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Market Update under COVID-19 in the Philippines

Philippine Economy in the COVID-19 Pandemic

The new coronavirus COVID-19 has significantly worsened the economic growth rates of many countries in the world. Its negative effects in Southeast Asian countries are exceeding those in other regions.

The Philippine government reported a lower-than-expected year-over-year Gross Domestic Product (GDP) growth rate of -11.5% for 3Q 2020. This was an improvement over the 16.9% decline in 2Q, when the country experienced a severe lockdown, but it was the second consecutive quarter of double-digit declines.

According to Nomura's economic forecasts, real GDP growth for 2020 will be negative 3.6% for the world economy as a whole.[1] For emerging countries, including China, the decline, forecast at 2.2%, will be smaller than the -5.4% estimated for developed countries. Asian economies will experience growth of -7.1% in India, -6.9% in Thailand (which was most severely impacted by the slowdown in tourism), -6.3% in Malaysia, -5.2% in Singapore, and -9.8% in the Philippines. Among the countries in Southeast Asia, with the exception of Indonesia where the economy contracted by a relatively minor -2.3%, the expected decline in GDP will be at least as great or greater than the average for developed countries.

In terms of stock market performance, a leading indicator of economic growth, Southeast Asian markets in 2020 is lagging behind other markets around the world. The reasons for this are a deterioration in the profitability of major domestic companies due to a significant slowdown in consumption, a decline in foreign investment in Southeast Asia, and an increase in foreign investors who are significantly reducing exposures to Southeast Asian stocks.

In the Philippines, stock performance in 2020 was down 13.1% (end November 2020) from the beginning of the year (Table 1). In particular, the spread of the COVID-19 virus led to a lockdown of cities in the Philippines and the two-day suspension of stock exchange activity in March. On March 19, when the stock exchanges reopened, a number of major stocks dropped to half their value since the beginning of the year. The main stock index (PCOMP) recorded its largest one-day drop (13.3%) and hit its lowest level (4,623.42) since 2012.

For several years, the Philippine economy enjoyed one of the highest growth rates among Asian countries, but the sharp drop in stock prices has given rise to concerns about the future. In the face of the COVID-19 pandemic, the market response is very different from markets in developed economies, especially the U.S., which are performing well due to high market liquidity and ultra-low interest rates.

Digitalization

Regardless of this challenging macro environment during 2020, pandemic-related restrictions on people going out and socializing are causing online business to boom and digitalization to accelerate.

The consumer market in the Philippines has changed dramatically in the wake of the pandemic, with significant expansion of the e-commerce market. Air-conditioned shopping malls are the most common form of retail commerce in Southeast Asian countries, where year-round high temperatures make outdoor shopping uncomfortable. Until the pandemic the consumer market for in-store purchases in the Philippines was growing rapidly while e-commerce was sluggish, with only 4% of total sales. Also, in January 2020, Filipinos' average monthly spending on online purchases was only USD 89. E-commerce's share of total sales in the Philippines is particularly low among

Table 1: Historical Data of Philippine Stock Exchange

	2013	2014	2015	2016	2017	2018	2019	2020 YTD as of end November
Philippines COM Index	5,889.8	7,230.6	6,952.1	6,840.6	8,558.4	7,466.0	7,815.3	6,791.5
Y-Y (%)	1.3%	22.8%	**-3.9%**	**-1.6%**	25.1%	**-12.8%**	4.7%	-13.1%
Market Capitalization (PHP Trillion)	11.93	14.25	13.47	14.44	17.58	16.15	16.71	15.18
Y-Y (%)	9.1%	19.4%	**-5.5%**	7.2%	21.8%	**-8.2%**	3.4%	-9.1%
Market Capitalization (Domestic Companies, Trillion)	9.65	11.71	11.19	11.87	14.49	13.54	13.95	12.57
Y-Y (%)	2.5%	21.4%	**-4.5%**	6.1%	22.0%	**-6.6%**	3.0%	-9.9%
Average Daily Turnover (PHP Billion)	10.52	8.80	8.96	7.81	8.06	7.155	7.29	7.18
Y-Y (%)		**-16.3%**	1.8%	**-12.8%**	3.2%	**-11.3%**	2.0%	**0.4%**
Same above without Block Deal (PHP Billion)		7.81	7.51	7.19	6.94	6.31	6.26	6.34
Y-Y (%)			**-3.8%**	**-4.3%**	**-3.5%**	**-9.1%**	**-0.8%**	**1.3%**
Share of Block Deal (Daily)		11.3%	16.2%	7.9%	13.9%	11.7%	14.2%	11.7%
Foreign Investors Share	51%	49%	48%	51%	50%	51%	55%	47%
Net Foreigner Purchase (PHP Billion)	15.6	55.7	**-59.7**	2.2	56.2	**-60.9**	**-14.2**	-120.2
P/E (Stock Price/ EPS) (Times)	17.8	20.1	19.5	17.9	22.3	17.9	16.5	20.4

