

## **The Impact of China's New Normal on the Philippine Economy**

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### **Abstract**

Despite being an economically challenging time for China and the global economy, the period since 2012 has been one of high economic growth for the ASEAN countries as the Philippines and other East Asian economies are using their fiscal and monetary ammunition to stimulate their economies' domestic demand. The economic slowdown of China from 2012 to the present coincides with the period when the Philippines has been going into strong domestic demand generation and rebalancing to offset a weak external sector. However, given the fact that the bilateral trade of Philippines and China takes up not more than 5% of Philippine GDP, China's economic restructuring alone will most likely have a small to moderate impact on the Philippines' trade sector. Meanwhile, the weak global trade and the falling Chinese imports from East Asia have reduced the vertical trade integration of ASEAN+3 in the period after the global financial crisis. The obstacle to vertical trade integration in East Asia may not bode well for regional dynamism in the world of globalization. While the pivot of the Duterte administration towards China (away from the US) has resulted in a negotiated but still-to-be-realized package of US\$9 billion loans and US\$15 billion worth of investments over the next five years, the role of the PRC as a lender and investor in the Philippines will very potentially be more vital and crucial in the future. Any fall in China's capability to fulfill these loans and investments have the potential to change the course of growth and infrastructure in the Philippines.

**Keywords:** *Economic slowdown, bilateral trade, Philippines, China*

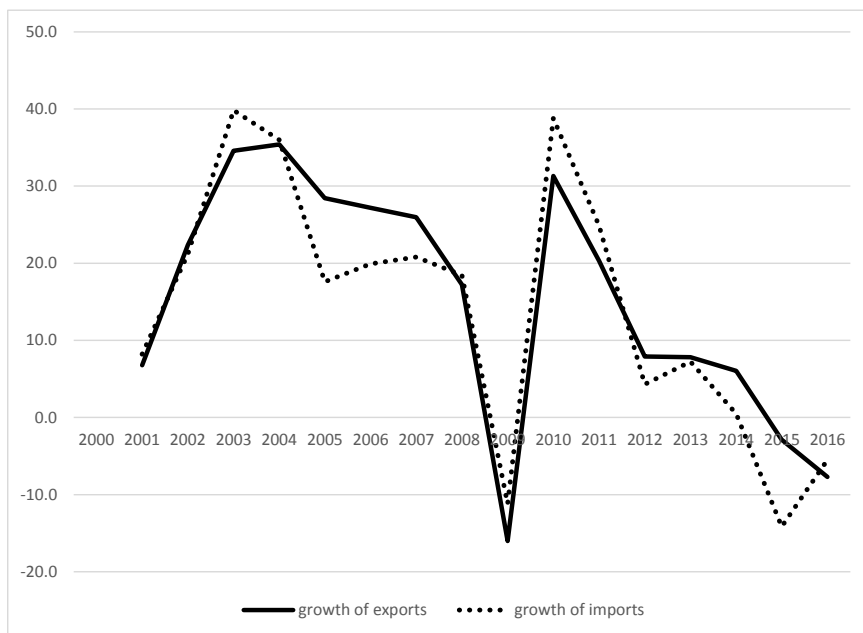
### **1. Introduction: China's Slowdown**

There have been serious concerns in the global markets, particularly the Asian regional markets, about the possible disorderly and damaging effects of a serious slowdown or hard landing of the economy of the People's Republic

of China (PRC). The slowdown in the Chinese economy was felt first in 2012 when the PRC’s GDP growth rate fell from almost 10% in 2011 to 7.7% in 2012. The growth rates in succeeding years did not improve and even fell further to 7.4% in 2013 and to 6.9% in 2015. The Chinese GDP growth rate fell further to 6.7% in 2016, but the authorities announced in mid-April 2017 a 6.9% growth rebound for the first and second quarters of 2017. The concern with China’s slowdown has concentrated much on the slowdown in the growth of the manufacturing sector, which has led to a significant fall in the growth of China’s imports. This affects exports of Asian countries, and more generally global exports. Throughout much of 2015 and 2016, global commodity prices, led by oil and gasoline, had fallen due partly to the slowdown in the large imports from China.

Figure 1 shows the rapid increase in the export and import growth rates of the PRC from 2000 to 2011, with the exception of 2001 (the global dot-com recession) and 2009 (the Global Financial Crisis, GFC). But both export and import growth increasingly declined during the period 2012 to 2016, with the growth rates going into negative territory in 2015-16. It must also be pointed out that Figure 1 shows that import growth declined faster than export growth in the 2012 to 2015 period. Imports fell by a whopping 14% between 2014

**Figure 1** Growth of Merchandise Exports and Merchandise Imports of PRC



Source: Calculated from ADB Key Indicators 2016. Data for 2016 was derived from CNBC 2017, based on Reuters.

and 2015. In 2016, initial reports from official data, and quoted by Reuters (CNBC, 2017) shows exports fell heavily by 7.7% and imports fell further by 5.5%, much smaller though compared to 2015<sup>1</sup>.

There are two opposing camps viewing the Chinese economic slowdown. The optimists see a soft landing as likely since China's problem is mainly an aggregate demand problem with export and investment demand cooling down and a need to switch to consumption spending. This also requires a shift from a more industrial economy to a service-based economy. The solution is made easier given that China still has a low GDP per capita compared to developed countries and has a lot of room to catch up in terms of stimulating domestic demand. This is true especially if they use more of fiscal stimulus than credit expansion (the latter has caused high debt problems in the past). Economists in this camp include former World Bank economist Justin Lin, Yale's Stephen Roach, Goldman Sachs' former chief economist Jim O'Neill and Nobel Laureates Joseph Stiglitz and Michael Spence.

On the other hand, the more pessimistic economists concentrate on the excess capacity of China's economy and the need for a supply-side solution. Excess capacity especially in favoured state-owned enterprises (SOEs) like steel and cement is a major problem and will lead to "zombie" firms with bad debts leading to possible major financial crisis. The PRC's pro-SOE stance, lack of privatization and lack of competitive market policies, coupled with the Chinese Communist Party's strong reliance on SOE revenues and lack of political will for major economic reforms, may lead to a hard landing or long-run stagnation with high financial defaults similar to the Japanese economy in the 1990s and 2000s. These economists include Keyu Jin, professor at the London School of Economics, Zhang Jun, Director of Fudan University's China Center for Economic Studies and Woo Wing Thy of the University of California, Davis<sup>2</sup>.

GDP growth of the PRC slowed further to 6.7% in 2016. This was far better than market expectations, and reduced global concerns on China in the second half of 2016. Initial estimate of China had the growth in the first semester of 2017 to be 6.9%, which further buoyed the market sentiments on China. The victory of Donald Trump as President of the United States in late 2016, his stated promise to impose 45% tariffs on Chinese imports, his insistence that China is practising unfair trade and manipulating its currency, his de-facto two China policy, and possible retaliatory and more confrontational stance by China in the South China Sea – all brought back global concerns on harmful economic and political relations between China and the US. But the cordial meeting concerning controversial trade issues between President Trump and President Xi Jinping in the first week of August 2016 allayed, temporarily at least, the strong fears of a trade war between the two economic giants and strong protectionist policies from the US.

It is the aim of this paper to find out the vulnerability of the Philippine economy to a continuous Chinese slowdown and cutback in China's imports, as well as volatilities caused by the Chinese economy. It also explores the impact on the Philippine economy in case China falls into a hard landing.

## **2. The Macro-economy of the Philippines in the 2000s: Stimulating Domestic Demand and Relying Less on Exports**

The traditional way to investigate the impact on the Philippines of China's slowdown is to assume that the most direct effect would be the effect on Philippine exports as China significantly reduces its imports. This section shows that this is not a major concern for the Philippines because the 2000s already saw Philippine exports and imports fall significantly as a percentage of GDP. The dwindling trade sector was due, first, to Philippine exports not doing as well as (or competing badly with) other East Asian exports. Second, the export share in the economy fell further due to the massive decline in global trade in the Global Financial Crisis (GFC) of 2008-2009, and very frail recoveries of the First World economies in 2011 to the present period. This is shown in Table 1.

The National Income Accounts show that Philippine exports of goods and services fell continuously (with only a few temporary upturn years) from 51.4% of GDP in 2000 to 27.5% of GDP in 2016. The sharp fall of exports during the GFC years of 2008 and 2009 is very obvious in Table 1. But the fall had been continuous since 2001. Imports behaved similarly, falling continuously from 53.4% of GDP in 2000 to 36.1% in 2016. The rise in imports from 33.5% in 2015 to 36.1% in 2016, in addition to the decline of exports from 28.2% in 2015 to 27.5% in 2016, has raised trade deficits to an almost alarming point of 8.6% of GDP. In this context, the continuing decline of Philippine exports to China and other countries is beginning to cause some worries. But overseas workers remittances are still relatively alright (though not as vibrant as before) and, as of now, still provide strong foreign exchange funds to support the trade deficit.

The slowing Chinese economy contributed to the falling global trade from 2012 to 2016, leading to the further decline in Philippine export share from 32.0% of GDP in 2011 to 27.5% in 2016. However, 2012 to 2016 is exactly the period when the Aquino government consciously and successfully stimulated the domestic demand of the economy through higher government investments and public expenditures, as well as sovereign credit upgrades awarded to the country for its improved macroeconomic fundamentals. These fundamentals consist mainly of a strong fiscal sector (with the imposition of excise [sin] taxes on cigarettes and alcohol), strong current account balances due to remittances of overseas Filipinos workers (OFWs),

**Table 1** Share of Components of Gross Domestic Product (GDP) and Gross National Income (GNI) – as % of GDP

<i>Item</i>	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
I. Household Final Consumption Expenditures	72.2	73.6	73.9	74.4	74.5	75.0	74.6	73.5	74.3	74.7	71.6	73.5	74.2	73.4	72.5	73.8	73.7
II. General Government Consumption Expenditures	11.4	11.1	10.6	10.2	9.4	9.0	9.2	9.3	8.8	9.9	9.7	9.7	10.8	10.8	10.5	11.0	11.2
III. Gross Domestic Capital Formation	18.4	22.1	24.5	23.0	21.6	21.6	18.0	17.3	19.3	16.6	20.5	20.5	18.2	20.0	20.5	20.6	23.6
A. Fixed Capital Formation	22.1	20.8	20.6	20.7	20.3	19.9	20.1	19.9	19.7	19.0	20.5	18.7	19.6	20.6	20.6	21.4	23.8
B. Changes in Inventories	-3.7	1.3	3.9	2.3	1.3	1.6	-2.1	-2.6	-0.4	-2.4	0.0	1.7	-1.4	-0.6	-0.1	-0.9	-0.2
IV. Net Exports	-2.0	-6.9	-8.9	-7.5	-5.5	-5.6	-1.8	-0.1	-2.5	-1.1	-1.8	-3.6	-3.3	-4.2	-3.6	-5.3	-8.5
A. Exports of Goods and Services	51.4	46.0	46.7	47.2	48.6	46.1	46.6	43.3	36.9	32.2	34.8	32.0	30.8	28.0	28.8	28.2	27.5
B. Less: Imports of Goods and Non-Factor Services	53.4	52.9	55.7	54.7	54.1	51.7	48.4	43.4	39.4	33.4	36.6	35.7	34.1	32.2	32.4	33.5	36.1
Expenditures on Gross Domestic Product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Net Primary Income	17.2	18.1	18.6	22.5	23.1	25.9	25.7	25.3	26.6	32.7	20.5	19.8	20.5	21.5	21.0	21.0	20.4
Expenditures on Gross National Income	117.2	118.1	118.6	122.5	123.1	125.9	125.7	125.3	126.6	132.7	120.5	119.8	120.5	121.5	121.0	121.0	120.4
Growth Rate of GDP	4.41	2.89	3.65	4.97	6.70	4.78	5.24	6.62	4.15	1.15	7.63	3.66	6.68	7.06	6.13	5.81	6.84

Source: Calculations by author based on original data from Bangko Sentral ng Pilipinas, <[www.bsp.gov.ph/](http://www.bsp.gov.ph/)>.

and an accommodative monetary policy with sound prudential measures. Table 1 shows further that despite trade deficits (with imports being larger than exports), the Philippine economy has been earning foreign exchange instead of depleting its foreign exchange despite significant trade deficits due to a large net primary income in the external current account. This is due to remittances of overseas Filipino workers who bring home overseas remittances of more than 20% of GDP<sup>3</sup>. Thus, the Philippines had been building up foreign exchange reserves in the 2000s despite trade deficits and a weak export performance. This mitigates the impact of export cutbacks due to a slowdown or decline in the imports of PRC.

