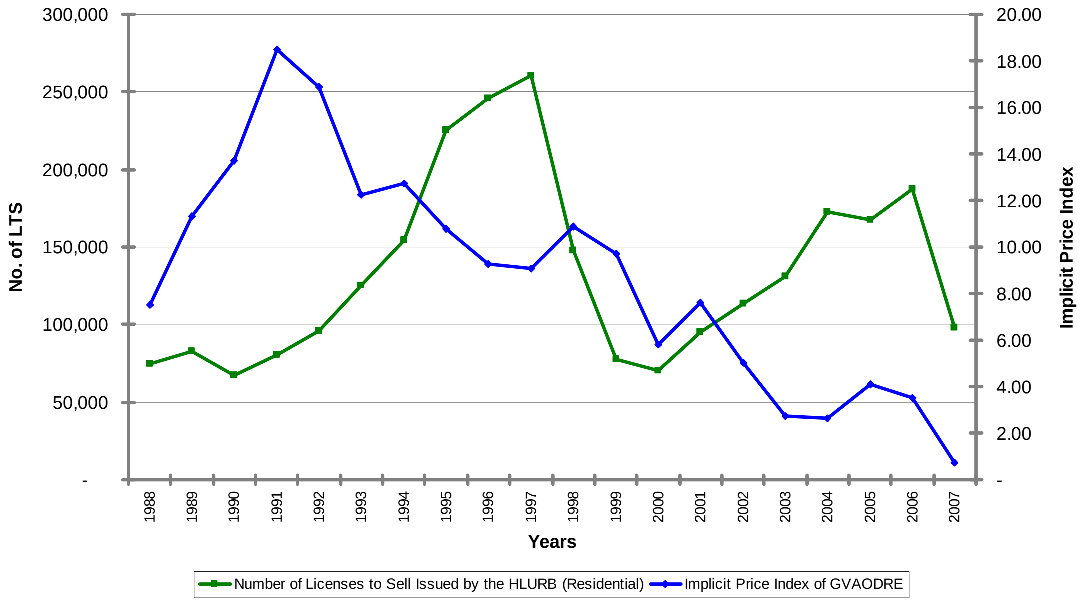
Source of basic data: PIDS

HLURB Licenses to Sell (LTS) vs. Implicit Price Index (IPI) of GVAODRE

The IPI of GVAODRE, which is inversely related to the number of HLURB-approved LTS, has been declining (Figure 9). There is a lot of housing inventory out there, which pushes prices down. Thus, developers should produce less and wait until prices go up again. Prudently, developers are auto-responding to price stimuli.

It is important to note that HGC is threatened with a spike in calls if it continues guarantying this bulging inventory of housing units without any sure takers. Certain interest groups would like a continuous real estate boom and have a tendency to let government agencies get all the risks while they get all the commissions and profits.

Figure 9. HLURB LTS & Growth in IPI of GVAODRE, Philippines: 1988-2007.