Source: Philippine Stock Exchange (PSE)

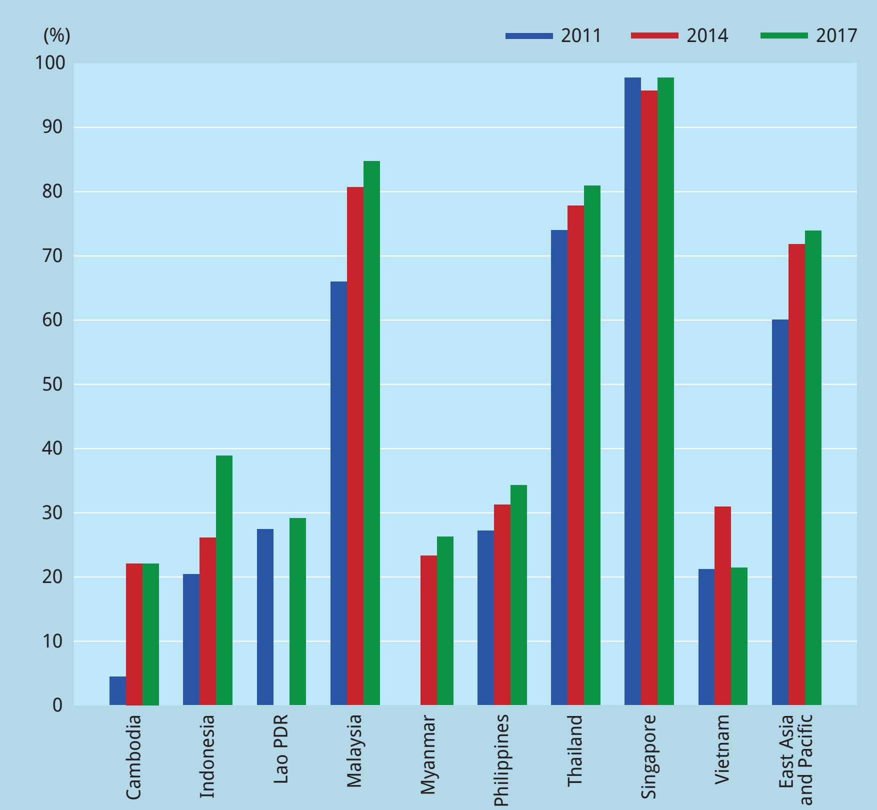
Southeast Asian countries, and is far below the 30% share in China and South Korea, where e-commerce culture has taken precedence. However, e-commerce business in the Philippines has grown rapidly since the pandemic.

The COVID-19 crisis is going to accelerate the shift towards online consumption. Social distancing is accelerating the growth of digital delivery models, including online sale of goods and trade in services such as education and banking as well as entertainment. This change in consumer behavior is likely to persist in the post-COVID-19 world.

In addition to expansion of the e-commerce market, improvements in the Internet environment and infrastructure and the penetration of smartphones are important factors in the growth of online sales. On the other hand, the Philippines lags in terms of convenience of payment methods (Digital Payment System) and logistic of goods delivery and distribution capabilities.