It could be observed in Table 1 that fixed capital formation (including government investments) returned to more than 20% of GDP in 2010-2016 (reaching 23.6% in 2016 – the highest since 2002), and government expenditures went beyond 10% of GDP. During this period, the Philippines won a series of upgrades from the international rating agencies of S&P, Moody's and Fitch, with the Philippines reaching the minimum investment grade rating of BBB. The period of 2012-2016 have been years of high economic growth for the Philippines, with GDP growth rate ranging from 5.8% to 7.0% despite an unfriendly global environment. This high growth continued in the first semester of 2017 when Philippine GDP growth was around 6.5%. It had been achieved in other Southeast Asian economies such as Vietnam, Indonesia, Cambodia and Laos as well. In summary, on a macro perspective, the decline in the share of the trade sector in the Philippines has been more than compensated by the promotion and stimulation of domestic demand. Foreign exchange reserves remain strong despite trade deficits because of overseas workers' remittances.

### **3. Philippine Exports to China<sup>4</sup>**

#### ***3.1. Level and Composition of Philippine Exports to China***

Table 2a shows Philippine exports of goods as percent of GDP, including exports to PRC, Hong Kong and other countries. It shows that, as a percent of GDP, total exports of Philippine products made up 47% of GDP in 2000, and continuously declined to 18.4% of GDP in 2016.<sup>5</sup> This is consistent with the trend shown in Table 1. The table shows that, as a percentage of GDP, exports to PRC and Hong Kong increased to around 3.9% of GDP (with PRC increasing much faster and catching up with Hong Kong) in 2007. The GFC brought this down to less than 2% for both countries in 2009. The recovery thereafter never brought the exports of both countries back to the heights of the 2007 level. Exports to Hong Kong hovered below 2% of GDP (with a slight blip above 2% in 2015 and 2016) while exports to PRC improved to

**Table 2a** Total Value of Exports, Exports to PRC and Hong Kong, as % of GDP

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Total exports	47.00	42.16	43.28	43.18	43.43	40.02	38.79	33.79	28.27	22.81	25.80	21.55	20.83	20.85	21.82	19.65	18.36
Exports to HK and PRC	3.17	3.11	4.57	6.24	6.35	7.20	6.82	7.74	6.02	3.65	5.04	4.43	4.38	4.25	4.91	4.20	4.15
Exports to HK	2.35	2.07	2.90	3.69	3.44	3.24	3.03	3.89	2.87	1.91	2.17	1.65	1.91	1.67	1.94	2.14	2.15
Exports to PRC	0.82	1.04	1.67	2.56	2.90	3.96	3.79	3.85	3.15	1.74	2.87	2.78	2.47	2.58	2.98	2.06	2.02

**Table 2b** Total Exports: FOB Value in Million USD and Percent Share of PRC and HK

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Total Exports	38078	32150	35208	36231	39681	41255	47410	50466	49078	38436	51498	48305	52100	56698	62102	58827	55981
PRC and Hong Kong	6.75	7.38	10.55	14.46	14.61	17.98	17.58	22.89	21.31	15.99	19.54	20.58	21.01	20.40	22.51	21.36	22.67
PRC	1.74	2.47	3.85	5.92	6.69	9.88	9.76	11.39	11.14	7.63	11.12	12.91	11.84	12.39	13.63	10.50	10.98
Hong Kong	5.01	4.91	6.70	8.54	7.93	8.10	7.82	11.50	10.16	8.36	8.42	7.66	9.17	8.01	8.88	10.86	11.70

**Table 2c** Merchandise Exports from Japan, USA, PRC, HK, Taiwan 2016 (in USD Million, fob, in % of GDP and % share)

	Million USD	% of GDP	% Share
Total	55981	18.36	100.00
Japan	9488	3.11	16.95
USA	8602	2.82	15.37
HK	6548	2.15	11.70
PRC	6144	2.02	10.98
PRC+HK	12692	4.16	22.67
Taiwan	1121	0.37	2.00
Others	24078	7.90	43.01

Source: Philippine Statistical Authority.

below 3% until 2014, but fell back to 2% of GDP in 2015 and 2016 affected most likely by the slowdown of China's manufacturing imports. The export share of PRC is thus not a very large number for the Philippines (2% of GDP). The combined exports to PRC and Hong Kong sums up to only 4.2% of GDP in 2015 and 2016.

Table 2b shows the total Philippine exports of goods in fob million US dollars, and the percent share of the PRC and Hong Kong markets in total exports. From just 6.75% of the country share of exports (with PRC having less than 2% share) in 2000, the two economies combined climbed to more than 20% in less than 10 years. By 2016, the total amount of the two economies still hold more than 22% share of Philippine exports – around 11% for PRC and 11.7% for Hong Kong.

Table 2c shows that the top destination country for Philippine exports in 2016 is Japan with almost 17% of the export share, followed by the US with around 15.4% of the share. Hong Kong and China are almost tied in third place with each having an export share hovering around 11% in 2016. If we combine Hong Kong and China, the two economies will become the top export destination for the Philippines, taking up 22.7% of the total in 2016<sup>6</sup>.

Table 3 shows the composition of the exports of the Philippines to major countries in the first semester of 2016. It can be seen that the top export of the Philippines is electronic products. This cuts across exports to all countries, pointing to the lack of diversification in Philippine exports. The concentration on electronic exports is strongest in Singapore, Hong Kong and Germany, comprising more than 80% of the exports in the first semester of 2016.

**Table 3** Philippine Exports to Major Trading Partners by Top Five Commodities, First Semester, 2016

<i>Country/Commodity</i>	<i>Value</i>	<i>% Share</i>
<b>Japan</b>	<b>5,747.52</b>	<b>100.0</b>
Woodcraft and Furniture	1,528.63	26.6
Electronic Products	1,513.05	26.3
Machinery and Transport	484.12	8.4
Other Manufactured Goods	419.05	7.3
<b>United States of America</b>	<b>4,269.78</b>	<b>100.0</b>
Electronic Products	1,836.62	43.0
Ignition Wiring Sets and Other Wiring Sets Used in Vehicles	326.16	7.6
Machinery and Transport Equipment	295.11	6.9
Other Manufactured Goods	281.51	6.6



**Table 3** (continued)

<i>Country/Commodity</i>	<i>Value</i>	<i>% Share</i>
<b>Hong Kong</b>	<b>3,010.34</b>	<b>100.0</b>
Electronic Products	2,556.16	84.9
Gold	101.95	3.4
Other Manufactured Goods	59.99	2.0
Electronic Equipment and Parts	48.34	1.6
Fish, Fresh or Preserved	42.37	1.4
<b>People's Republic of China</b>	<b>2,701.61</b>	<b>100.0</b>
Electronic Products	1,629.06	60.3
Other Manufactured Goods	235.89	8.7
Other Mineral Products	170.12	6.3
Chemicals	112.59	4.2
Machinery and Transport Equipment	97.56	3.6
<b>Singapore</b>	<b>1,808.66</b>	<b>100.0</b>
Electronic Products	1,585.47	87.7
Petroleum Products	34.92	1.9
Electronic Equipment and Parts	29.84	1.6
Other Manufactured Goods	23.95	1.3
Woodcraft and Furniture	23.37	1.3
<b>Germany</b>	<b>1,129.21</b>	<b>100.0</b>
Electronic Products	925.04	81.9
Other Manufactured Goods	75.42	6.7
Articles of Apparel and Clothing	15.38	1.4
Machinery and Transport Equipment	13.12	1.2
Tuna	11.52	1.0
<b>Thailand</b>	<b>1,019.53</b>	<b>100.0</b>
Electronic Products	469.62	46.1
Other Manufactured Goods	145.31	14.3
Metal Components	124.42	12.2
Machinery and Transport Equip	83.50	8.2
Ignition Wiring Sets and Other Wiring Sets Used in Vehicles	47.73	4.7
<b>Republic of Korea</b>	<b>985.59</b>	<b>100.0</b>
Electronic Products	464.25	47.1
Other Manufactured Goods	97.98	9.9
Copper Concentrates	88.63	9.0
Bananas (Fresh)	47.70	4.8
Pineapple and Pineapple Products	42.27	4.3

Source: Philippine Statistical Authority

The concentration is less for China with electronics comprising 60% of the exports. The concentration is lower in the US, Thailand and South Korea with the share of electronics comprising from 40% to 50% of the exports. Exports to Japan is the least dependent on electronics as it comprised only 26% of the total in the first half of 2016.

Table 4 shows that the composition of the top exports to PRC changed significantly through the years. Semiconductor components and devices were the top exports and even grew in concentration from 2000 to 2008, comprising more than 70% of total exports to PRC. But this declined rapidly during the GFC to less than 30% by 2015 and 2016. What grew in terms of composition were electronic data processing products, other mineral products, chemicals, other manufactures, machinery and transport equipment, electronic equipment and parts and copper concentrates. All these changes seem to indicate shifts in the product patterns of trade integration between China and the Philippines. The rise of electronic data processing vis-à-vis semiconductor components may serve as a signal of China's upgrading into higher-tech products such as laptops, desktops and the like. The shift to other mineral products, chemicals, other manufactures, and machinery and transport equipment may point to shifts in trading from the global value chain system into more basic and consumer goods in the 2010s. This will be made clearer in the next section. But all in all, Table 4 still indicates that electronic exports – semi-conductors and electronic data processing combined – make up a much bigger share of exports to Hong Kong and China compared to other countries.

Table 5 shows that exports to Hong Kong are very concentrated to a few products. This is also true, but less so for PRC, compared to exports to other countries. The top 10 exports to Hong Kong make up 93% to 95% of total exports in 2014 and 2015, while the top 5 exports make up around 90% of total exports. For the Philippine exports to PRC, the top 10 make up close to 90% of total exports in recent years, and the top 5 make up around three-fourths of total exports. This compares with exports to other countries, where the top 10 exports make up three-fourths of the total, and the top 5 below 60%. The concentration of a few exports to Hong Kong and PRC seems to point to more exports in the global chain of electronic products where the Philippines provide intermediate inputs and capital goods, such as semiconductor components and electronic data processing devices. The concentration in the vertical trade integration of electronic products is much less with other export destination countries. Vertical trade integration and global value chains will be discussed in the next section.