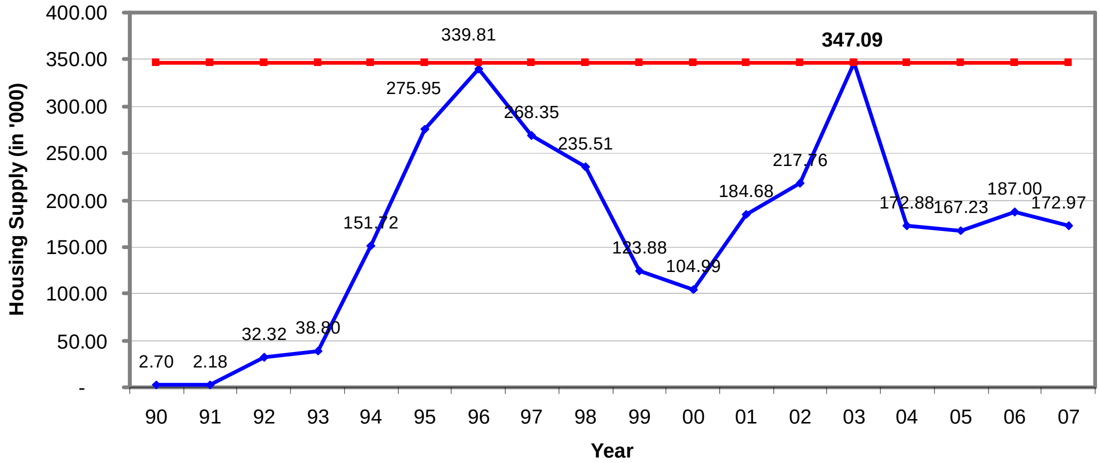
Source of basic data: HLURB, NSCB

Annual Housing Supply

The private sector should studiously avoid over-producing, even if they have that inherent tendency to over produce. On the average, the country's housing system produces only some 200,000 units a year.

The problem with some interest groups is that they will keep on stressing that there is a housing need and an annual housing back-log of 600,000 to 900,000. Then, they use this to justify whatever concessions they want from government agencies such as HLURB, PAG-IBIG, NHMFC, and HGC. But they are nowhere to be found when trouble erupts.

Figure 10. Annual Housing Supply, Philippines: 1988-2007



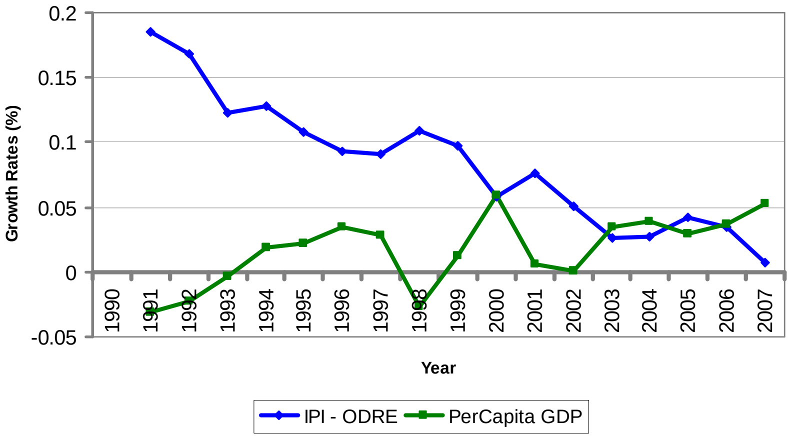
Source of basic data: HLURB LTS

Per Capita GDP and IPI ODRE

Intuitively, one can expect a correspondence between per capita GDP growth and house price inflation. Whenever there is an increase in income, an increase in demand and prices follows. However, house prices have counter-intuitively responded to per capita GDP growth. House prices have increased when incomes have fallen.

The convergence of per capita GDP growth rates and IPI-ODRE (Figure 11) manifests sustainability. Although there is a divergence of late, it is a divergence in favor of sustainability. As one can see, house price have decreased when incomes have risen.