In the Philippines, only about 30% of the total population 15 years and older has access to a bank account or online and mobile banking, and the number of people with credit cards is only 6-7 million (industry estimate), so it has taken a long time to increase the number of consumers with non-cash means of payment for e-commerce transactions (Figure 1).

Figure 1: Percentage of Adults (15+) with Transaction Accounts in ASEAN Countries



Source: Bangko Sentral ng Pilipinas

Currently, only two online banks (or so-called digital or virtual banks) — ING of the Netherlands and CIMB of Malaysia — operate in the Philippines without branches, entirely on the Internet. Among traditional commercial banks with a nationwide network of branches, Union Bank has been focusing on online banking in recent years. Banks in the Philippines are committed to improving their digital banking services in the pandemic environment, although it may take a longer time for them to offer advanced digital banking services than those in neighboring countries.

The financial industry is not affected by the sub-optimal effects of the logistical environment, since it is a business that does not have to actually deliver parcels to consumers, but it does greatly influence individual investors' participation in the capital markets, as well as the growth potential of capital markets businesses. Under the lockdown, the digitalization momentum in the finance industry accelerated, with commercial banks reporting a substantial surge in daily sign-ups for online and mobile banking portals. Also, the incumbent telecommunication player reported that mobile data traffic more than doubled in the first half of 2020.[2]

The Philippines faces many logistics challenges, with logistics costs as a percentage of retail sales price a major impediment to growth. In addition to the "optimal taxation system" (a hidden problem in the e-commerce market that won't be discussed here), several other logistics issues have prevented the Philippines from harnessing its inherent e-commerce potential.

For example, transportation and distribution costs in the Philippines are quite high compared to other Southeast Asian countries. In the Philippines, parcel delivery equals 27% of the retail price, which is a higher ratio than in Indonesia or Viet Nam and nearly 2.5 the ratio in Thailand.

Yet another impediment is that many Filipinos buy from foreign e-commerce sites, which means that these purchases do not generate any sales tax revenue for the Philippine government.

Against these impediments, some factors favor the growth potential for online busines in the Philippines. Filipinos spend more time on the Internet and smartphones than people in any other country and they spend more time communicating through social media (Figure 2). Business owners and consumers seem particularly excited about the prospect of expanding their online businesses in the Philippines, which has had some of the most restrictive lockdown regulations in Southeast Asia during the pandemic. With the announcement of the continuation of the Community Quarantine across the country until at the end of 2020, the daily behavior of Filipinos is likely to change once they are fully aware that they will continue to be unable to go to school and be restricted from going out well into 2021.

In a country where the average age of the population is only 24 years and where millennials and Gen-Xers make up a large portion of the population, it is not surprising that many consumers are receptive to new business models such as online businesses and mobile banking. Mr. Lopez of the Department of Transport commented that 73,276 new online businesses were registered in the Philippines during the pandemic, a remarkable increase from the 1,753 registered online businesses before the pandemic.[3]