Figure 2 shows the graph of the ratio of exports to PRC to GDP for key emerging markets in Asia (Deorukhar and Le, 2016). It can be seen that Taiwan, Korea, Malaysia, Vietnam and Thailand have large exports to PRC,

**Table 4** Philippine Exports to Hong Kong, China and Other Countries by Commodity Groupings: 2010 to 2016  
(Total in million US\$, Components in % of Total)

Year	2000	2005	2007	2008	2009	2010	2012	2013	2014	2015	2016
<b>Total Exports (in million US\$)</b>	<b>38078</b>	<b>41255</b>	<b>50466</b>	<b>49078</b>	<b>38436</b>	<b>51498</b>	<b>52100</b>	<b>56698</b>	<b>62102</b>	<b>58827</b>	<b>17363</b>
<b>Hong Kong (in million US\$)</b>	<b>1907</b>	<b>3341</b>	<b>5804</b>	<b>4987</b>	<b>3213</b>	<b>4336</b>	<b>4776</b>	<b>4541</b>	<b>5512</b>	<b>6391</b>	<b>1907</b>
Components/Devices (Semiconductors)	66.41	71.95	80.42	74.61	73.05	70.41	57.51	58.73	64.53	73.16	72.48
Electronic Data Processing	7.78	11.02	3.65	6.68	5.94	12.94	6.93	16.43	15.72	10.86	9.20
Machinery & Transport Equipment	0.41	0.80	0.53	0.54	0.84	0.64	0.81	1.83	5.02	2.56	1.41
Other Manufactures	2.18	1.76	3.54	1.48	2.19	2.74	5.69	5.90	2.41	2.22	2.00
<b>PRC (in million US\$)</b>	<b>663</b>	<b>4077</b>	<b>5750</b>	<b>5469</b>	<b>2934</b>	<b>5724</b>	<b>6169</b>	<b>7025</b>	<b>8467</b>	<b>6175</b>	<b>1672</b>
Components/Devices (Semiconductors)	39.77	59.90	67.04	72.17	52.87	44.94	40.66	25.40	21.71	29.45	26.60
Electronic Data Processing	9.45	25.02	10.18	10.73	14.10	25.45	18.91	20.61	22.31	21.41	32.13
Other Mineral Products	1.16	0.67	5.55	2.62	3.86	3.88	10.38	13.30	19.85	11.07	2.87
Chemicals	3.11	0.73	1.27	1.57	3.85	4.08	3.52	7.39	7.93	7.18	5.14
Other Manufactures	2.76	1.16	0.90	1.09	2.42	3.96	4.47	9.63	6.36	6.44	7.78
Machinery & Transport Equipment	0.82	0.73	0.85	0.83	1.49	1.03	2.46	1.89	2.39	2.68	3.78
Electronic Equipment & Parts	0.63	0.11	0.33	0.43	0.41	0.21	1.74	1.39	1.23	2.64	2.20
Copper Concentrates	0.70	0.00	0.14	0.12	2.39	2.02	0.84	0.88	0.05	2.62	2.83
<b>Other Countries (in million US\$)</b>	<b>35508</b>	<b>33837</b>	<b>38912</b>	<b>38621</b>	<b>32289</b>	<b>41437</b>	<b>41154</b>	<b>45131</b>	<b>48122</b>	<b>46262</b>	<b>13785</b>
Components/Devices (Semiconductors)	52.79	45.41	38.81	34.64	36.19	43.94	29.68	28.68	27.41	31.20	32.02
Machinery & Transport Equipment	1.30	4.03	3.31	3.79	4.31	4.12	6.63	4.15	7.47	7.82	7.37
Other Manufactures	1.37	3.11	3.68	4.35	4.44	4.72	8.78	10.08	9.34	7.47	6.92
Electronic Data Processing	13.30	12.16	11.98	11.12	13.40	8.37	3.74	5.10	6.34	6.50	6.86
Woodcrafts Furniture, Furniture	0.59	0.41	1.98	2.38	2.54	2.48	5.24	6.83	6.15	6.06	7.35
Ignition Wiring Sets	1.61	2.11	2.28	2.22	2.31	2.62	3.49	3.82	4.36	4.58	4.96
Articles of Apparel	4.10	4.06	3.92	3.51	3.34	2.69	3.33	3.33	3.75	3.06	2.54
Chemicals	0.57	1.04	2.14	2.41	2.21	2.79	3.44	4.61	3.12	2.86	2.87
Coconut Oil	1.27	1.94	1.85	2.58	1.78	2.83	2.46	2.13	2.46	2.41	1.79

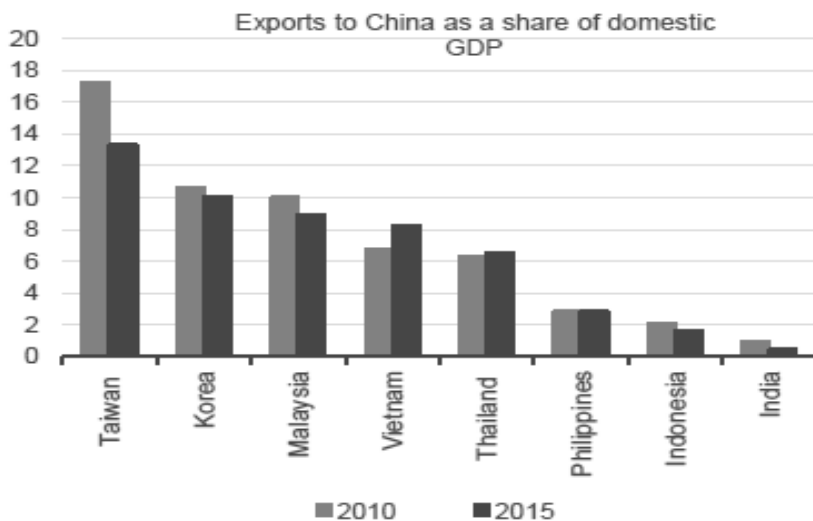
Note: FOB value in USD; 2016 data covers the reference months January to April only.

Source: Philippine Statistical Authority.

**Table 5** Concentration of Philippine Exports (% Share of Top 5, Top 10, Top 20 Exports)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
<b>Hong Kong</b>																	
Top 20	91.9	92.0	93.2	94.4	92.7	93.3	94.7	96.3	95.3	93.6	94.7	93.1	93.9	96.4	97.7	98.7	99.1
Top 10	85.0	83.6	87.5	90.7	87.9	89.2	90.8	93.8	92.6	89.7	91.4	88.2	86.2	89.9	93.0	95.3	95.1
Top 5	77.3	77.9	82.9	86.5	85.9	85.9	84.0	89.5	84.7	83.1	88.0	84.2	80.8	84.4	89.0	90.2	86.2
<b>PRC</b>																	
Top 20	83.4	82.6	82.4	88.1	90.9	93.8	93.8	95.5	94.1	93.6	93.3	94.3	95.8	95.4	96.0	96.3	96.4
Top 10	65.7	68.2	74.4	75.8	81.3	89.5	88.3	87.3	90.6	83.0	86.8	85.8	88.4	85.4	86.9	88.2	88.9
Top 5	56.2	61.0	70.0	72.8	79.1	87.5	85.5	85.0	88.2	77.1	82.3	81.6	78.0	76.3	78.2	75.6	74.5
<b>Other Countries</b>																	
Top 20	81.9	79.4	80.8	79.8	81.6	81.8	80.0	78.5	77.1	80.9	83.3	78.1	85.1	83.9	86.5	87.0	87.4
Top 10	77.6	74.1	76.2	74.6	75.8	75.4	72.9	71.0	68.3	71.8	76.2	70.3	70.7	71.7	72.8	74.3	74.8
Top 5	69.4	65.2	67.6	65.4	66.4	65.1	62.7	59.8	56.3	60.9	63.6	54.6	54.1	54.8	56.7	59.0	60.5

Source: Philippine Statistical Authority.

**Figure 2** Exports to China as Share of GDP

Source: BBVA Research, Haver Database.

from more than 6% of GDP for Thailand to a high 13% of GDP for Taiwan. The Philippines, Indonesia and India, on the other hand, have low exports to GDP ratios, at less than 3% of GDP in 2015. It can also be seen in Figure 2 that, compared to 2010, exports to China for most of the Asian countries have gone down. The main exceptions are Vietnam and Thailand, where exports to China (as shares of GDP) have gone up from 2010 to 2015.

In summary, PRC accounts for around 11% of Philippine exports in 2016, and Hong Kong for more than 11%. Thus, Philippine exports to PRC and Hong Kong comprise a significant share of Philippine exports (a combined sum of more than 20%). However, Philippine exports had not grown as large as the exports of other East Asian economies (measured as percent to GDP). Philippine exports to PRC and Hong Kong comprise only slightly more than 2% of GDP for each of the economies above. Therefore, the Philippines is not as vulnerable to a collapse in Chinese imports as other East Asian countries.

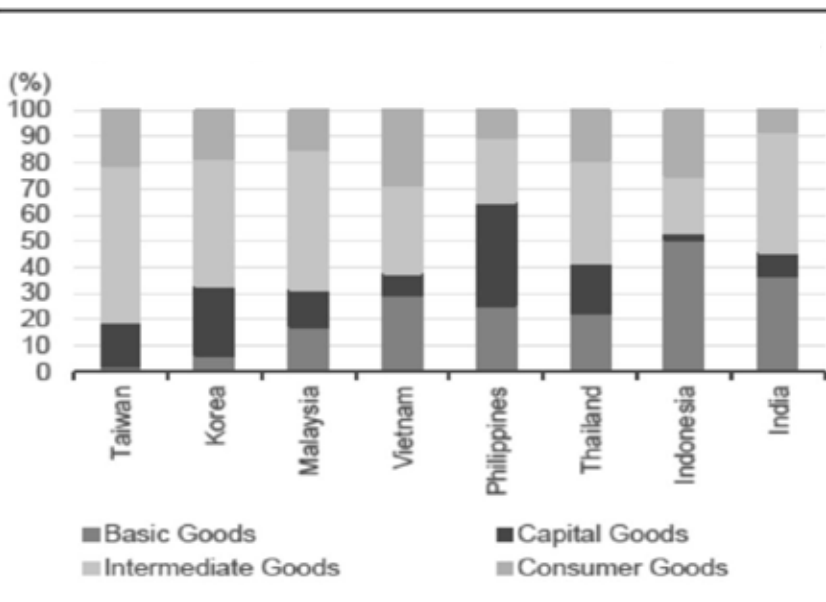
### ***3.2. Philippine Exports to China in the Context of ASEAN+3 Integration***

The 2000s saw a big rise in trade integration in ASEAN+3 (the 3 being China, Korea and Japan)<sup>7</sup>. The focal point of the integration was China, a major hub for the processing and assembly of East Asian intermediate products and

capital goods for export to developed economies. The dynamic exporting countries in East Asia also process and assemble intermediate inputs and capital goods derived from other East Asian countries as well. This global value chain has led to more integration within ASEAN+3 in the 2000s. Figure 3 shows the compositions of the exports of selected Asian countries to the PRC in 2014 (Deorukhar and Le, 2016). One can see that capital goods and intermediate products form a significant portion of the exports of the Asian economies to the PRC, comprising 50% or more of total exports (with the exception of Indonesia, whose exports were more on basic commodities and consumer goods).

