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Philippines economy: bouncing back quickly - Q3 update January 2023

MARKET REPORT

January 2023

Summary

- The Philippine economy continues to rebound from the pandemic thanks to strong domestic activity and the easing of COVID-19 restrictions. This is despite accelerating inflation and a depreciated Peso. Growth for 2022 is now expected to reach 7.2% before slowing to an average of 5.7% per annum from 2023 to 2025.
- This buoyancy is reflected in the Philippines' two-way trade with the rest of the world, which was up 12.3% in the year to October compared to the same period in the previous year. In that period New Zealand's merchandise exports to the Philippines were also up 31% ($202m NZD), with strong growth in dairy and meat. But several key New Zealand exports remain below pre-pandemic levels: wood, paper, fruit, and seafood.
- Service (mainly tourism and education) exports to Philippines remain well below pre-pandemic levels, but are also improving; a number of NZ companies are establishing or re-establishing offices in the Philippines to service this growth, and to take advantage of the competitive business process outsourcing sector in the Philippines.
- MFAT and MPI lobbying successfully protected multi-millions worth of New Zealand butter exports, which had been at risk because of changes a year or so ago to Philippine import regulations.
- Renewable energy, govtech and agritech appear to be areas for further growth opportunities, reflecting the Philippines prioritising those areas, including incentivising greater foreign direct investment in some of them.

Report

The Philippine Economy - bouncing back quickly

The Philippine economy continues to rebound from the effects of COVID-19 despite ongoing headwinds. Growth for the year to September 2022 reached 7.7%, largely on the back of resurgent domestic demand. This has returned the economy to pre-pandemic levels (finishing the year at #1 for South-East Asia, just ahead of Viet Nam and Malaysia, according to the Economist Intelligence Unit).

The border reopening and release of pent up demand, along with improved employment conditions, have all contributed to increased domestic activity. This is particularly true of the services sector which has benefitted from the easing of movement and gathering restrictions. Household incomes have also been buoyed by growth in remittances from overseas workers – a critical part of the Philippine economy.

But inflation, a worry - and the Philippine Central Bank tightens monetary policy

These gains were achieved despite accelerating price increases. The annual inflation rate rose to 8.0% in November from 7.7% in October (the highest in 14 years). This was driven by rising global commodity prices and a depreciating Peso, which significantly impacted the Philippines as a net importer of food, fertiliser and fuel. Recent extreme weather events have also harmed domestic food production, placing further pressure on prices. The Philippine Central Bank has responded by rapidly increasing the central interest rate from 2 to 5% between May and November 2022, with further increases signalled.

… a tighter labour market belies persistent poverty

The generally positive trajectory has also been reflected in the labour market with unemployment falling to 4.5 percent in October - the lowest since the onset of COVID-19. While this coincided with a fall in labour force participation from 65.2 to 64.2 percent, jobless Filipinos also eased overall, falling from 3.5 million in October 2021 to 2.24 million in October this year.

While unemployment is the lowest since the onset of the COVID-19 pandemic, more Filipinos are employed in low paying jobs that are not keeping up with the rising cost of living, meaning the poverty index is not reducing as desired. Marcos Jr's overall public approval of 57% for his performance contrasts with 42% disapproving of the administration's response to inflation and 49% of Filipino families rating themselves as poor according to the latest Social Weather Stations (SWS) survey.

Medium-term prospects: brace for a slowdown

Against this backdrop, the World Bank has upwardly revised its growth expectations for the Philippines to 7.2% for 2022 before projecting the economy slowing to an average of 5.7% from 2023 to 2025. This reflects the impact of stronger than expected domestic activity in recent quarters alongside the increasing effect of higher interest rates and deteriorating external conditions, including due to the war in Ukraine. Monetary tightening in advanced economies will also be increasingly felt in the Philippines as it places downward pressure on the Peso and reduces capital availability.

The Government response: more public investment...

Critical to the Philippines' growth prospect will be the investment decisions made by government, particularly as externally driven demand eases. President Ferdinand Marcos Jr has signalled that his administration intends to maintain high levels of public investment over the medium term which could serve to soften negative effects if the global economy continues to deteriorate. This is reflected in the 5-year Philippine Development Plan, which outlines the government's high-level economic strategy for the period from 2023 through to 2028.