Figure 11. Per Capita GDP Growth Rates and IPI-ODRE, Philippines: 1990-2007

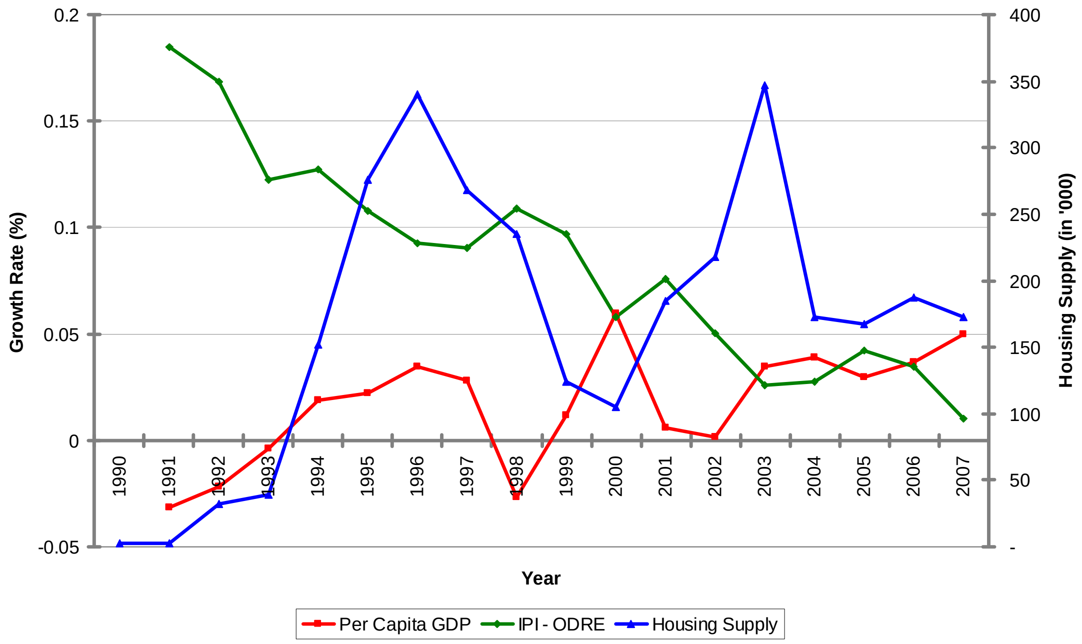


Source of basic data: National Income Accounts

Per Capita GDP, IPI GVAODRE and Housing Supply

Figure 12 overlays per capita GDP, IPI GVAODRE and licenses to sell from HLURB. Housing supply moves positively with per capita GDP but it in an amplified pro-cyclical manner that causes an over supply.

Figure 12. Per Capita GDP and IPI-ODRE Growth Rates, and Housing Supply, Philippines: 1990-2007

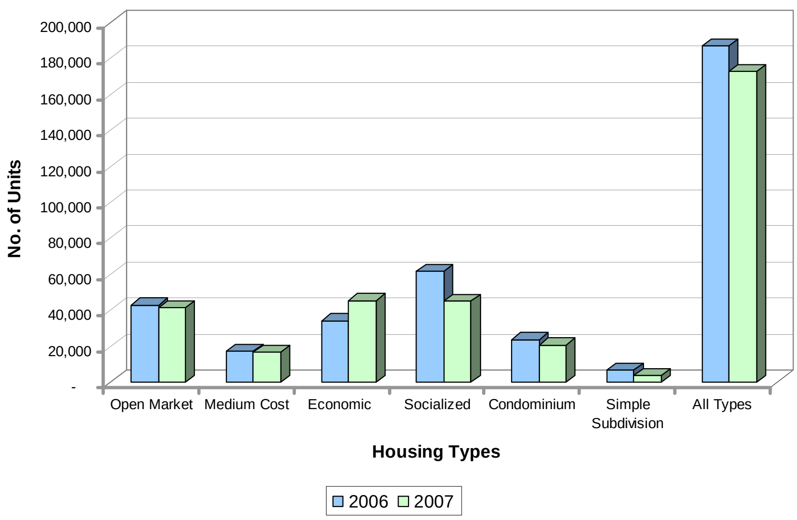


Source of basic data: National Income Accounts and HLURB

Housing Supply

There was a 7.5% decrease in the number of housing units from 187,001 units to 172,967 units for the period 2006 to 2007. Among the housing types, only the economic housing supply increased by 31.8% from 34,363 units to 45,292 units in 2007.

Figure 13. Number of Housing Supply by Type, Philippines: 2006.