Surprisingly, the Philippines (Figure 3) has the largest component of capital goods in the composition of its exports to PRC. We can explain this by pointing to Table 5 where we can see that some of the latest top exports of the Philippines to PRC are made up of electronic data processing, machinery and transport equipment and electronic and office equipment. Other major exports also include semiconductor components, other mineral products, chemicals and other manufactures, which make up much of the intermediate input components. It must be pointed out, however, that the capital goods component of Philippine exports is import-intensive, meaning the high-tech

**Figure 3** Composition of Exports to China as Share of Total Exports, 2014



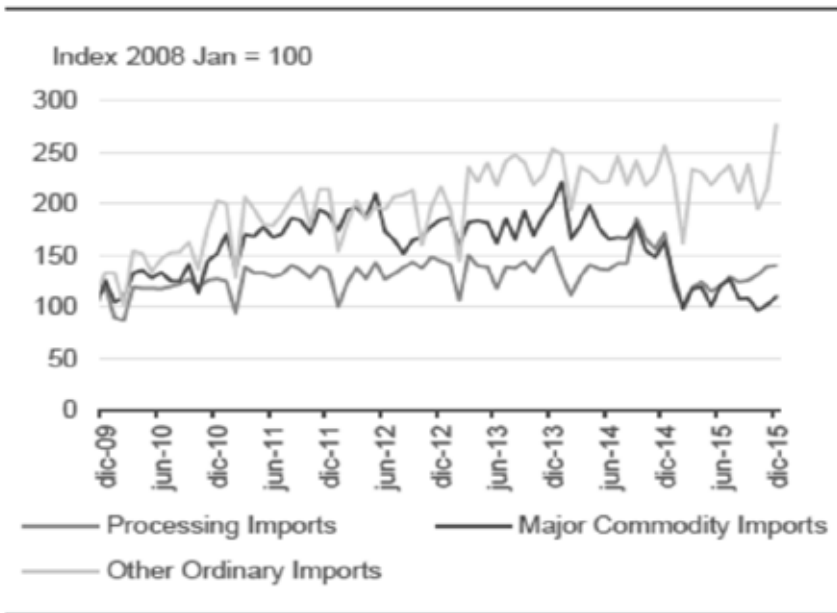
Source: BBVA Research, UNCTAD Database.

parts and intermediate inputs (such as microchips, integrated circuits) are mostly imported. This reduces the seemingly high-tech feature of Philippine exports to PRC, since the more high-tech components of the electronic products are not produced in the country.

The good days of vertical integration and global value chain in ASEAN+3 is being challenged in recent years due to weak global export demand from developed countries as well as China's structural transformation away from external demand towards domestic demand and from investments to consumption. Figure 4 shows the pattern of processing imports (imports of intermediate inputs and capital goods for further processing domestically), commodity imports and other imports (consumer goods and capital goods). It can be seen that 2014 saw the start of the sharp decline of commodity imports lasting all the way through 2015. Processing imports also started a significant decline especially in 2015. Thus falling commodity imports and processing imports from China translate into rather significant adverse impact on countries exporting commodity and intermediate inputs and capital goods to China, based on the global value chain system.

Inasmuch as the Philippines participated in the vertical integration and global value chain expansion of ASEAN+3 in the 2000s, the decline in

**Figure 4** Indices of China's Processing, Commodity and Other Imports

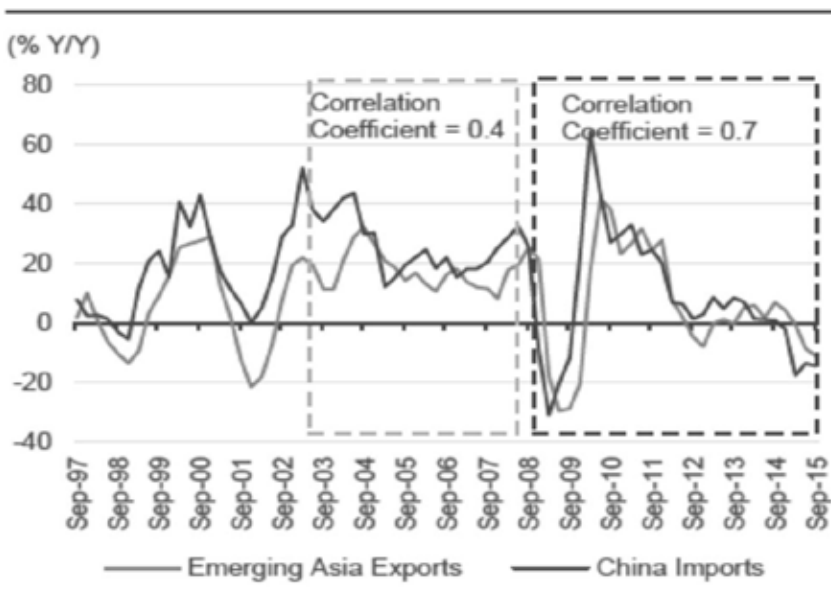


Source: BBVA Research, Haver Analytics.

the current trend of vertical integration might have a negative impact on Philippine exports. But inasmuch as the Philippines was not as successful as the other ASEAN countries in the vertical integration and global chain production process, the loss is not as big as in the other countries. Furthermore, we had seen in Tables 4 and 5 that Philippine exports to China and other countries had been overly dependent on electronic and semiconductor products which rely on cheap labour in the assembly process. These are the exports that are part of the vertical integration and global value chain. Would the loosening of vertical trade integration with China perhaps allow a more healthy diversification of Philippine exports in ASEAN+3 to include other products such as basic goods and other more value-added manufactures? This is an empirical research begging to be undertaken.

Figure 5 shows that the movement of China’s imports and emerging Asia’s exports had been more correlated since after the GFC – from the third quarter of 2009 to the present. The weaker conditions for global exports facing the Asian economies, including regional export demand (especially from PRC) had made movements of exports in the ASEAN+3 area more correlated (with less room for choices and alternatives in national exports and imports). This means that economies that strongly export to China with high domestic value-added content will be more adversely affected by a

**Figure 5** Correlation of China’s Imports and Emerging Asia Exports



Source: BBVA Research, Haver Analytics.



China slowdown or a China economic crash. The Philippines, as we explained earlier, is not so exposed to Chinese imports, and therefore will not be as affected as Taiwan, Korea, Malaysia, Vietnam and Thailand.

### ***3.3. Who will Benefit if China Abandons Labor-Intensive and Low- and Middle-Skilled Technology-Intensive Exports***

It is a known fact that China is losing some foreign investments due to its rising wages. At the same time, it is going up the technology ladder to higher-skilled and technology-intensive products. This will leave room for other Asian economies to take China's place in labour-intensive, resource-intensive manufactured exports and low-/middle-skilled and technology-intensive manufactured exports<sup>8</sup>. One simple way to look at this is to study the revealed comparative advantage (RCA) of exports which is the ratio of a particular product's share in a country's exports to the same product's world share in total world exports. If the ratio is more than 1, the country or economy is said to have a revealed comparative advantage in that product.

Table 6 shows the RCA for the different categories of products for China and selected East Asian economies. It can be seen that for labour-intensive, resource-intensive manufactures, the countries with RCA are Cambodia, Vietnam and Indonesia. And indeed these countries are already getting higher foreign investments in the last few years for the production of this type of product. The most notable among these countries is Vietnam. For low/medium-skilled technology-intensive manufactures, the country that is set on filling China's shoes is Thailand. Among the countries challenging China for the high-skilled technology-intensive manufactures, Malaysia, Singapore and the Philippines all have higher wages than China for high-skilled workers and so are less competitive than China. The Philippines in addition is burdened by having weak infrastructure and lagging technological development. Furthermore, Philippines production of high-skilled technology-intensive manufactures are highly import-intensive, where the high-tech and high-skilled components of the product are mostly imported rather than produced within the country (see section 4.) All in all, the countries most likely to benefit from China's "flying geese" departure from some export sectors will be mainly Vietnam – plus Cambodia and Indonesia – for the labour-intensive, resource-intensive manufactures. For the low/medium skilled technology-intensive manufactures, Thailand seems to be a front runner, but Vietnam, though it does not have an RCA in these products, is fast gaining ground in this territory because of foreign investments going into these sectors.

The Philippines with relatively high wages, inadequate and inefficient infrastructure, high import intensity and low technological development, unfortunately, as of now, seems unlikely to take over the products that

**Table 6** RCA Index on Manufactured Goods Based on Degree of Manufacturing, 2013

	<i>China</i>	<i>Cambodia</i>	<i>Indonesia</i>	<i>Malaysia</i>	<i>Philippines</i>	<i>Singapore</i>	<i>Thailand</i>	<i>Viet Nam</i>
Labour-intensive and resource-intensive manufactures	1.76	6.67	2.82	0.77	0.98	0.14	0.70	3.53
Low-skill and technology-intensive manufactures	1.07	0.43	0.81	0.50	0.44	0.45	0.76	0.73
Medium-skill and technology-intensive manufactures	0.71	0.08	0.73	0.57	0.74	0.58	1.17	0.41
High-skill and technology-intensive manufactures	0.98	0.07	0.68	1.56	1.36	1.77	1.02	0.74

Source: Mendoza et al. (2015), p. 15. Based on UNCTAD 2013 data.

China is imparting to other economies. The Philippines has to significantly improve in infrastructure and technology/productivity to compete well in the ASEAN+3 region.

#### **4. Philippine Imports from PRC and Hong Kong**

Even less affected by China's slowdown would be the imports of the Philippines from the PRC and Hong Kong. This is because it is unlikely that China will reduce its own exports to markets that actually demand them, unless there is total political and economic chaos and disorder. Furthermore, there will always be more alternatives open for the Philippines to access imports from other economies if imports from PRC are closed.

Table 7a shows that imports from China to the Philippines have grown continuously through the 2000s, from 1% of GDP in 2000, to almost 5% of GDP in 2016. This translates (Table 7b) to a rise from 2.4% of total imports coming from the PRC in 2000 to 18.5% in 2016. Hong Kong, on the other hand, had a share of 3.7% of total imports in 2000 that rose to around 4% before the GFC (especially in 2005 to 2007), but fell to around 2.5-3.0% in 2014-2016. This translates into only 0.6-0.8% of GDP in 2015-16. Thus for imports, the PRC dominates Hong Kong, with the two economies adding up to 19-21% of total imports in 2015-16.

China is the top country source of Philippine imports. This is clearly shown in Table 7c, where 18.5% of the country's total merchandise imports in 2016 came from China. A far second is Japan, providing only 11.8% of Philippine imports, with the US third with 8.9% of Philippine imports in 2016. The combined imports from China and Hong Kong comprise 21.4% of total imports in 2016. This is more than one-fifth of total imports. Thus, even if there is no problem presented by China's slowdown on Philippine imports from China, the availability and prices of these imports from China will have impact on the Philippine economy.

Table 8 shows that the composition of imports coming from China has shifted strongly from semi-conductor components/devices and electronic data processing – imported inputs to Philippine electronic exports – in the period before and during the GFC (mid-2000s to 2009) to consumer and intermediate manufactures, such as iron and steel, industrial machinery and equipment, mineral fuels and lubricants, metal products and transport equipment in 2010 to 2016. This points to the weak global and regional export demand after the GFC, and the Philippine rebalancing towards a higher share of domestic demand.

