



"Goodbye America": The State of US-Philippines Relations

Summary:

- Anti-US rhetoric is raising short-term political uncertainty about Philippine policy.
- Political uncertainty is adding to headwinds confronting the Philippines' economy.
- Despite a strengthening domestic economy, a perception gap is emerging.

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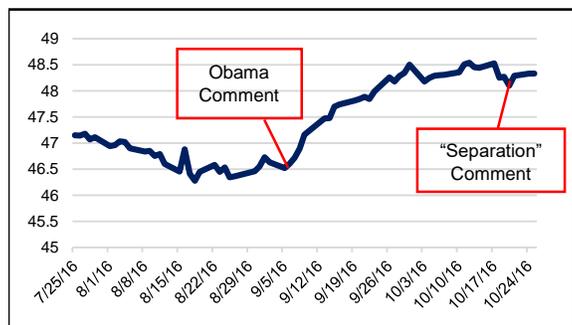
Duterte's October Surprise

Newly elected Philippine President Rodrigo Duterte continues his bombastic rhetoric, which received widespread notoriety during the campaign. However, recent anti-US tirades raise concerns over resetting the long-standing US-Philippines relationship. A quick sampling of recent statements include: calling US President Obama a "son of a whore";¹ ending US-Philippines military cooperation and removal of US forces in the country;² and, announcing a "separation" from the US and pivot towards China.³ Almost immediately, Philippine officials have sought to clarify and walk back these statements.⁴ It is unclear if Duterte's comments indeed signal a new geopolitical strategy or are unscripted outbursts from a leader with a history of anti-Americanism.⁵ Regardless, this anti-US stance is at odds with post-election expectations suggesting a moderate Duterte administration expected to maintain recent economic policies.

US-Philippines Economic Ties

The political uncertainty triggered by Duterte's comments are poorly timed given current economic trends. While the Philippines was Asia's top performer to start 2016, recording 6.6% GDP growth in Q2, the economy is beginning to face headwinds. A growing trade imbalance has narrowed the country's current account surplus which is expected to fall below \$5 billion in 2017.⁶ The Philippines stock market (PSE) has retreated 8% from July's high. The peso is at a seven-year low versus the US dollar (Figure 1). Yields on its 15-year dollar bonds have risen 26 basis point month-to-date.⁷ Further, the relatively low yields and historically tight spreads on Philippine bonds make them vulnerable to a possible US Federal Reserve rate hike.

Figure 1. Peso v. USD Exchange Rate



Source: Northwest Passage, Bloomberg data as of 10/26/2016

Moreover, his comments raise red flags given the country's deep ties to the US economy. Nearly 43% of total overseas remittances come from deployed workers in the US. These remittances are a major economic contributor, accounting for approximately 10% of GDP.⁸ While total inflows continue to grow, this growth has slowed pointing to an overall weakening trend. Further decline is expected as the number of workers based in the US continues to decrease.⁹

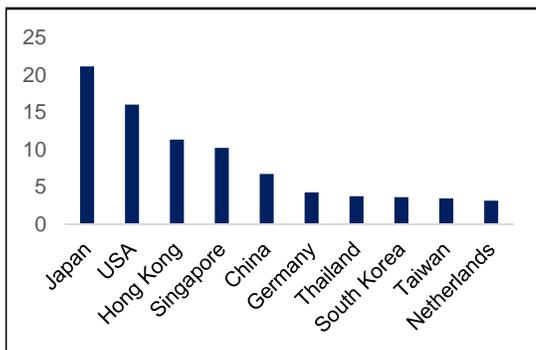
Even the economic success of the business process outsourcing (BPO) sector in the Philippines, providing English-language call centers and back operations services, is in jeopardy. BPO sector revenues are expected to pass \$25 billion this year.¹⁰ However, nearly 80% of the services provided by the over 1 million BPO employees in the Philippines are for US

companies.¹¹ In light of recent news, Philippine providers are facing increasingly anxious US customers.

A strategic pivot towards China could also damage trade with Japan, the Philippines' largest import partner (Figure 2). Japan is also the biggest contributor of development assistance and loans to the Philippines. During the recently concluded state visit to Japan, officials there pressed for clarification about Philippine policy including the ongoing South China Sea dispute, where both countries have maritime claims against China. A change in the US-Philippines strategic footing would alter Japanese-Philippines relations accordingly.

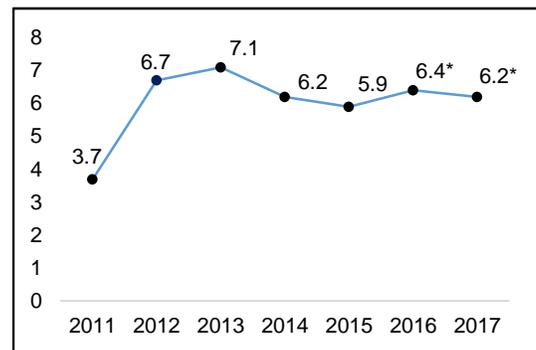
However, political uncertainty has not impacted recent GDP forecasts. The IMF and ADB lifted their projections, estimating 6.4% growth for 2016 and 6.7% and 6.2% for 2017, respectively (Figure 3). Observers point to robust domestic demand, fueled by private and public sector consumption, lifting the economy despite external headwinds (*i.e.* slower global growth).

Figure 2. Top Export Markets FY 2015 (%)



Source: Northwest Passage; Philippines Department of Trade and Industry

Figure 3. GDP Growth (%)



Source: Northwest Passage; Asian Development Bank
*Forecasted growth.

Fallout: Budding Perception Gap

Domestically, support for Duterte's shift from the US is uncertain. He is extremely popular with his approval rating at 75%.¹² This popularity is due in part to his appeal to Pilipino nationalism, which includes kernels of anti-colonialism and anti-Americanism. His remarks clearly resonate those sentiments. At the same time, though, recent polling shows America as the Philippines' most popular international partner while China is the most unpopular.¹³ Any separation from the US will be easier said than done, and fiery rhetoric has not translated into action yet.¹⁴ We do not expect significant changes in US-Philippines relations or policies in the near-term.

Nevertheless, investors should brace themselves for further unsettling outbursts given Duterte's unencumbered, off-the-cuff demeanor, even after his recent tête-à-tête with the Almighty.¹⁵ With FDI inflows already slowing, it is likely that US direct investment will further slow until the political dust settles. Despite a strengthening domestic economy, the Philippines is liable to endure a "perception gap" with political uncertainty pushing investors to look elsewhere in the region for opportunities.¹⁶ The major rating agencies have taken notice of the news from the Philippines as well. Standard & Poor's recently warned of "rising uncertainties surrounding the stability, predictability and accountability" of the Duterte administration making a higher rating "unlikely over our two-year rating horizon."¹⁷ We expect them to watch the situation carefully.

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⁸ Nyshka. "Philippine President Duterte Threatens to 'break Up' with US. Here's What It Means."

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¹⁰ Ibid.

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