Economic and business update for the Philippines

Market Report

AUGUST 2022

Rāpopoto - Summary

- The Philippines posted growth of 8.2% in its Gross Domestic Product (GDP) during the first quarter of 2022 and expanded less than expected in the second quarter at 7.4%, but still on track with the official 2022 growth target.
- Due to rising domestic investment and consumption as pandemic restrictions eased, the Philippine economy is poised to grow by 6.5% - 7.5% in 2022 and could further rise by 8% in 2023, forecasted to be the highest economic growth rate among ASEAN+3 countries.
- Key changes to the Foreign Investment Act and Public Service Amendment Act have now been signed into law. The amendments are expected to promote foreign investment by reducing foreign ownership restrictions while also removing restrictions on foreign equity in most public service companies.
- Further engagements and strengthening of bilateral trade between New Zealand and the Philippines are expected to stem from membership of the Indo-Pacific Economic Framework for Prosperity (IPEF). Firm statements are being made regarding RCEP, but it remains unratified. Negotiations to upgrade the ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA) are ongoing and are expected to further reduce trade barriers and boost two-way trade.
- To date, indications are that the new administration of President Marcos Jr will continue in the same vein as the previous administration with a more robust approach and a relatively orthodox and business-friendly ideology.

Pūrongo - Report

Philippine Economic Updates: Performance, Challenges, and Policies

On As the Philippines emerges from the worst of the pandemic and transitions to a new administration, the economy is well placed to regain lost ground and return to its pre-pandemic trajectory. Loosening restrictions saw the country post year on year Gross Domestic Product (GDP) growth of 8.2% for the first quarter and 7.4% for the second quarter of the year, building on the momentum generated in 2021 when the economy grew by 5.6% and returned above its pre-pandemic level. This was largely driven by the continuing resumption of activity in the country's major economic sectors including agriculture, forestry, and fisheries. Retail and services have also experienced considerable growth as pandemic-related restrictions ease, allowing a gradual resumption of domestic and international tourism.

Merchandise trade has also grown, with total exports up 7.1% in the year to June 2022. This growth has been broadly in line with the traditional composition of the Philippines' exports, with 7 of the country's top 10 commodity groups recording an annual increase, including their number 1 export – electronic products. Other strong performers have been coconut oil which surged by 180.5% (likely benefiting from disruptions to Ukrainian sunflower oil exports), mineral products (up 32.9%), and chemicals (up 23.6%), reflecting the rising price of commodities globally and the increasing demand for industrial inputs as economies return to scale.

Although New Zealand exports to the Philippines are still down ~27% compared to pre-pandemic levels, they grew 2.6% in the year to March 2022. New Zealand's largest export to the Philippines, Dairy (accounting for some 71% of total exports), was down 1% over this period, but was offset by strong growth in other key exports, particularly wood (5%), meat (55%), and food preparations (20%).

Concerns that meat exports would be impacted by the expiration of New Zealand's accreditation to export meat into the Philippines have been largely relieved. The Department of Agriculture, through the Bureau of Animal Industry, has assured that there will be no trade disruption of accredited commodities provided food safety guidelines are followed and no transboundary animal diseases are reported.

Outlook

Looking ahead, economists see a range of factors affecting overall GDP growth, but remain optimistic about the outlook for 2022 and beyond. ADB and the World Bank forecast strong GDP growth due to rising vaccination rates, falling COVID-19 infections, and normalising economic activity (specifically in services) following the lifting of pandemic restrictions.

The outlook is also buoyed by strong fundamentals relative to many of its ASEAN neighbours. Unemployment now sits at 6% (having reached 10% in 2020) and remittances from Filipinos working abroad, an important stabiliser in the Philippines' economy, are steadily growing as key markets rebound from the pandemic (especially the US, China, UAE, and Japan.

The return of international investment is also expected to play a key role in the Philippines' recovery, particularly in the wake of legislative changes to the Public Service and Foreign Investment Acts in March 2022. The amendments seek to strengthen foreign investment by allowing foreigners to build and fully own domestic enterprises, while also lowering the minimum employment and paid-in capital (for select technology) that is required, while also removing restrictions on foreign equity in most public service companies, including key utilities and infrastructure holdings (e.g. ports, expressways, railways).