The still significant imports of semiconductor products and electronic data processing show that intermediate inputs for electronic exports are largely imported. Thus the RCA rating of the Philippines in Table 6 is disputable

**Table 7a** Total Value of Imports, Imports to PRC and Hong Kong, as % of GDP

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Total imports	45.67	45.81	50.51	50.74	50.46	48.01	44.25	38.83	34.80	27.23	29.29	28.60	26.33	24.18	24.14	24.97	26.62
Hong Kong & PRC	2.75	3.28	3.73	4.37	5.08	5.00	4.96	4.39	3.84	3.33	3.27	3.63	3.48	3.67	4.29	4.70	5.70
Hong Kong	1.67	1.87	2.07	2.04	2.00	1.96	1.80	1.56	1.21	0.92	0.78	0.72	0.62	0.50	0.61	0.65	0.79
PRC	1.08	1.41	1.66	2.32	3.08	3.04	3.17	2.83	2.63	2.41	2.48	2.91	2.86	3.16	3.68	4.05	4.92

**Table 7b** Imports: CIF Value in Million USD and Percent Share by Countries

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Total	37002	34939	41092	42576	46102	49487	54078	57996	60420	45878	58468	64097	65839	65739	68704	74750	81154
PRC & Hong Kong	6.02	7.15	7.39	8.6	10.07	10.42	11.22	11.31	11.03	12.22	11.15	12.7	13.23	15.17	17.78	18.82	21.43
PRC	2.37	3.07	3.29	4.58	6.11	6.33	7.16	7.3	7.55	8.85	8.47	10.19	10.87	13.08	15.24	16.23	18.47
Hong Kong	3.65	4.07	4.1	4.02	3.96	4.08	4.06	4.01	3.48	3.37	2.68	2.51	2.36	2.09	2.53	2.59	2.96

**Table 7c** Merchandise Imports from Japan, USA, PRC, HK, Taiwan 2016 (in USD Million, CIF, in % of GDP and % Share)

	Million USD, CIF	In % of GDP	% share
Total	81154	26.62	100.00
PRC + Hong Kong	17391	5.70	21.43
PRC	14990	4.92	18.47
Hong Kong	2401	0.79	2.96
Taiwan	5151	1.69	6.35
Japan	9540	3.13	11.76
USA	7216	2.37	8.89

Source: Philippine Statistical Authority.

**Table 8** Philippine Imports from Hong Kong, China and Other Countries by Commodity Groupings: 2000 to 2016  
(Total in million US\$, Components in % of Total)

Year	2000	2005	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
<b>Total Imports (in million US\$)</b>	<b>37002</b>	<b>49487</b>	<b>57996</b>	<b>60420</b>	<b>45878</b>	<b>58468</b>	<b>64097</b>	<b>65839</b>	<b>65739</b>	<b>68704</b>	<b>74750</b>	<b>26884</b>
<b>Hong Kong (in million US\$)</b>	<b>1351</b>	<b>2021</b>	<b>2326</b>	<b>2102</b>	<b>1548</b>	<b>1566</b>	<b>1608</b>	<b>1553</b>	<b>1373</b>	<b>1741</b>	<b>1934</b>	<b>776</b>
Components/Devices Semiconductors	21.42	22.14	21.71	19.42	20.86	29.13	30.26	28.93	27.07	26.45	25.13	23.62
Electronic Data Processing	5.30	31.52	31.65	33.76	30.46	24.99	17.29	7.77	7.03	8.82	12.62	9.77
Telecommunication	2.75	1.31	3.45	5.23	7.68	6.44	7.42	7.22	7.67	6.96	8.46	10.37
Transport Equipment	5.74	0.49	0.55	0.61	0.36	0.69	0.65	1.05	2.17	8.26	6.68	6.58
Industrial Machinery and Equipment	3.81	2.53	2.38	2.95	2.97	4.55	5.37	5.38	5.66	5.33	6.02	6.31
Communication Radar	2.69	1.22	1.08	1.27	0.92	1.71	5.33	5.63	9.48	7.47	5.17	6.22
Telecom Equipment and Elec. Machinery	2.80	3.28	2.94	3.29	2.50	3.06	2.81	3.66	4.26	3.83	4.64	5.75
<b>PRC (in million US\$)</b>	<b>875</b>	<b>3134</b>	<b>4233</b>	<b>4561</b>	<b>4060</b>	<b>4954</b>	<b>6533</b>	<b>7155</b>	<b>8597</b>	<b>10472</b>	<b>12131</b>	<b>4753</b>
Iron and Steel	3.81	7.40	8.43	8.55	2.50	6.12	6.35	5.33	6.22	9.45	15.76	12.68
Components/Devices Semiconductors	7.64	24.23	20.58	21.16	22.82	13.82	8.96	7.89	6.31	8.18	10.17	10.26
Industrial Machinery and Equipment	3.69	3.04	4.50	5.03	4.67	5.97	6.41	7.06	7.15	7.18	7.23	7.21
Mineral Fuels, Lubricants and Related Mat.	4.63	4.38	3.28	4.59	7.44	4.45	8.25	7.36	10.15	9.67	5.07	7.59
Metal Products	3.37	2.03	2.81	2.53	2.32	2.76	3.59	3.70	3.63	3.86	4.20	4.22
Transport Equipment	1.04	1.55	2.92	2.32	1.79	2.44	2.54	3.61	3.72	3.78	3.87	3.34
Non-metallic Mineral Manufactures	3.22	2.31	2.25	2.58	2.89	3.21	2.86	3.81	4.02	3.92	3.45	3.46
Telecommunication	0.59	3.09	4.25	5.14	7.42	5.70	4.97	7.54	5.09	3.92	3.33	6.83
Miscellaneous Manufactures	3.50	1.70	1.82	1.85	2.11	2.89	3.78	3.48	3.67	4.15	3.29	3.18
Telecom Equipment and Elec. Machinery	2.88	3.82	3.12	2.59	2.64	3.37	3.24	3.28	3.26	3.46	3.01	2.59
Electronic Data Processing	2.79	9.59	6.72	6.50	7.75	9.19	5.30	4.98	3.49	3.48	3.00	3.36
<b>Other Countries (in million US\$)</b>	<b>875</b>	<b>3134</b>	<b>4233</b>	<b>4561</b>	<b>4060</b>	<b>4954</b>	<b>6533</b>	<b>7155</b>	<b>8597</b>	<b>10472</b>	<b>12131</b>	<b>4753</b>
Components/Devices Semiconductors	34.06	38.89	36.93	28.00	26.41	27.27	24.46	20.85	20.56	19.00	24.11	20.93
Mineral Fuels, Lubricants and Related Mat.	11.58	14.41	18.94	23.42	18.26	18.63	22.08	23.77	22.70	22.18	14.93	10.41
Transport Equipment	2.83	3.15	4.66	5.11	5.74	6.83	5.95	8.38	10.98	10.52	9.73	11.67
Industrial Machinery and Equipment	5.73	3.91	3.88	4.07	4.08	4.50	4.77	4.98	4.87	4.61	5.60	7.04
Other Food and Live Animals	1.77	1.57	1.63	1.93	2.42	2.80	2.65	2.74	3.03	3.81	4.11	4.27

Note: CIF value in USD; 2016 data covers the reference months January to April only.

Source: Philippine Statistical Authority.

since its RCA in highly-skilled, technology-intensive electronic products is mainly assembly and processing of high-tech micro-chips and sophisticated integrated circuits. The product may be rated as high-skilled and technology-intensive. But if the technology and sophisticated inputs are all imported, and simple assembly and processing are the value-added of the Philippines, the economy does not really have an RCA for a high-tech product.

Table 9 shows that Philippine imports from China are less dependent on electronic products compared to other top source countries like the US, Thailand, Singapore, Korea and Taiwan. Imports from Japan are also no longer too reliant on electronic products.

We have discussed early on that the Philippine trade on goods is traditionally in deficit, meaning that net exports (exports less imports) are usually negative overall for most years. One question is: what is the trade balance with the PRC and with Hong Kong? Table 10 shows that the Philippines has a strong trade surplus with Hong Kong, with exports going to Hong Kong far higher than imports coming from Hong Kong. This trend has been growing in the recent years. However, it is China that is more interesting. From small trade deficits with China, the Philippines started to have significant trade surplus with PRC from 2005-2008, the height of vertical trade integration and global value chains in ASEAN+3. The post-GFC

**Table 9** Philippine Imports to Major Trading Partners by Top Five Commodities: First Semester, 2016

(CIF: Value in Million US Dollars)

<i>Country/Commodity</i>	<i>Value</i>	<i>% Share</i>
<b>People's Republic of China</b>	<b>7,114.38</b>	<b>100.0</b>
Electronic Products	1,639.11	23.0
Iron and Steel	1,047.27	14.7
Mineral Fuels, Lubricants and Related Materials	537.25	7.6
Industrial Machinery and Equipment	521.36	7.3
Miscellaneous Manufactured Articles	410.92	5.8
<b>Japan</b>	<b>4,477.19</b>	<b>100.0</b>
Electronic Products	1,310.73	29.3
Industrial Machinery and Equipment	698.64	15.6
Transport Equipment	686.97	15.3
Telecommunication Equipment and Electrical Machinery	277.41	6.2
Iron and Steel	199.21	4.4

**Table 9** (continued)

<i>Country/Commodity</i>	<i>Value</i>	<i>% Share</i>
<b>United States of America</b>	<b>3,356.69</b>	<b>100.0</b>
Electronic Products	1,381.10	41.1
Feeding Stuff for Animals (Not Including Unmilled Cereals)	354.09	10.5
Cereals and Cereal Preparations	202.37	6.0
Industrial Machinery and Equipment	176.22	5.2
Other Food and Live Animals	165.48	4.9
<b>Thailand</b>	<b>3,207.89</b>	<b>100.0</b>
Transport Equipment	1,279.05	39.9
Electronic Products	527.04	16.4
Other Food and Live Animals	181.28	5.7
Industrial Machinery and Equipment	179.15	5.6
Plastics in Primary and Non-Primary Forms	145.94	4.5
<b>Singapore</b>	<b>2,564.26</b>	<b>100.0</b>
Electronic Products	1,177.98	45.9
Mineral Fuels, Lubricants and Related Materials	294.56	11.5
Other Food and Live Animals	172.46	6.7
Industrial Machinery and Equipment	144.39	5.6
Plastics in Primary and Non-Primary Forms	125.80	4.9
<b>Republic of Korea</b>	<b>2,549.81</b>	<b>100.0</b>
Electronic Products	908.34	35.6
Mineral Fuels, Lubricants and Related Materials	418.95	16.4
Transport Equipment	237.91	9.3
Industrial Machinery and Equipment	176.10	6.9
Textile Yarn, Fabrics, Made-up Articles and Related Products	86.51	3.4
<b>Taiwan</b>	<b>2,538.05</b>	<b>100.0</b>
Electronic Products	1,472.70	58.0
Mineral Fuels, Lubricants and Related Materials	244.87	9.6
Industrial Machinery and Equipment	135.20	5.3
Iron and Steel	98.43	3.9
Plastics in Primary and Non-Primary Forms	63.07	2.5

Source: Philippine Statistical Authority.

