Economic Report

SENATE ECONOMIC PLANNING OFFICE

July 2024 **ER-2024-**

<u>2024 Mid-year Economic Report</u>

Testing Resiliency, Bracing for Headwinds

The Philippine economy concluded 2023 as the fastest-growing among ASEAN nations. However, global headwinds will test its resilience in 2024. The 5.7 percent first quarter growth was below market expectation. Persistent inflation and the exhaustion of pent-up demand continue to weigh on private household consumption. This is reflected in moderating investments, which are being held back by high interest rates. Government spending is also being constrained by fiscal consolidation efforts. On the production side, the services sector, particularly tourism and business services, remained buoyant, while manufacturing showed moderate growth. To reach the official growth target of 6.0 – 7.0 percent, the economy needs to grow by an average of 6.1 percent during the remaining quarters of the year.

Despite the challenges, there is room for optimism. The labor market remained adaptable, with stable employment rates and steady remittances contributing to economic resilience. Likewise, steady inflows of foreign direct investment and a balanced trade performance also supported economic stability. Macroeconomic fundamentals, while not as robust as in the pre-pandemic era, remain sound -- due to prudent monetary policies (i.e., managing inflation) and pragmatic fiscal policies (i.e., constrained government spending, focusing on essential services and infrastructure). Poverty rates remained stable due to targeted government support programs. Thus, the growth outlook remains positive, albeit subdued, as external headwinds gather.

Increasing geopolitical tensions and fragmentation in global trade policies could keep commodity prices elevated. While headline and core inflation are now within the monetary authority's target range, upward inflationary pressures could still prove stubborn. This could delay policy rate normalization, which, in turn, could weigh on growth prospects. Given limited fiscal resources, targeted support programs, rather than blanket measures, might be necessary. Fiscal discipline, a steadfast commitment to fiscal consolidation, and prudent debt management are seen as crucial to mitigating the adverse effects of external risks. Finally, continued structural reforms are expected to enhance the economy's adaptability and resilience in an ever-changing economic environment.

Real Sector

First Quarter Growth, 2024		PH Growth Forecast, 2024	
Philippines	5.7	ADB	6.0
Vietnam	5.7	IMF	6.0
China	5.3	World Bank	5.8
Indonesia	5.1	Fitch	6.2
Malaysia	4.3	S&P Global	6.1
Korea, South	3.1	Nomura	6.0
Singapore	2.7	Official target	6.0 – 7.0
Thailand	1.5		

The Philippines recorded slower-than-expected growth in the first quarter of 2024. Real gross domestic product (GDP) grew by 5.7 percent, the slowest first-quarter expansion since the pandemic and below the market consensus forecast of 5.9 percent. Nonetheless, this growth rate positions the Philippines alongside Vietnam (5.7 percent) and ahead of China (5.3 percent), Indonesia (5.1 percent), and Malaysia (4.3 percent). Multilateral organizations affirm the resilience of the Philippine economy and project it as a frontrunner in ASEAN for 2024.

Growth targets were adjusted downward and aligned with global economic prospects. In response to global economic conditions, the government adjusted growth targets downward in April 2024, from 6.5 – 7.5 percent to 6.0 – 7.0 percent. The first quarter growth rate of 5.7 percent fell below the market consensus forecast of 5.9 percent and is the slowest first-quarter growth rate since the pandemic. To meet this year's growth target, the economy would need to grow by 6.1 percent for the remaining three quarters. The downward adjustment and less- than-stellar performance in the first quarter are attributed to external headwinds that are expected to adversely affect growth prospects. These include geopolitical tensions, fragmentation in global trade policies, and trade protectionism, which could keep global commodity prices elevated. Indeed, inflation remains a key concern, although headline and core inflation have returned to the central bank's target range.

Household consumption has consistently been the main growth driver on the expenditure side. However, data suggest an exhaustion of pent-up demand, with persistent inflation and reduced policy support preventing a return to pre-pandemic growth rates. Inflation and external headwinds likewise resulted in business sentiment turning less upbeat in the first quarter as overall confidence index declined to 33.1 percent from 35.9 percent in the fourth quarter of 2023. This is mirrored by moderating private investments which is being held back by high borrowing costs. Moreover, while net exports contributed positively to first quarter growth, this was due to slowing imports rather than surging exports. Furthermore, while the government remains committed to its infrastructure program and although disbursements increased by 16.2 percent year-on-year as of April, government consumption in the first quarter was constrained by fiscal consolidation efforts. Note that disbursed amounts may not have been spent early on during the first quarter.