... but growing public debt still a concern

Though the Philippines has generally been known for its prudent fiscal policies, the increasing national debt still remains a concern. Government debt has swelled to a record PHP13.52 trillion (NZD390 billion), not helped by a weak Peso. But Finance Secretary Benjamin Diokno remains optimistic the Philippines will hit or exceed its growth targets this fiscal year.

Philippines' trade with the rest of the world growing...

The recent buoyancy in the Philippine economy has been reflected in the Philippines' trade profile with both imports and exports recovering further in Q3 2022 despite a weakening Peso. Exports for the year to October were up 20% compared with a year earlier while imports rose by 7.5%, resulting in a net improvement in the country's trade balance (the deficit reducing by 13.5%).

Implications for New Zealand

New Zealand's trading relationship with the Philippine's also benefited from rebounding demand with merchandise exports up 31% ($202m NZD), in the year to September. This was particularly driven by **strong growth in dairy and meat exports**, up 28 and 114% respectively, and saw trade receipts return to their pre-pandemic level.

Although up on the previous year, **several key sectors, including wood, paper, and fruit, all remain down** compared with 2019 (by 7, 23, and 27% respectively) suggesting the recovery still has a way to go. **Seafood exports** have also struggled to regain ground in the pandemic's wake, remaining 44% below 2019 levels.

New Zealand's **service exports to the Philippines are also showing signs of recovery** despite remaining 75% below pre-pandemic levels for the year to September. Third quarter travel exports (accounting for some two thirds of New Zealand's service exports to the Philippines) were up 97% compared with the same period in 2021, reflecting the impact of easing border restrictions.

Food shortages creating opportunities for exporters from New Zealand

President Marcos Jr's focus on modernising Philippines' farming has been given an early validation: significant sugar and onion shortages that began in the second half of 2022 highlight the food security challenges the Philippines face.

Prices for white onions have reached PHP 400 (NZD 11.40) per kilo under continuing shortages, and the President has given approval to import an additional 21,060 tonnes.

... particularly onions

A key focus for New Zealand over the past few years has been to support New Zealand onion exporters gaining improved commercial access to the Philippine market. The current state of government to government talks on importing New Zealand onions, combined with additional lobbying to demonstrate how New Zealand can help ease the current shortages, has moved New Zealand closer to unlocking this access.

... dairy trade also preserved

The release of a revised circular on trans-fatty acid (TFA) content from the Philippines Food and Drug Administration in December has preserved multi-million dollars worth of butter products export.

This revision reflected efforts by MFAT and MPI to bring to its attention the original circular's exclusion from importing any food products above a certain percentage of TFA, without distinction of source, which would exclude all importation of pure butter to the Philippines. New Zealand successfully argued a distinction should be made between naturally occurring TFAs and industrially produced TFAs.

Marcos Jr Administration’s focus on agricultural, energy and government reform re-affirms opportunities for New Zealand Govtech, Agritech and Renewable Energy

President Marcos Jr’s prioritising food security, energy security and government streamlining and e-government re-affirms New Zealand’s effort in these areas remains relevant.

President Marcos Jr’s personal interest in **agriculture** has motivated the bureaucracy to explore opportunities to not only improve livelihoods for those Filipinos most at risk of starvation, but also to improve the export capability of the agricultural sector. This aligns well with New Zealand’s existing initiatives, though the New Zealand Aid Programme and G2G, but also with the increasing interest from New Zealand agricultural or food and beverage players seeking to establish a footprint in the Philippines and to develop consulting and other business opportunities – particularly in Mindanao.

Renewable energy opportunities have increased under the Marcos Jr Administration, reflecting its commitment to accelerating a green energy transition. On 15 November 2022, the Philippines approved 100% foreign ownership of renewable energy production. The Constitution limits foreign ownership of energy production to 40%, but a Supreme Court ruling has deemed renewable energy to fall outside the original intent of the Constitution.

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