**Table 10** Philippine Net Exports as % of GDP: Total and PRC & Hong Kong, and Other Countries, 2000-2016

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Net Exports	1.33	-3.66	-7.23	-7.56	-7.03	-7.99	-5.46	-5.04	-6.53	-4.42	-3.49	-7.05	-5.49	-3.32	-2.32	-5.32	-8.26
HK and PRC	0.42	-0.16	0.83	1.88	1.26	2.19	1.86	3.34	2.19	0.32	1.77	0.80	0.89	0.59	0.62	-0.50	-1.54
Hong Kong	0.69	0.20	0.83	1.65	1.44	1.28	1.23	2.33	1.66	0.99	1.39	0.93	1.29	1.17	1.32	1.49	1.36
PRC	-0.26	-0.37	0.00	0.23	-0.18	0.91	0.62	1.02	0.52	-0.67	0.39	-0.13	-0.39	-0.58	-0.70	-1.99	-2.90
Other countries	0.90	-3.49	-8.06	-9.44	-8.29	-10.18	-7.31	-8.39	-8.72	-4.74	-5.27	-7.85	-6.39	-3.91	-2.94	-4.82	-6.71

Source: Calculated from Bangko Sentral ng Pilipinas and Philippine Statistical Authority.



period saw trade deficits with China returning in 2011 up to the present. As intermediate exports waned and Chinese domestic demand oriented imports (manufactured and consumer goods) increased, trade deficits rose, reaching its peak in the most recent period. In 2016, trade deficits with the PRC reached 2.9% of GDP. The trade deficit with China has drastically increased from 2014, when it was just 0.7% of GDP. Again this is a sign of the waning of vertical trade integration and global value chains in East Asia as developed markets' exports remain in the doldrums, while Asian economies rebalance towards domestic demand. It must be pointed out that the trade deficit with China of 2.9% of GDP is a significant portion of the huge trade deficit of the Philippines in 2016, which is 8.3% of GDP. As was discussed earlier, this large deficit is being cushioned by strong international reserves due to overseas workers' remittances.

## **6. Chinese Investments in the Philippines and Chinese Loans to the Philippines: Major Prospects in the Future**

Table 11 gives us the list of approved foreign investments for the Philippines in 2015 and 2016. One can see that China is not a big foreign investor of the Philippines at present. For 2015 and 2016 combined, the approved foreign investment of China is less than US\$3 billion, or a minute 0.6% of the total approved foreign investment for the two years. Hong Kong comprised slightly more, or around US\$3.5 billion for the two years, making up 0.8% of the total approved foreign investments to the Philippines for 2015 and 2016. Hong Kong and China combined provided around US\$6.5 billion, or only 1.4% of total approved foreign investment for 2015 and 2016. This compares very badly with the top foreign investors in the country such as the Netherlands, Japan and the US, which provided 28.5%, 17.6% and 11.5%, respectively, of total approved foreign investments in 2015 and 2016. It seems the Philippines is not a top area of investment for PRC. Especially under the Aquino Administration (2011-2015), territorial disputes in the South China Sea between the Philippines and China had reduced investment, loans and official development assistance from China.

Table 12 shows the breakdowns of external debt in the Philippines from 2005 to 2016. As can be seen from the table, in 2015, China lagged far behind top bilateral lenders to the country, led by Japan, which owns close to one-third of the total bilateral external debt of the Philippines. In 2015 and 2016, the other top lenders to the Philippines ahead of China are the United Kingdom, US, Germany and France. China's loans to the Philippines, as of end-June 2016, supported some infrastructure projects: power generation (US\$403 million), ports development (US\$124 million), water supply (US\$108 million) and irrigation (US\$76 billion).<sup>9</sup> The low performance of

**Table 11** Total Approved Foreign Investments by Country of Investor, 2015 to 2016 (in million pesos)

<i>Country</i>	<i>Approved Foreign Investment</i>		<i>Total 2015 &amp; 2016</i>	<i>% to Total</i>	<i>Growth 2015- 2016</i>
	<i>2015</i>	<i>2016</i>			
Total	245,215.7	219,038.6	464,254.3	100.0	(10.7)
Netherlands	82,726.6	49,445.9	132,172.5	28.5	(40.2)
Japan	54,711.1	27,058.7	81,769.9	17.6	(50.5)
USA	21,740.6	31,427.8	53,168.3	11.5	44.6
Singapore	16,817.2	24,056.0	40,873.2	8.8	43.0
South Korea	23,165.6	16,134.5	39,300.1	8.5	(30.4)
Australia	538.3	32,439.8	32,978.1	7.1	5,926.7
Others	12,817.0	8,625.9	21,442.9	4.6	(32.7)
British Virgin Islands	5,625.7	4,520.6	10,146.2	2.2	(19.6)
UK	4,129.2	4,733.9	8,863.1	1.9	14.6
Cayman Islands	4,428.6	3,656.4	8,084.9	1.7	(17.4)
Germany	3,064.7	4,904.6	7,969.3	1.7	60.0
Taiwan	5,457.7	1,608.4	7,066.1	1.5	(70.5)
Malaysia	2,904.3	1,084.5	3,988.8	0.9	(62.7)
Hongkong	2,134.1	1,401.2	3,535.3	0.8	(34.3)
India	1,760.5	1,595.6	3,356.2	0.7	(9.4)
Thailand	448.9	2,567.2	3,016.1	0.6	471.9
China (PROC)	1,455.1	1,519.4	2,974.4	0.6	4.4
Canada	329.7	1,395.6	1,725.2	0.4	323.3
Switzerland	918.6	412.0	1,330.6	0.3	(55.2)
France	21.5	444.3	465.8	0.1	1,970.4
Denmark	20.8	6.4	27.1	0.0	(69.4)

Source: Philippine Statistical Authority.

**Table 12** Philippines: Total External Debt by Country Profile (US\$ million, end of period)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
By Source	61,555	61,372	66,508	65,228	64,738	73,594	75,569	79,949	78,489	77,674	77,474	74,763
Country	35,399	33,567	38,109	37,145	32,605	38,735	39,905	43,062	43,454	42,003	42,702	40,862
of which:												
USA	4,478	3,376	3,149	3,977	2,220	2,865	3,884	5,116	4,719	4,569	3,631	3,499
Japan	12,787	11,978	16,348	17,969	16,002	17,016	16,472	15,421	13,401	11,686	12,296	12,134
UK	1,408	585	711	816	730	2,031	1,691	2,616	4,774	4,784	4,217	4,098
France	2,460	3,374	3,639	827	842	1,220	1,244	1,184	1,394	1,096	1,042	1,141
Germany	3,625	4,376	3,665	3,265	2,396	2,772	2,015	2,088	1,566	1,560	1,837	1,584
PRC	305	318	371	470	432	866	1,480	1,611	1,745	1,989	1,108	949*
Multilateral Agencies	7,516	7,299	7,891	9,082	10,939	10,908	11,581	11,698	10,366	10,663	11,783	11,971
Bondholders/Noteholders	18,640	20,507	20,508	19,000	21,195	23,951	24,084	25,190	24,669	25,008	22,989	21,930

Note: \* PRC data for 2016 is for Jan-June only.

Source: Bangko Sentral ng Pilipinas.

Chinese ODA and state banks loans to the Philippines no doubt is related to the Philippines' territorial disputes with China.

Furthermore, Chinese ODA and loans had become controversial because the money had gone into projects tainted with corruption. The most notorious is the ZTE-NBN (National Broadband Network) project where then Philippine President Gloria Arroyo and her husband were implicated in receiving bribe money from Chinese company ZTE to win a bid for setting up the national government broadband network in 2007-2008. The deal awarded to ZTE was cancelled after a political outcry against Arroyo shook the government (Landingin, 2010).

But the biggest victim is the North Luzon Railway (Northrail) project funded by the Export-Import Bank of China with a US\$900 million loan. After releasing the first tranche of US\$400 million, China Ex-Im Bank asked for the immediate payment of the disbursed portion of US\$185 million and cancelled the first tranche loan. This was in the midst of a strong dispute between China and the Philippines over islands in a section of the South China Sea (the disputed area is called the West Philippine Sea) and charges of corruption on the Philippine side in terms of right-of-way and relocation of those affected by the railway project. The entire Northrail loan was abrogated<sup>10</sup> and the forthcoming Southrail loan also cancelled in 2010. Thus ODA projects with China have been jeopardized by the political tension between the two countries, and charges of corruption (Landingin, 2010).

As a result of the above, China did not become a significant ODA funder and lender to the Philippines. Thus, it was not just a Chinese slowdown that was affecting the access to Chinese funds and the Asian Infrastructure Investment Bank (AIIB) in 2015-16. The Philippines was one of the last to sign up as a partner member of AIIB in December 2015, because of its political problems with China.

The new President of the Philippines Rodrigo Duterte has announced a more accommodative stance on the Philippine-China territorial dispute and expressed the wish that China would fund his ambitious national railway program. This occurred despite the recent ruling on 11 July 2016 from the Hague in favour of the Philippines' claim of China's infringement on the sovereignty of the Philippines in the South China Sea.

In September 2016, President Duterte made a historic visit to China and announced the China pivot – the Philippine's turn towards China as a major economic partner and away from the US (due to the latter's criticism of human rights abuses and extrajudicial killings in the drug war program of Duterte). This resulted in a US\$24 billion investment and loan package deal consisting of US\$9 billion of soft loans – US\$6 billion from the PRC government as ODA and US\$3 billion as a credit line from the Bank of China. The US\$15 billion investments from PRC will go partly to projects outlined

in the preliminary agreements, including projects involving railways, ports, energy, mining and agriculture. The US\$24 billion package will cover a period of five years (Remo, 2016).

Following the China pivot by the Duterte administration, the Asian Infrastructure Investment Bank (AIIB) established by the PRC and of which the Philippines is a co-founder, has agreed to fund the P23.46 billion Metro Manila flood control program, and the P37.7 billion bus rapid transit (BRT) system along the major highway of Metro Manila (De la Paz, 2016). If all these come to fruition, China will be the biggest investor and lender to the Philippines in the next five years (i.e. for the whole term of President Duterte). A China slowdown and hard landing on China which reduces its capacity to fulfil these loans and investments may entail very major opportunity costs to the Philippines. If, on the other hand, the loans and investments will be implemented, strong mutually agreed-upon regulations against corruption and inadequate implementation which had plagued past Chinese-funded investments and loans will have to be instituted.

There are some Filipinos who expressed concern that the large loans will make the Philippines highly and dangerously indebted to China. This of course depends on the effects of these debts on the fiscal deficit and foreign debt to GDP ratio. Given that the debts are long-term, the danger is in the long-run – if the Philippines does not translate the projects into foreign exchange and fiscal earning achievements.

## **7. Hong Kong, Taiwan and China as Sources of Overseas Filipino Workers' (OFW) Remittances**

The Philippines has an economy that is very dependent on its overseas workers' remittances. As discussed earlier, the remittances provide a very strong cushion and buffer offsetting the depletion of foreign exchange reserves due to high trade deficits. OFW remittances make up more than 20% of the country's Gross National Income, further comprising a major source of Philippine consumption expenditure. Thus a stop to the employment of overseas Filipinos will have a major impact on the economy. Table 13 shows the major countries on which Filipino overseas incomes depend. The biggest remittances come from the Americas (mainly the US and Canada, comprising 36.2% of total remittances in 2016), and the Middle East (comprising 28.1% of total remittances in 2016). Asia is providing the third largest source of remittances, increasing its share to 18.3% of the total remittances by 2016. Hong Kong and Taiwan are major employers of overseas Filipino workers. But the combined remittances from Hong Kong (2.8% of the total), Taiwan (1.2%) and the PRC make up only 4.6% of the total remittances for 2016, with China providing only 0.6% in 2016. Thus, a decline in the economies of

**Table 13** Philippines: Overseas Filipinos' Cash Remittances by Country and Region (thousand US\$)

	2012	2013	2014	2015	2016
Total	21,391,333	22,984,035	24,628,058	25,606,830	26,899,840
ASIA	13.8	14.5	17.9	17.9	18.3
China (Mainland)	0.4	0.4	0.1	0.2	0.6
Hong Kong	2.0	2.4	3.7	3.6	2.8
Korea	0.8	0.8	0.7	0.9	0.8
Japan	4.7	3.9	5.8	4.8	5.1
Malaysia	0.8	1.2	0.8	1.3	1.2
Singapore	4.0	4.6	5.7	5.9	6.2
Taiwan	0.8	0.9	0.9	0.9	1.2
Americas	52.3	47.4	35.5	36.6	36.2
Europe	16.0	17.2	16.9	16.2	14.1
Middle East	16.2	18.9	26.8	26.2	28.1