Services production continued to buttress the economy. Buoyed by an 18.3 percent increase in tourist arrivals, which generated approximately PhP158 billion tourist receipts.[1] This growth bolstered accommodation and food services (13.9 percent) and wholesale and retail trade and repair of motor vehicles (6.4 percent). The industry sector also recorded a strong growth of 5.1 percent in the first quarter, with the slowdown in public construction offset by a revival in manufacturing. In particular, manufacturing of computer, electronic, and optical products as well as furniture grew by 8.2 percent and 6.8 percent, respectively. Meanwhile the weak performance of the agriculture sector is attributed to the heatwave associated with El Niño, resulting in PhP5.9 billion worth of damage.[2]

[1] WB PH Economic Update June 2024

[2] https://mbc.com.ph/2024/05/09/gdp-insights-mbc-economy-2024-may/

Table 1. Growth Rates at constant 2018 prices

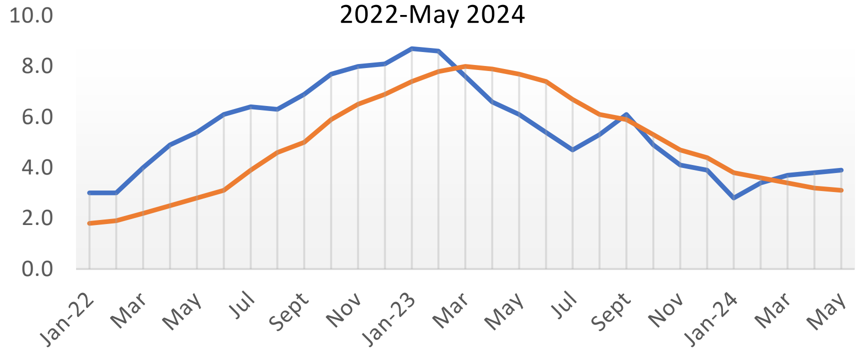
Particulars	2022 - 2023				2024	Annual	
	Q1	Q2	Q3	Q4	Q1	2022	2023
Gross Domestic Product	**6.4**	**4.3**	**6.0**	**5.6**	5.7	**7.6**	**5.6**
Net primary income from the rest of the world	82.4	90.7	111.6	97.7	57.0	81.1	95.6
Gross National Income	**10.0**	**8.6**	**12.1**	**11.1**	9.7	**9.9**	**10.5**
Expenditure							
Household final consumption	**6.4**	**5.5**	**5.1**	**5.3**	**4.6**	**8.4**	**5.6**
Government final consumption	**6.2**	**-7.1**	**6.7**	**-1.8**	**1.7**	**4.6**	**1.0**
Gross capital formation	**12.6**	**0.3**	**-1.4**	**11.2**	**1.3**	**14.2**	**5.6**
Gross fixed capital formation	10.9	4.0	8.1	10.2	2.3	9.7	8.3
1. Construction	14.6	2.4	12.6	10.1	6.8	12.1	9.9
2. Durable equipment	8.1	10.5	1.7	14.6	-4.8	8.4	8.7
3. Breeding stocks and orchard devt.	2.0	0.0	0.7	1.0	0.0	0.5	0.9
4. Intellectual property products	2.5	3.6	1.9	4.7	3.4	4.0	3.2
Exports of goods and services	**1.0**	**4.4**	**2.6**	**-2.6**	**7.5**	**10.9**	**1.4**
Exports of goods	-14.9	-0.9	-2.3	-11.6	5.8	4.8	-7.4
Exports of services	20.2	10.4	11.4	12.3	8.9	21.5	13.6
Less : Imports of goods and services	**4.7**	**0.2**	**-1.1**	**2.9**	**2.3**	**14.0**	**1.7**
Imports of goods	0.5	-5.0	-8.0	-2.6	-3.6	8.7	-3.8
Imports of services	23.6	31.3	28.6	21.0	24.4	44.3	26.1
Industry							
Agriculture, forestry, and fishing	**2.2**	**0.2**	**0.9**	**1.4**	**0.4**	**0.5**	**1.2**
Industry	**4.0**	**2.1**	**5.6**	**3.2**	**5.1**	**6.7**	**3.7**
Mining and quarrying	-2.2	-2.9	5.1	10.3	0.3	6.4	2.6
Manufacturing	1.9	1.1	1.8	0.6	4.5	4.9	1.3
Electricity, steam, water and waste mngt	7.2	4.7	6.7	6.4	6.3	5.2	6.3
Construction	11.1	3.6	14.2	8.5	7.0	12.3	9.3
Services	**8.4**	**6.1**	**6.8**	**7.4**	**6.9**	**9.2**	**7.2**
Wholesale and retail trade; repair of motor vehicles and motorcycles	6.8	5.2	4.9	5.2	6.4	8.6	5.5
Transportation and storage	14.6	17.5	12.1	9.7	5.6	24.3	13.5
Accommodation and food service	27.8	27.2	21.0	19.2	13.9	32.5	23.8
Information and communication	4.7	3.7	4.2	3.6	4.2	7.9	4.1
Financial and insurance	8.8	5.3	9.6	11.8	10.0	7.2	8.9
Real estate and ownership of dwellings	3.2	2.9	4.2	3.9	4.1	5.3	3.5
Professional and business services	7.8	6.7	6.3	6.0	7.5	9.1	6.7
Public administration and defense; compulsory social activities	1.5	-2.4	3.6	8.6	3.8	3.7	2.8
Education	6.6	6.9	6.4	7.9	4.6	7.5	7.0
Human health and social work	7.7	8.3	7.1	6.4	8.5	3.6	7.4
Other services	37.0	21.9	15.9	11.9	8.5	30.1	21.7