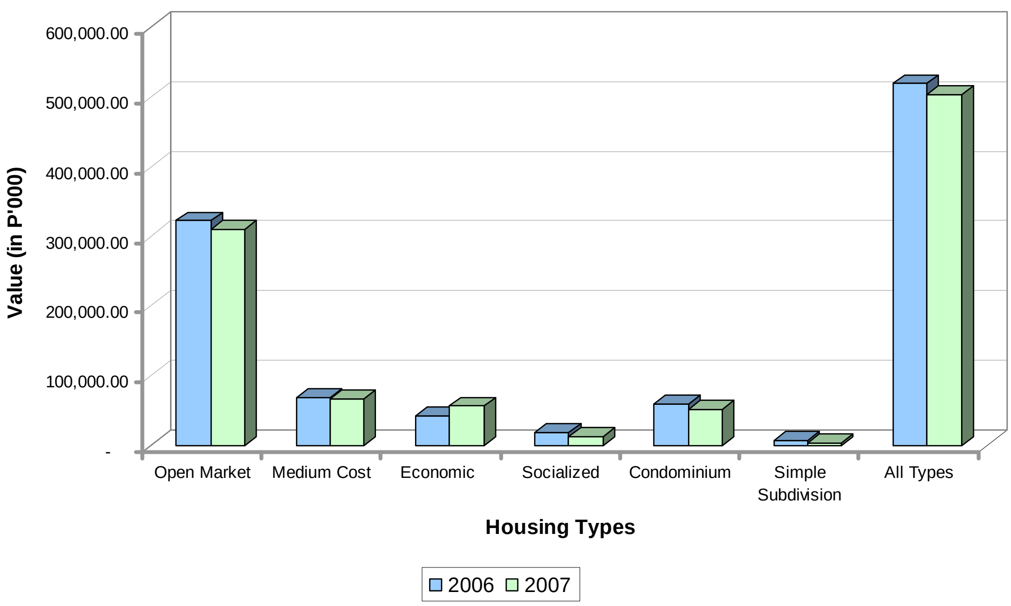


Source of basic data: HLURB

Estimated Value of Housing Supply

Likewise, there was a 3.09% decrease in the value of housing supply from ₱519Bn in 2006 to ₱503Bn in 2007. Only the value of economic housing increased from 42Bn in 2006 to 56Bn in 2007.

Figure 15. Estimated Value of Housing Supply by Type, Philippines: 2006



Source of basic data: HLURB0

2007 National Income Accounts

EXPENDITURE SHARE	2007 GROWTH	CONTRIBUTION TO GNP GROWTH
1. Personal Consumption Expenditure	6%	55%
2. Government Consumption	10%	7%
3. Capital Formation	9%	19%
A. Fixed Capital	10%	19%
Construction	18%	15%
Durable Equipment	3%	3%
Breeding Stock	0%	0%
Orchard Development	5%	1%
4. Export	3%	18%
Merchandise Exports	2%	10%
Non-Factor Services	9%	8%
5. Less: Imports	-5%	-33%
Merchandise Imports	-7%	-38%
Non-Factor Services	15%	5%
GROSS DOMESTIC PRODUCT	7%	86%
GROSS NATIONAL PRODUCT	8%	100%

Source of basic data: NSCB

TYPE OF INDUSTRY	2007 GROWTH	CONTRIBUTION TO GNP GROWTH
1. Agriculture, Fishery, Forestry	5%	11%
Agriculture and Fishery	5%	11%
Forestry	12%	0%
2. Industry Sector	7%	25%
Mining & Quarrying	25%	4%
Manufacturing	3%	9%
Construction	19%	9%
Electric, Gas & Water	7%	3%
3. Services Sector	9%	49%
Transport, Comm., Storage	8%	8%
Trade	10%	19%
Finance	12%	8%
O. Dwellings & R. Estate	6%	3%
Private Services	9%	9%
Government Services	3%	2%
Gross Domestic Product	7%	86%
Gross National Product	8%	100%

Source of basic data: NSCB

Projections of Selected Economic Indicators

INDICATORS	2006	2007	2008
Peso to US$1	51.31	46.15	41.7
91-Day T-Bills	5.4%	3.4%	4.0%
Overseas Filipinos' Remittances (in U.S. dollars)	12.8B	14.4B	16B
Banks' TOTAL LOANS (GROSS in Php)	2.1T	2.2T	2.3T
Banks' NON-PERFORMING LOANS (GROSS in PhP)	117B	98B	107B
Lending Rate	9.71%	8.68%	8.8%
Inflation Rate	6.2%	2.8%	8.3%[6]
GNP (growth)	5.4%	7.8%	6.4%
GDP (growth)	5.4%	7.3%	6.0%
AFF (growth)	5.1%	5.0%	3.8%
Industry (growth)	4.6%	7.0%	5.2%
Services (growth)	6.7%	9.0%	7.2%
Capital Formation (Growth)	2.1%	9.0%	6.5%

Source of basic data: http://publication.pids.gov.ph/details.phtml?pid=4273; www.economist.com; HGC projections.

[6] Source: http://www.census.gov.ph/, accessed 7 May 2008