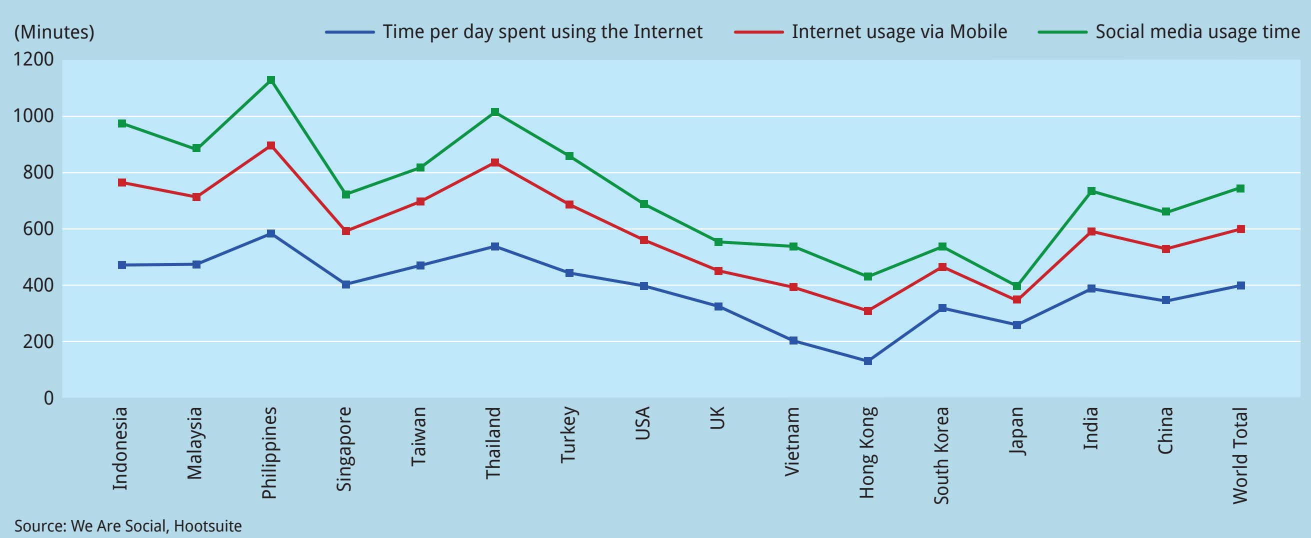
In sum, as web business in the Philippines is expanding rapidly in parallel with the rest of the world, the country provides a good example of the possibilities and issues with digital transformation (DX) or business model transformation.

Diversification of Asset Management

With economic activity stagnating due to the impact of the pandemic, and with no expectation of a rapid recovery, bank lending has declined significantly (2.8% Y-Y Sep 2020). The Bangko Sentral ng Pilipinas cut its policy rate by 0.25% to 2.0% on November 19, 2020, the lowest in Philippine history. This was the fifth consecutive time in 2020 alone that the policy rate has been cut as the government is doing everything possible to prevent the economy from falling into a recession. The central bank's low interest rate policy is likely to remain in place for the foreseeable future.

On the other hand, low interest rates

Figure 2: Average Hours on Internet and Social Media



Source: We Are Social, Hootsuite

have led to the diversification in the asset management trends of domestic investors in the Philippines. Savings-type insurance products, real estate investments, and investment trusts are the main products for individuals' asset management in the Philippines, and among them, the share of real estate investments is extremely high. Investment trusts, which should be the core of financial asset management, are divided into two product categories: Unit Investment Trust Funds (UITFs) sold by commercial banks and Mutual Funds sold mainly by asset management companies and brokerage firms. The market growth of investment trusts has been slower than in the surrounding emerging economies because of the different licenses required to sell these products and the segregation of regulators between central banks and the SEC. In addition, direct competition from financial products sold by insurance companies pitching high investment returns seems to be tough.

In the Philippines, while the penetration of traditional financial products supervised by the financial authorities is still low, unique online companies in the asset management and investment business are emerging on the e-commerce platform. One is Coin Pro, which offers investment opportunities in the Bitcoin market and has attracted a new investor base. Beside financial products, a growing number of startups are efficient online real estate investment intermediaries. The crypto currency player, eToro, which is rapidly growing its online investor base worldwide, is also spending a lot of money on advertising in the Philippines, and Filipinos who watch YouTube in the pandemic-forced isolation of their homes probably see eToro's advertisements several times a day.

Not long ago, it was common knowledge that "investment" meant "products sold by existing financial institutions," but today's younger generation of Filipinos seems to believe that there are business opportunities beyond the traditional financial products sold by commercial banks, securities firms and insurance companies. The financial and investment management industry which used to be dominated by face-to-face sales, is changing. It is now possible to understand the appeal of financial products through computer screens and images, and the Internet infrastructure has become a tool to skillfully capture the investment minds of consumers. This change has been accelerated during the pandemic when people are required to avoid human contact as much as possible. "Easy-to-understand asset management ideas for young people" offered by startups rather than historic financial institutions may be especially acceptable in the Philippines where young people make up a large proportion of the population.