Philippine Statistics Authority

Inflation

Slight uptrend in headline inflation rate was observed in first half of 2024, although it remains within the BSP's target range. Year-on-year headline inflation reached 3.7 percent in June 2024, a slight drop from May 2024's 3.9 percent but significantly lower than the 5.4 percent recorded in June 2023. Core inflation, which excludes certain food and energy items, remained steady at 3.1 percent in both May and June 2024 but was still substantially lower than the 7.4 percent in June 2023.

Figure 1. Headline and Core Inflation (in %), 2022-May 2024



Source: Bangko Sentral ng Pilipinas

Year-to-date headline inflation from January to June 2024 dropped to 3.5 percent. Food inflation, which stood at 9.0 percent last year, moderated to 5.3 percent in the first six months due to negative inflation rates of key food items such as sugar, vegetables, and oils/fats. However, this moderation was offset by a substantial increase in rice prices, which surged by 23.3 percent for the period compared to a modest 2.9 percent rise in 2023.

Table 2. June 2024 year-on year (y-o-y) and year-to-date (y-t-d)
Inflation rate and contribution to inflation of selected items

Commodities	Inflation		Percentage Point Contribution	
	June 2024 Y-o-y	June 2024 Y-t-d	June 2024 Y-o-y	June 2024 Y-t-d
All items	**3.7**	**3.5**	**3.7**	**3.5**
Food	**6.1**	**5.3**	**2.3**	**2.0**
Rice	22.5	23.3	2.0	2.1
Corn	13.1	1.4	0.1	0.0
Flour, Bread and Other Bakery	3.0	4.3	0.1	0.1
Meat and Other Parts of Slaughtered	3.1	1.3	0.2	0.1
Oils and Fats	-3.0	-4.1	0.0	0.0
Vegetables	7.2	-4.6	0.2	-0.1
Sugar, Confectionery and Desserts	-3.0	-2.5	0.0	0.0
Non-Food	**2.3**	**2.3**	**1.4**	**1.4**
Electricity, Gas and Other Fuels	-5.7	-4.6	-0.4	-0.3
Passenger Transport Services	3.3	2.9	0.2	0.1
Restaurants and Accommodation	5.1	5.4	0.5	0.5