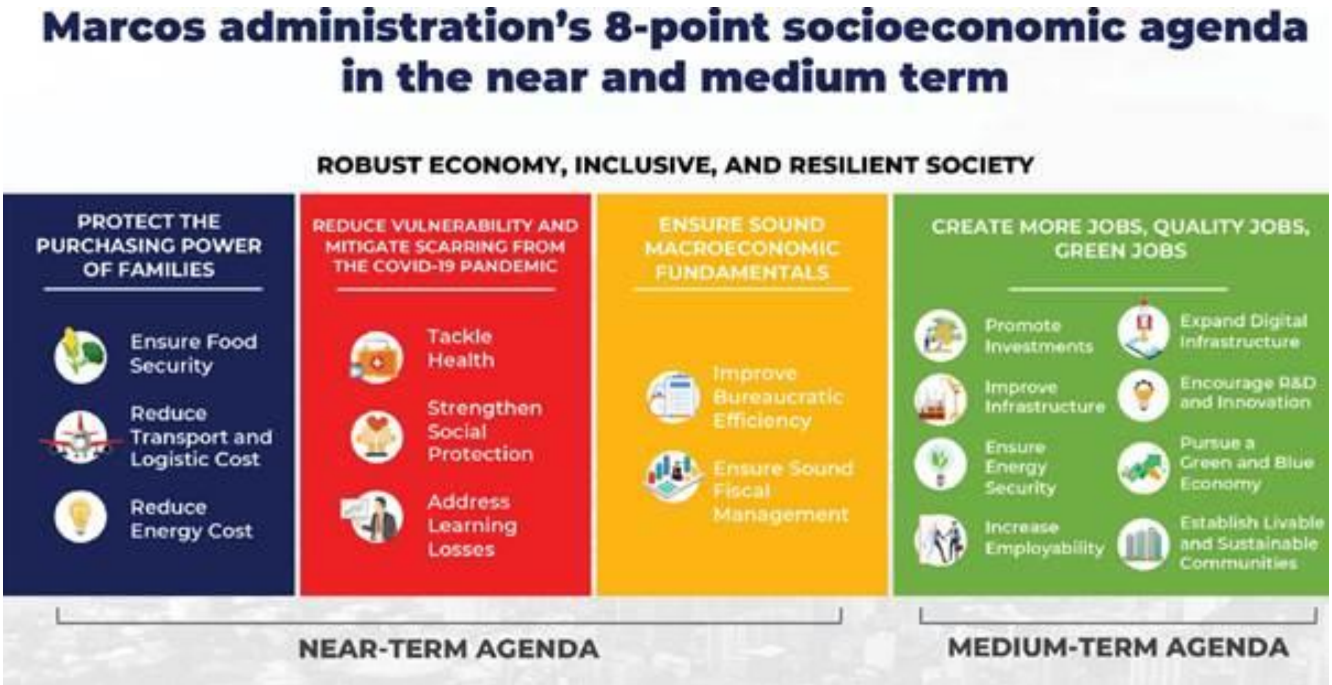
As is the case for most economies, the key downside risk remains the prospect of further COVID-19 waves due to the emergence of new variants. President Ferdinand "BongBong" Marcos Jr. stated during his State of the Nation Address on 25 July 2022 that the country cannot afford another lockdown and is looking to revise COVID-19 restrictions in the country by mid-August.

Inflation is likely to persist in the medium-term. While the Philippines has little direct trade exposure to Russia and Ukraine, the invasion's impact on global food and energy prices has already been sorely felt, with prices up 6.4% in the year to July. The Philippines has also been affected by the prospect of rising interest rates in the US and elsewhere which have weakened the Peso exchange rate and further lifted the price of imports. This will not only present economic headwinds but also a political challenge for President Marcos Jr. Despite announcing a monthly cash payment (PHP 500/NZD 14.63) for Filipinos earning below the median wage and a fuel subsidy for taxi and public transport drivers, there are signs of growing frustration at the Government's response (or perceived lack thereof).

Following speculation that the Bangko Sentral ng Pilipinas (BSP) would take a more dovish approach to fighting inflation, noting concerns around an overcorrection, the bank unexpectedly tightened their benchmark rate by 75 basis points on July 14, bringing it to 3.25%. Most commentators now see the policy rate reaching 4.5% by the end of year (still below the 2019 highwater mark of 4.75%).