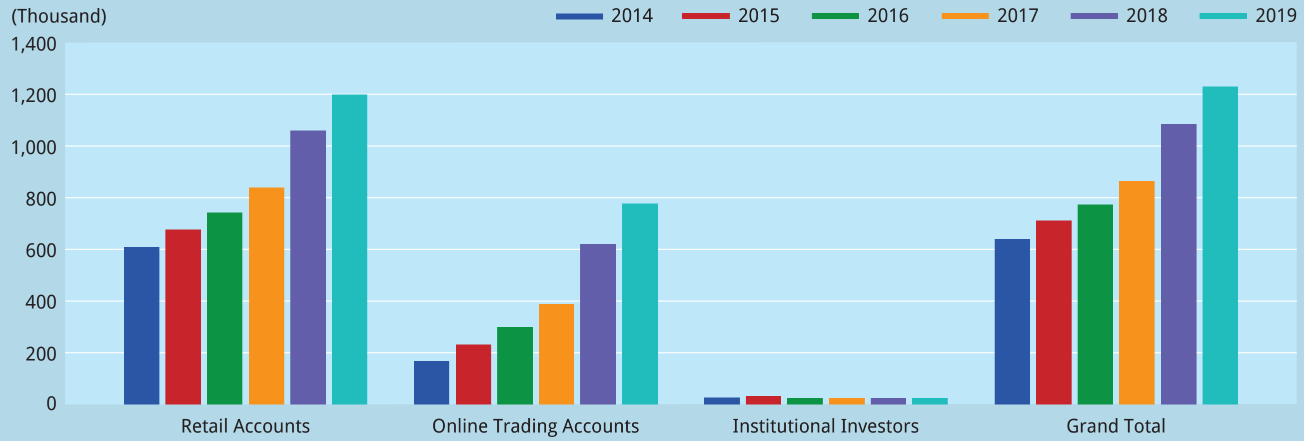
State of the Philippine Stock Exchange

Direct investment in the stock market in the Philippines is small. The average daily trading value of the Philippine Stock Exchange at the end of November was only PHP 7.2 billion (about USD 150 million), which is low compared to the daily volume in other Asian countries. In addition, foreign investors account for almost half of the market's trading value. This means that the daily trading value for individual and institutional Filipino investors is around USD 75 million. Trading volume is small compared to the market's capitalization, which is nearly PHP 15.2 trillion, because the major conglomerates in the Philippines have been holding most of the shares issued by listed companies for a long time.

In terms of liquidity, the Philippine stock market is still in its infancy, but the pandemic has brought new investor activity through the expansion of online business. Until a few years ago, only a limited number of citizens in the Philippines had stock trading accounts. But during the decade from 2010, the number of trading accounts expanded rapidly, especially in the last six years, when it doubled from 600,000 to 1.2 million, driven by online trading accounts (Figure 3).

The share of online retail trading accounts grew from 29% (174,000 accounts) in 2014 to 65% (782,000 accounts) in 2019, which means that the number of online accounts alone grew nearly four times in five years. During this same period, the average daily trading value on the Philippine Exchange, excluding block trades such as crosses and matching, declined every single year, from PHP 7.8 billion to PHP 6.3 billion. The conclusion is that the growth of online trading accounts is not due to market overheating, but simply to the con-

Figure 3: Trading Accounts at the Philippine Stock Exchange



Source: PSE

venience of online trading and people's increasing familiarity with online and smart phone trading.

An appropriate indicator of the growth of online trading by retail investors is the market share of COL Financial, a specialized online brokerage firm with more than 50% market share in online trading. The company has increased its market share significantly since the pandemic. While the stock market has not risen steadily during this period, there has been a steady increase in the number of retail investors buying and selling, especially those using online brokerage platforms, as opposed to foreign investors who have historically been the biggest sellers.