Notes: Year-to-date covers the period from start of the year until the reference month. Year-on-year compares the same time period in two successive years.
Source: Bangko Sentral ng Pilipinas

Meanwhile, the inflation rate for electricity, gas, and other fuels saw a year-to-date decrease of 4.6 percent, contrasting sharply with the 10.4 percent inflation rate observed in the previous year. The deflation is attributed mainly to the sharp drop in electricity prices. For example, the electricity rate for residential consumers in the Metro Manila settled at Php9.47 per kilowatt-hour (kWh) in June 2024, a big decrease from the Php11.91/kWh seen in June 2023. The inflation rate for passenger transport services rose modestly by 2.9 percent during this period, in contrast to the 12.8 percent recorded in 2023.

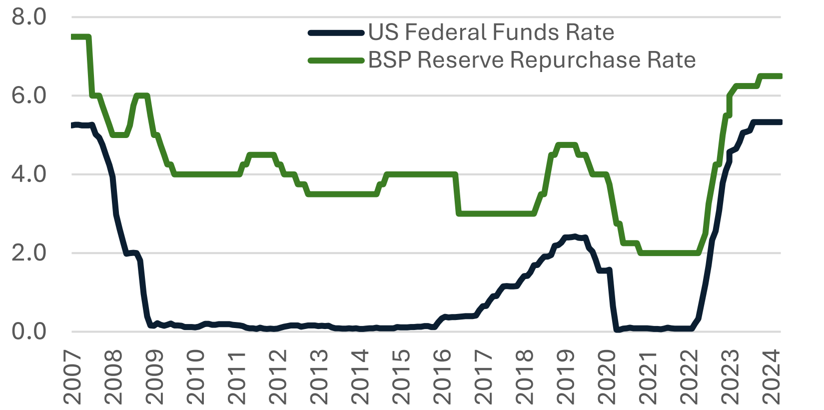
In terms of contribution to the overall year-to-date headline inflation rate, food and non-alcoholic beverages emerged as the largest contributor among major commodities, accounting for 57.1 percent share or 2.0 percentage points. Following closely behind were restaurant and accommodation services, contributing 14.2 percent share or 0.5 percentage points, and transport, contributing 5.7 percent share or 0.2 percentage points.

In the latter half of 2024, rice price inflation is expected to decrease following the Supreme Court's decision not to issue a temporary restraining order against Executive Order (EO) No. 62. This order reduces the tariff rates on imported rice from 35 percent to 15 percent until 2028. Instead, the High Court directed the Office of the President, the Office of the Executive Secretary, the National Economic and Development Authority, and the Tariff Commission to respond within 10 days to the complaint of the farmers' groups which argues that the EO was implemented without required public hearings and investigation under the Customs Modernization and Tariff Act.

With EO No. 62 still in effect, the reduced tariff rates on imported rice began on July 5, 2024, and will apply to other goods starting July 20, 2024. The BSP estimates that these tariff cuts will lower rice prices by 14.8 percent over the next 12 months. Consequently, the inflation rate is projected to be 3.1 percent in 2024 and 2025, within the target range of 2.0 to 4.0 percent.

BSP maintains policy rate at 17-year high and signals possible rate cut in August 2024. In its June 27, 2024 meeting, the Bangko Sentral ng Pilipinas (BSP) decided to maintain its policy rates, hinting at a potential rate cut in August. The reverse repurchase rate (RRP) remains at a 17-year high of 6.5 percent, with overnight deposit and lending facilities at 6.0 percent and 7.0 percent, respectively.