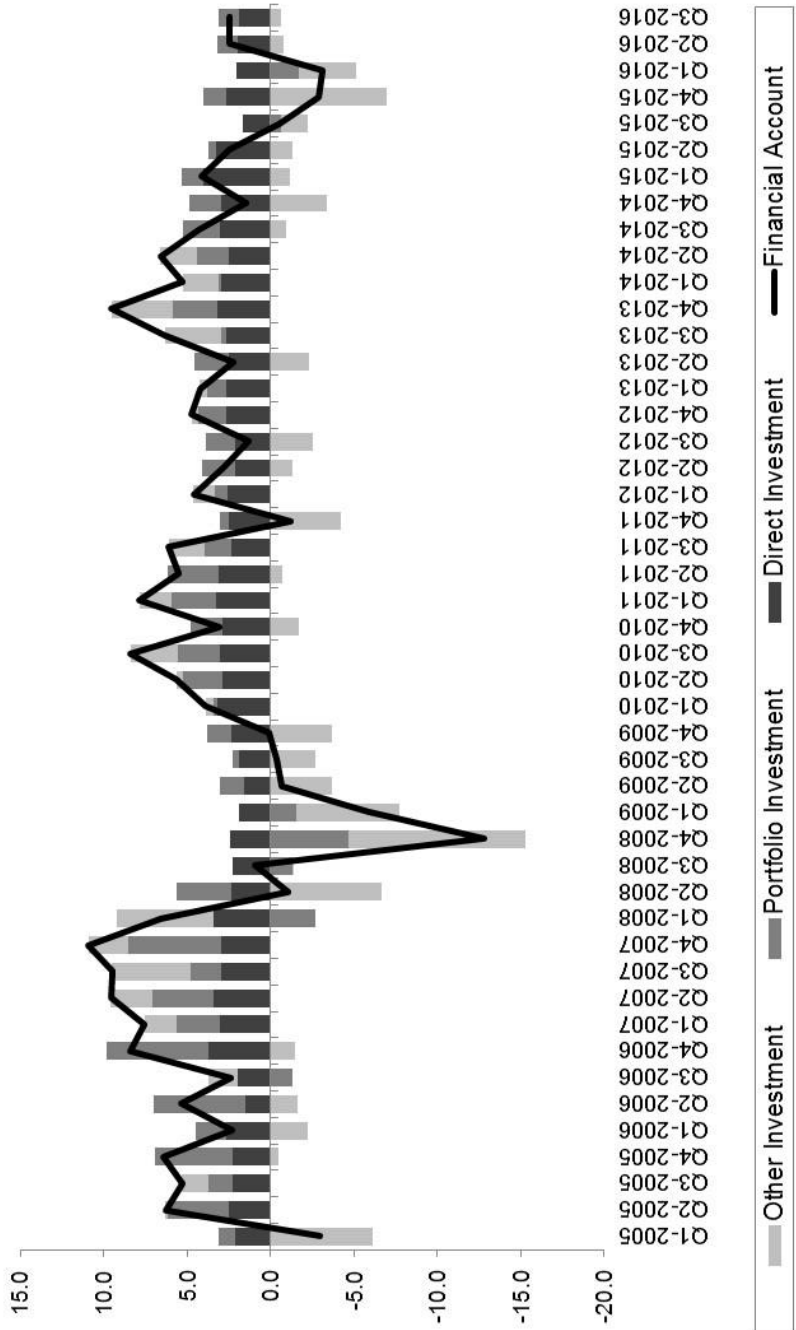
Source: Data are based on bank reports submitted to the Bangko Sentral ng Pilipinas.

Hong Kong, Taiwan and PRC will not cause a major decline in the Philippine economy, although many Filipino families will be affected. More than US\$1.3 billion of overseas workers' remittances would have been jeopardized in 2016 if the entire Hong Kong-Taiwan-PRC set of economies had been shut to overseas Filipino workers.

## 8. Transmission of China Economic Woes to the Philippine Economy via Global Financial Markets

Based on the experience in 2015, a volatile and unpredictable impact of the slowdown of China is the strong volatilities and declines in the global financial markets. The world was rocked by the China slowdown throughout 2015, especially its attempt to widen its currency band in the third and fourth quarters of 2015. This brought massive foreign capital outflow from emerging markets, especially in East Asia. ASEAN+3 was hard-hit. Figure 6 shows that in ASEAN+3 as a whole net financial flows (as percentage of GDP) from foreigners went into negative territory in the third and fourth quarters of 2015 and first quarter of 2016, when China rattled the financial markets (simultaneous with global fears of prospective increases in the US Federal interest rate). Such significant negative flows of foreign capital for ASEAN+3 only happened during the GFC in 2008-9. The negative flows in late 2015 were not as deep as in the GFC, but can get worse if the China problem worsens. The experience in 2008-9 showed massive outflows of foreign funds from emerging markets causing sharp depreciations and losses in

**Figure 6** Non-resident Flows – ASEAN+3 (% of GDP)



Notes: Break in comparability of data for PHI (2005), BRU (2010) and MAL (2010). For Malaysia, this effectively discounted “other investments” in its assets and liabilities breakdown.

1. For consistency of charts, net of “other investment” corresponds to resident inflow for Malaysia starting 2010.
  2. In the case of Lao PDR, net of direct, portfolio and other investments corresponds to “non-resident inflows” direct, portfolio and other investments starting 2014.
  3. ASEAN+3 excludes CAM starting Q12015; BRU and VIE for Q12016; LAO and MYA for Q32016; PRC and HKG for Q42016.
- Source: *Balance of Payments Statistics*, International Monetary Fund.

foreign reserves. Korea ran into trouble then and had to go to currency swaps with the US, Japan and PRC. The stock market collapse also triggered wide losses of confidence in the economies and hits investments and consumption hard, leading to recessionary tendencies. Foreign flows in the stock market is captured in Figure 6 mainly by portfolio investments, or foreign flows into stocks and bonds. Note that in Figure 6, the foreign inflows out of ASEAN+3 from the third quarter of 2015 to the first quarter of 2016 (the most volatile period caused by worries over China) were mainly in the form of other investments and portfolio investments. Volatilities in portfolio investments represent much of the gyrations in the stock (and bond) markets. Other investments represent the gyrations on foreign loans (especially short-term foreign debts) and foreign currency deposits that flow out during perceived “bad” times.

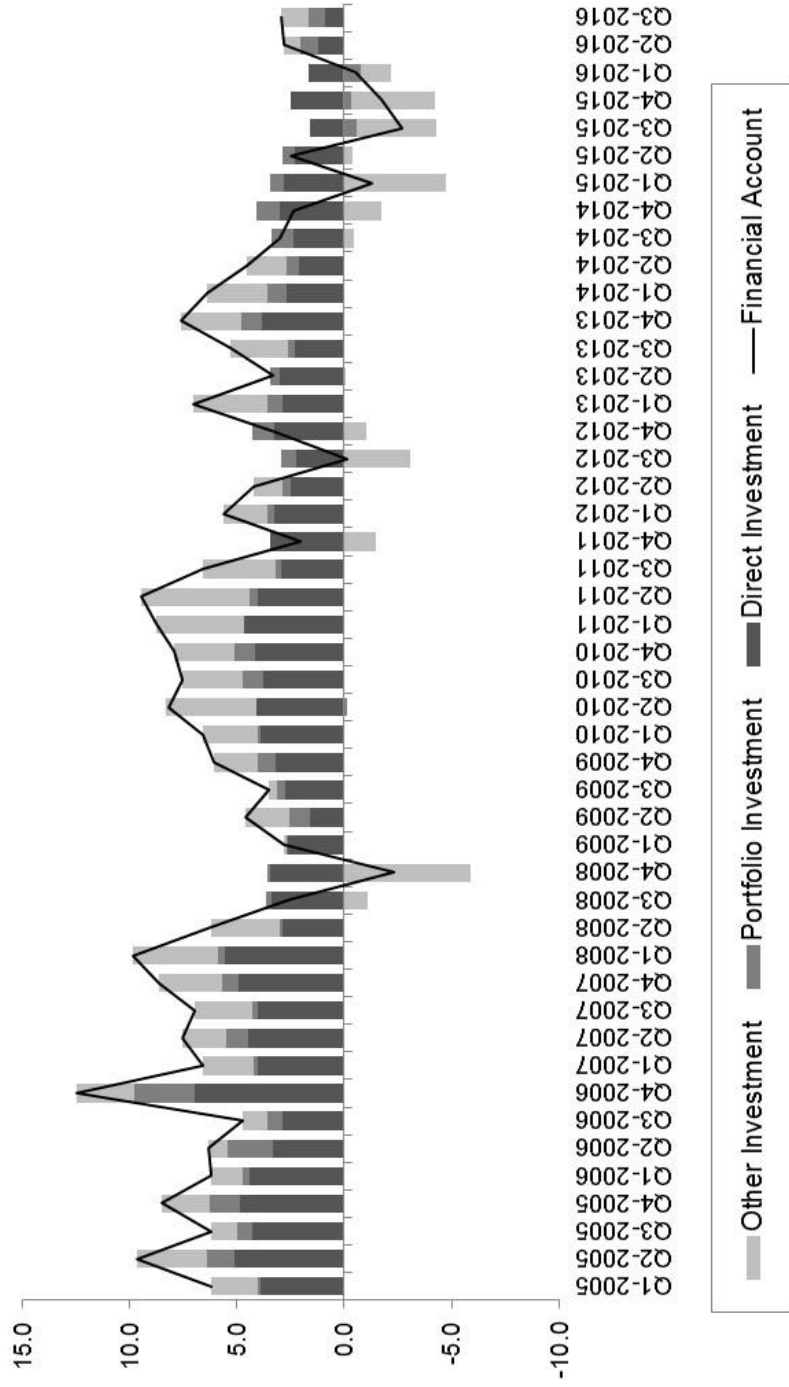
Thus the China problem can be a serious problem if it becomes a global and regional financial market problem, triggering losses of confidence and panics, as in 2008-9. This can only happen if China goes into a very hard landing such as a sharp recession and/or financial default/currency crises.

Figures 7a and Figure 7b show the international financial flows in and out of China itself. Figure 7a shows the net foreign (non-resident) inflows (foreign inflows less foreign outflows) into China. One can see from Figure 7a that the net foreign outflows out of China started much earlier in 2015, and in the third and fourth quarter of 2015, was bigger than the net outflows during the GFC. Of course these outflows were manageable because the capital account of China was still controlled and not liberalized. Figure 7b shows the net international financial flows in and out of China. It includes the foreign (non-resident) net flows plus the Chinese residents’ net flows. One can see in Figure 7b that Chinese residents significantly brought capital out of the country starting 2014, peaking at the third and fourth quarter of 2015. This made net financial flows go into very highly negative territory. Aggravating this is the large gap between the recorded flows and “errors and omissions”, bringing up the suspicion that much of the outflow may be “capital flight” by Chinese residents. The large net financial outflows (peaking at 8% of GDP in the third quarter of 2015) did not, however, cause any crisis in China given its trillions dollars worth of foreign exchange reserves.

Figure 8 shows the foreign flows in and out of the Philippines. Note that net foreign flows during the turbulent periods of 2015 and early 2016 did not bring foreign financial flows into negative territory as it did during the GFC. But note that there were significant outflows of portfolio investment from the second quarter of 2015 to the first quarter of 2016. The volatilities in the stock market did bring losses of confidence and currency depreciation during this period, but was not serious enough to cause a financial panic or crisis.