The biggest news in the Philippine securities market in 2020 was the first listing of a real estate investment trust (REIT). Having enacted REIT legislation in 2009, the Philippines should have been a leader in the REIT market in Asia, but it lagged behind Singapore, Malaysia, Thailand, and Indonesia until finally listing its first REITs in 2020. The reason for the delay of more than a decade was the hesitance of issuing companies due to strict restrictions in the Philippines' REIT laws. The two issues raised concerned the requirement for the float ratio of shares to be at least two-thirds within three years of listing and the tax system. In the meantime, the real estate market in the Philippines continued to soar to the point of becoming overheated and investors' calls for REIT listings only grew stronger.

After many years of discussion between the Bureau of Internal Revenue (BIR), the Department of Finance and the Securities and Exchange Commission, the law was finally amended in January 2020. The relaxation of the float ratio to 33% and the easing of the income tax requirements have made it more attractive for real estate companies to list their REITs. Ayala Group's AREIT became the first REIT to be listed in the Philippines, on August 13, with high expectations. The deal size was PHP 13.6 billion (about USD 280 million, offering price PHP 27).

Since REITs are a new product category in the Philippines, different from common stock, some preparation was necessary and there were some glitches. Prior to the listing there was a lot of advertising to investors. In addition, traders in brokerage firms were offered seminars to educate them about the product and how to trade it. Then, because the method of placing orders for REITs with the stock exchange was set as a separate product from ordinary common stock, each securities company had to obtain a certificate in advance in order to trade the REIT. Some brokerage firms were not able to respond in time to the settlement system, causing them to suspend REIT trading. Also, some major securities firms that obtained the certificates found that they were unable to submit customer orders to the stock exchange on the day of listing due to system configuration, resulting in a great deal of confusion at first.

Initial Public Offerings (IPOs) listed on the Philippine Stock Exchange often open below the IPO price, and underwriting bankers need to pay more attention to pricing. This was the case with AREIT, which dropped to PHP 24.10 on August 14, but its share price has since recovered, and at the end of November it was PHP 27.35, nearly 10% above the IPO price. It seems to be attracting the interest of investors looking for stable distributions. The market is now focusing on DoubleDragon, the second REIT listing on the Philippine Stock Exchange.

Since foreigners are not allowed to own land or residential property in the Philippines (condominiums can be registered in the name of the owner, but land cannot be registered in the name of the foreigner), the listing of REITs has been attracting attention not only from investors in the Philippines, but also from overseas investors seeking liquidity and investment opportunities in the booming real estate market.

Summary

The Philippines is one of a few countries in the world where the demographic dividend will continue beyond the year 2040, making its future growth potential and business expectations high. The Philippines is poised to accelerate the growth of e-commerce, especially those businesses that are easily accepted by the younger generation. The rapid change in consumer behavior and business models in the financial industry as a result of the prolonged pandemic will further support the paradigm shift.

Notes

1 Nomura. (2020) "Global 2021 Economic Outlook," December 11, 2020.

2 "Mobile data traffic more than doubles in pandemic," *Manila Bulletin*, August 20, 2020.

3 "DTI sees 4K percent rise in online businesses during virus lockdown," *INQUIRER.net*, September 3, 2020.

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Koichi Katakawa joined Nomura in 1987 with a degree in Commerce from Osaka City University in Japan and initially held several positions in branch offices in Japan of Nomura Securities.

Following his study of Banking Administration and Management during 1992–1994 at Universidad Autónoma de Madrid, Koichi Katakawa spent 19 years in Europe holding various positions in Switzerland, Italy and Germany.

Mr. Katakawa was Country Head for Nomura's German business from 2006 to 2015 and Vice-Chairman of Nomura Asset Management Deutschland KAG mbH (currently, Nomura Asset Management Europe KVG mbH), a 100% subsidiary of Nomura Asset Management Co., Ltd., Tokyo.

In 2016, he became first President of BDO Nomura Securities, Inc. (currently BDO Securities, Inc.) which was established as a joint venture between BDO Unibank and Nomura Holdings. BDO Nomura Securities grew quickly into one of the largest online stockbrokers in the Philippines with a broad customer base of 350,000 accounts.

In 2021, Mr. Katakawa returned to Tokyo, Japan to take an assignment as General Manager of the Corporate Planning Department of Nomura Asset Management Co., Ltd. Japan.