

Executive Summary

Highlights

1. Growth of the Philippines' economy has been steady amid global trade tensions, supported by a domestically oriented economic structure and diversified export markets. Steady domestic consumption and a stable labor market continue to drive growth, while inflation has eased below the target range of Bangko Sentral ng Pilipinas (BSP). The near-term macroeconomic and financial outlook remains stable, underpinned by firm domestic demand and solid financial soundness indicators. However, sustaining long-term growth will require refining the growth strategy by upgrading services, and boosting private investment.

Outlook

2. The economy will continue to expand at a rate of above 5 percent growth rate, slower than the pre-COVID trend. Real GDP growth is projected at 5.2 percent in 2025 and 5.3 percent in 2026, below the 5.7 percent growth recorded in 2024. Private consumption is expected to grow steadily. Private investment and exports face headwinds from external uncertainties due to the US tariff policy, while public investment will be dampened by flood control project controversies. Additionally, the US tariff impact on goods exports would be negative and more pronounced in 2026, while in 2025, it will be partly offset by front-loaded export orders. However, the adverse effects on investment and exports would gradually phase out in H2 2026.

3. Inflation is expected to return to the BSP's target range. CPI inflation is projected at 1.7 percent in 2025, rising to 3.2 percent in 2026. The relatively low headline inflation reflects softer supply-side pressures, such as moderating food and global commodity prices, as well as the sustained effects of administrative measures, including tariff cuts on rice and the streamlining of nontariff barriers. Meanwhile, demand-side factors are expected to continue to steadily contribute to inflation.

4. Despite the current account remaining in deficit, the external position stayed adequate. The deficit persists but has been offset by sustained financial inflows. Looking ahead, the current account deficit is expected to persist, while the financial account should continue to register net inflows on the back of the country's stable economic outlook. The peso depreciated as the U.S.–Philippines interest rate differential narrowed, and gross international reserves remain adequate.

5. Monetary policy has entered an easing cycle, while banking sector performance has been solid. Since August 2024, the BSP has implemented seven rate cuts, bringing the policy rate down to 4.75 percent. For 2026, however, the inflation is expected to be well-within the BSP's target range of 2-4 percent. Bank lending has accelerated, especially in household loans, while nonperforming loan (NPL) ratios and bank profitability have remained stable with adequate liquidity and capital buffers.

6. Fiscal consolidation continues but is progressing more slowly than planned. The fiscal deficit is budgeted to narrow slightly to 5.5 percent of GDP in 2025 with moderate revenue growth. Medium-term consolidation is slower due to lower revenue ratios and higher expenditures to support growth and infrastructure.

Risks

7. While the near-term growth outlook remains stable, it is clouded by external uncertainties, and structural challenges pose greater obstacles to long-term growth potential. Downside risks

stem from aggressive US protectionism, tighter immigration policies for migrant workers, slower growth in key trading partners, more volatile global financial conditions, and potential inflationary pressures. Structural challenges—such as prolonged scarring from the COVID-19 pandemic, insufficient infrastructure development, and limited manufacturing capacity—continue to constrain the country's potential growth over the longer term.

Policy Recommendations

8. Fiscal, monetary and financial policies are broadly well-aligned to sustain macroeconomic stability and growth, and further policy considerations include:

- **Fiscal consolidation** should be pursued as planned, while being balanced with development priorities, particularly infrastructure and human investment.
- The BSP should continue **normalizing monetary policy** with cautious rate adjustments, taking into account the near-zero output gap and potential supply shocks.
- On financial stability, **forward-looking risk management** is vital, especially for rapid household loan growth, vulnerable corporate segments, and rising securities exposure.

9. The Philippines should enhance monetary policy transmission to strengthen the effectiveness of monetary policy in supporting growth. Policy recommendations include deepening liquidity and broadening the investor base in long-term bond markets, as well as enhancing interest rate pass-through, particularly for consumer and SME lending, by promoting broader use of shared credit data.

10. The government should refine the growth strategy, prioritizing the upgrading of sectors with comparative advantages while improving the overall business environment. Given that the existing strategy lacks clear sectoral priority, the authorities need to streamline targets and strengthen the performance evaluation framework for public spending. Emphasis should be placed on strengthening digital and infrastructure connectivity, and upskilling the workforce. These efforts should help the Philippines upgrade its services and manufacturing sectors to produce higher value-added exports.

11. The government should also crowd in private investment to ensure sustainable long-term economic growth. To address structural constraints, key policy priorities include accelerating infrastructure development, reducing legislative drag to improve the investment climate, and enhancing firms' access to long-term financing.