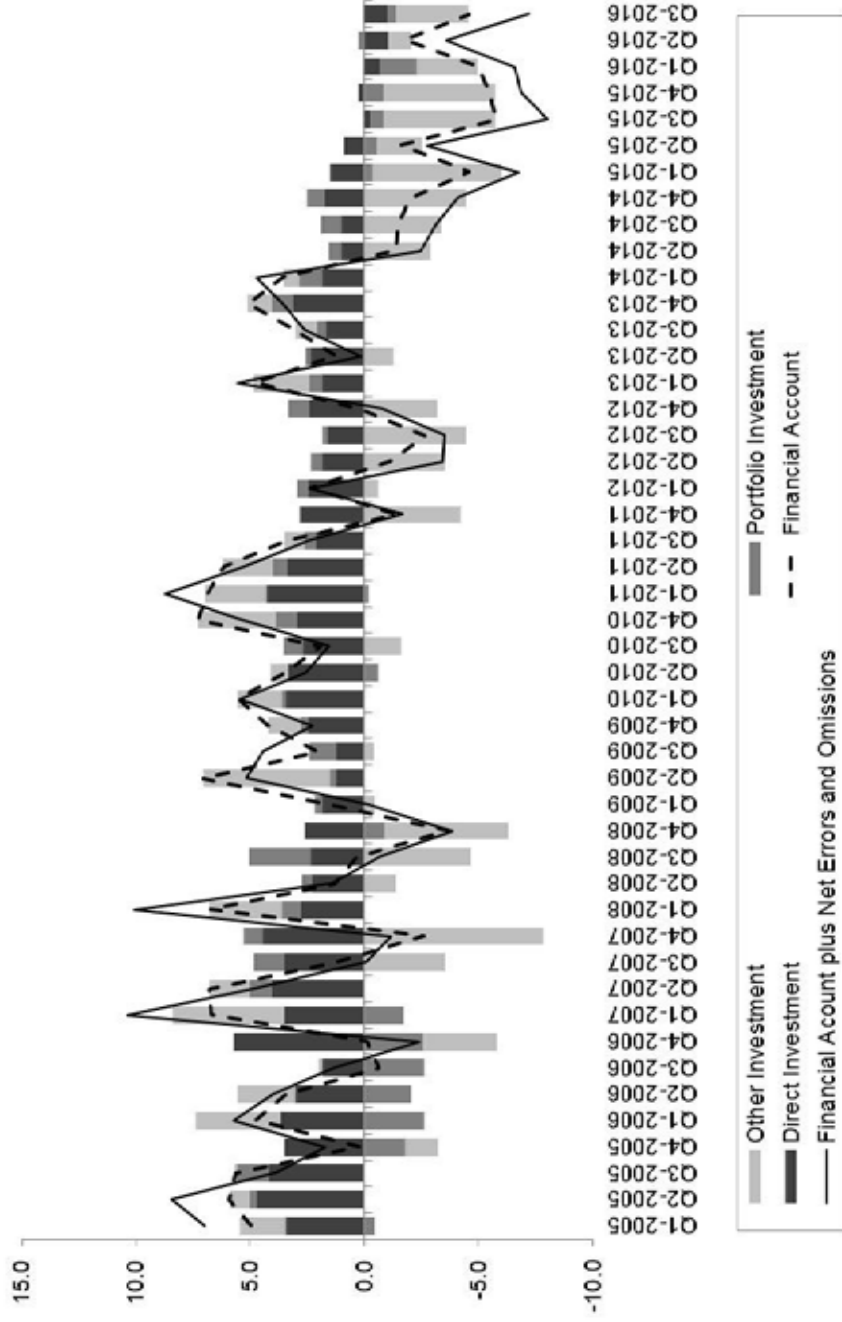


**Figure 7a** Non-resident Flows – PRC (% of GDP)



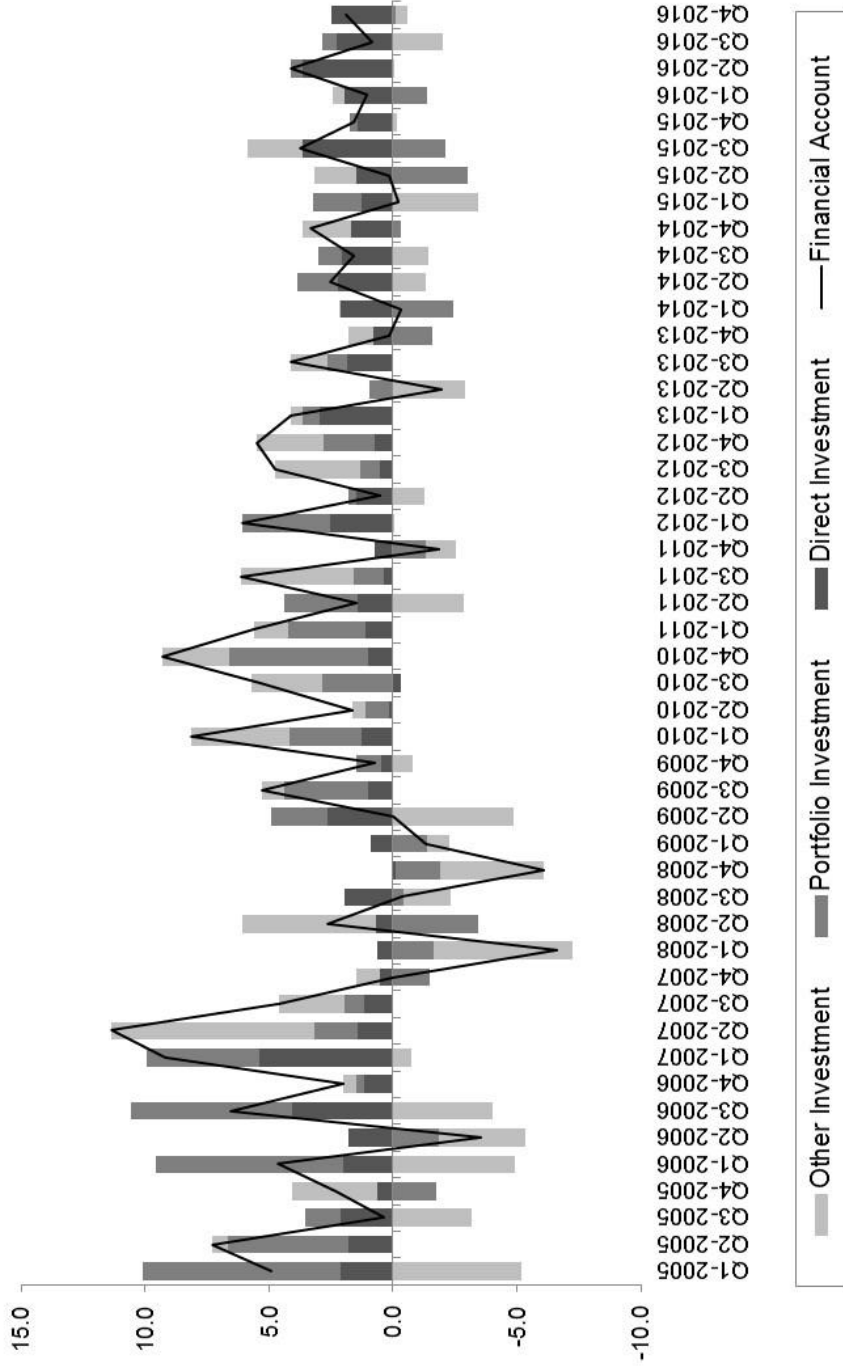
Source: *Balance of Payments Statistics*, International Monetary Fund

**Figure 7b** Net Financial (Non-resident and Resident) Flows – PRC (% of GDP)



Source: *Balance of Payments Statistics*, International Monetary Fund

**Figure 8** Non-resident Flows – Philippines (% of GDP)



Source: *Balance of Payments Statistics*, International Monetary Fund

## 9. Summary and Conclusion

In summary, the Philippines is not as vulnerable as other East Asian economies to the slowdown of Chinese imports arising from a Chinese economic slowdown or hard landing. This is because it is not very dependent on exports going to China (or Hong Kong).

However, a Chinese slowdown and a weak global economy may bring about a reduction in the vertical trade integration in ASEAN+3 as export production for the developed world is shifted towards production of traded goods for domestic demand. The result of reduction in Asian vertical trade integration may have a negative or a positive effect to the Philippines. The Philippines had not benefited as much as other East Asian countries (such as China, Malaysia, Thailand and Vietnam) in the vertical trade integration of East Asia because of its limited participation in the regional value chain and integration processes. On the one hand, a reduction of Chinese imports and vertical trade integration may lead to some lost exports of electronic inputs, which with the right policies, could have delivered higher technology if the Philippines was able to go into backward integration. But on the other, it may improve the composition of Philippine exports towards more consumer and final products as its current export composition is overly dependent and concentrated on low-end semiconductor and electronic products. The economy would be healthy if these other exports have higher value-added content and are less import-intensive. The current shift of trade to cater to the domestic demand of the region – rather than to integrated production of exports to developed markets – may provide an opportunity to diversify Philippine exports to the East Asian markets. In light of this, more detailed analyses of the trade structure between the two countries, as well as serious trade meetings and agreements, are required to upgrade the volume and quality of Philippine exports and trade with China.

Although Chinese investments and loans are still rather subdued now, the China pivot of the Duterte government may entail much dependence on Chinese funds and capital for infrastructure expansion in the future. Any China slowdown may affect future Chinese funding and investment in the Philippines and may have potential negative impact on future trends in infrastructure development and technological growth. In addition, perception of some corruption on both sides has tainted Chinese official development assistance and investments between the two countries. Some strengthening of institutions should be effected in preparation for the China pivot.

Bad news on the Chinese economy and Asian trade will no doubt affect financial markets and may cause currency depreciation, depletion of international reserves and reduced economic confidence in investments and domestic demand. One must not forget that the regional and national financial markets as relatively open capital markets can lead to uncontrollable external

volatilities. We had seen sufficient turmoil during late 2015 to remind us that the Chinese economy and its prospects affect not only the real sectors of exports, regional/global trade and foreign investments, but also provide enough ripples in the financial markets to affect currencies, equity markets, international reserves and overall economic confidence.

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### **Notes**

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1. It is not clear whether the 2016 data quoted by Reuters and CNBC are also merchandise trade data which was used by ADB for the other years.
2. Discussions of these issues and debates can be read in Stiglitz (2016), Woo (2016; 2017) .
3. Most experts think more than 20% of GDP is overestimating the Filipino overseas workers' remittances. The real figure may be around 10% of GDP, but this is still large compared to the trade deficits.
4. Including the Hong Kong Special Administrative Region. Hong Kong is included in this analysis because: 1) Hong Kong is part of China, and 2) many goods from the Philippines to China go through Hong Kong.
5. This differs from the percent of exports in Table 1 because: a) exports in Table 2 do not include exports of services while those in Table 1 do; and b) Table 1 is based on National Income Accounts while Table 2 is based on Balance of Payments and External Sector Accounts.

6. This is strengthened if we add Taiwan to this list of economies.
7. One should include Taiwan, of course, to complete the trade integration in East Asia.
8. It has been called the flying geese phenomenon.
9. This breakdown is based on statistics of Bangko Sentral ng Pilipinas, officially obtained by the author from its staff.
10. The Northrail project will be taken over by ODA to be given by Japan.

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