Economic policy under President Marcos Jr

The positive projections for economic growth are welcome news for the Marcos administration, whose economic policy started as a key unknown but was addressed during his first State of the Nation Address (SONA) and in more detail during the Post-(SONA) Economic Briefing. The economic team led by Finance Secretary Benjamin Diokno detailed the administration's 8-point socioeconomic agenda in the near and medium term on how they plan to achieve this, as below.



Trade Secretary Alfredo Pascual has stated the administration will prioritize ratification of the Regional Comprehensive Economic Partnership Agreement (RCEP). It has also been an early and vocal proponent of the US-led Indo-Pacific Economic Framework (IPEF), which despite the absence of any meaningful market access still has the prospect of facilitating trade. The administration has also expressed its support for concluding negotiations to upgrade the ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA).

On 26 July the New Zealand ambassador to the Philippines Peter Kell attended the Post-State of the Nation Economic

Briefing hosted by Secretary of Finance Benjamin Diokno. Secretary Diokno had his entire economic team there including Secretary of Education and Vice President Sara Duterte for what turned out be a comprehensive, thoughtful and well-organised explanation of the direction, approach and detail of the new administration's economic policy which was a key unknown when elected.

The event was well attended: senior leaders in the business community, representatives of the Asia Development Bank, UN and other multilateral partners, and many from the diplomatic corp were out in force.

The Marcos Jr Administration has adopted the country's first-ever Medium-Term Fiscal Framework

This Framework will serve as a blueprint to reduce the fiscal deficit, promote fiscal sustainability and enable robust economic growth.

Key elements of it include enhancing fairness and efficiency of the tax system, bringing down the debt-to-GDP ratio to less than 60% by 2025, reducing deficit-to-GDP ratio to 3% by 2028, and maintaining high investment in infrastructure at 5-6% of GDP annually.

The Marcos Jr Administration has inherited a solid platform for not only economic recovery but growth

The Duterte Administration had:

- amended the Retail Trade Liberalization Act, Foreign Investment Act and Public Service Act
- established the Corporate Recovery and Tax Incentives Act, making it easier for foreign investment to flow into the country
- consolidated many infrastructure projects from the previous administration as well as some new ones of its own and got many of them over the line, or close to the line, for implementation.

Continuity will be a feature of the Marcos Jr Administration's economic approach. Particularly the infrastructure projects, where Marcos Jr has said that he would like to "Build, Better, More," leveraging former President Duterte's "Build, Build, Build" programme.

The Philippines's growth prospects are bright, and projected to be the highest in the ASEAN+3 region

The economy grew 8.2% in the first quarter of this year. It is expected to grow by 6-6.5% this year and next. The government aims to undertake structural reforms and provide further opportunities that will have the economy grow by 8% from 2023 to 2028.

Renewable Energy

The Philippine Department of Energy conducted the first round of bidding for 2,000 MW of renewable capacity under the Green Energy Auction Program (GEAP) on 17 June 2022. There has been a steady increase in the share of renewable energy in recent years in the country, with solar now 5% and wind 2% of the installed capacity. Marcos Jr. has emphasised the importance of expanding the use and access to renewable energy in the Philippines.

Access in the Philippines

Businesses have noted that despite IPEF looking unlikely to result in any multilateral tariff reductions, they are optimistic that it could promote the resolution of certain non-tariff barriers (NTBs) they face in the market, such as the product registration and paper-based certification process, which if addressed would be of significant benefit. The government's ongoing push to further promote digitalisation and automation of government processes should also improve such processes in the market.

Accreditation for the Philippine Customs' "Green Lane" is resulting in positive experiences. Imports are automatically released and inspection is only done at the warehouse, significantly fast tracking customs clearance for imports.

Implications for New Zealand

There may be more opportunities for NZ Exporters as President Marcos Jr has vowed to ensure that food imports into the Philippines are not obstructed as part of his commitment to ensuring access to food for the people of the Philippines. The President's focus on renewable energy, improving bureaucratic efficiency should also continue to provide for NZ exporters in these areas.

This report is based on Philippine government official statistics, briefings and economic updates from ADB, World Bank Philippines, McKinsey & Company, and market insights from local banks (Banco de Oro and Bank of Philippine Islands).

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