Figure 2. BSP and US Federal Reserve Policy Rates, end of period (in %)



Source: Bangko Sentral ng Pilipinas

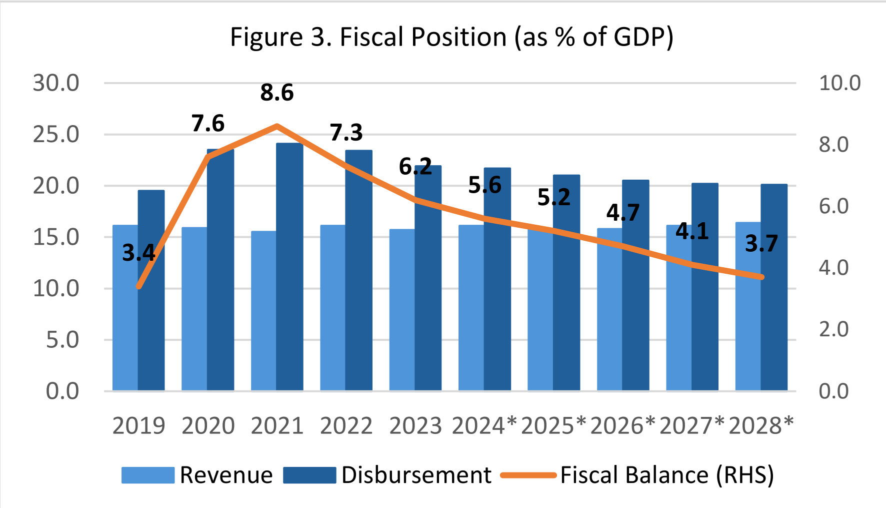
The implementation of both EO No. 62 and Administrative Order No. 20--aimed at streamlining administrative processes for the processing of imported goods, is expected to alleviate supply-side pressures, particularly on rice prices—a major driver of inflation this year. Consequently, the central bank has revised downwards its inflation forecasts to 3.1 percent for both 2024 and 2025 from its earlier forecasts of 3.8 percent and 3.7 percent, respectively.

While the anticipated decline in inflation rate provides the BSP with the flexibility to lower policy rates and support the economy, it must consider US economic conditions before adopting a change in its monetary policy. The Federal Reserve wants the inflation rate to remain stable at the 2 percent target before cutting its rates, which are projected as early as September 2024. A premature rate cut by the BSP could lead to capital outflows, putting downward pressure on the peso, which recently threatened to breach the PhP59/US$1 level, prompting central bank intervention. To deter disruptive foreign exchange speculation, the central bank revised its reporting guidelines for transactions conducted by authorized agent banks (AABs), AAB foreign exchange companies, and similar entities, imposing a maximum penalty of PhP1 million per transaction for violations. While the BSP estimates that the inflationary impact of a peso depreciation is modest—each 1.0 percent depreciation adds 0.36 percent to inflation—a premature rate cut could worsen local inflationary pressures by making imports more expensive due to a weaker peso.

Amidst the prevailing high interest rates set by the BSP, the banking system's non-performing loan (NPL) ratio reached 3.45 percent by the end of April 2024, with gross NPLs amounting to PhP480.65 billion out of a total loan portfolio of PhP13.94 trillion. This marks an increase from the 3.39 percent recorded in March 2024, where NPLs stood at PhP464.67 billion out of a total loan portfolio of PhP13.69 trillion, and the 3.41 percent observed in April 2023, with NPLs at PhP427.88 billion out of a total loan portfolio of Php12.56 trillion.

Fiscal

The fiscal deficit continues to narrow from its peak during the height of the pandemic. The fiscal consolidation plan remains aligned with the Medium-Term Fiscal Framework (MTFF) and aims to ensure that the economy will continue to outgrow debt in the medium term.



Source: Department of Finance

Revenue increases are expected to lead to improved tax effort. As of April 2024, total government revenue amounted to PhP1.470 trillion, accounting for approximately 34.1 percent of the full year programmed amount of PhP4.269 trillion and representing a 16.8 percent increase from the same period last year. The total tax take as of April was PhP1.282 trillion, attributed to the strong revenue performance of the Bureau of Internal Revenue (BIR) and the Bureau of Customs (BoC). The BIR's tax collection grew by 15.3 percent, mostly attributed to the VAT payments and income tax filing that is usually scheduled in April. Meanwhile, the BoC's anti-smuggling campaigns boosted the agency’s tax collection which grew by 6.5 percent during the said period, slower than the 10.7 percent growth in 2023. Nonetheless, actual tax effort (tax-to-GDP) as of the first quarter was 13.4 percent, a full percentage point below the full-year target of 14.4 percent.

Non-tax revenues increased by 48.8 percent, driven by significant income growth from the Bureau of the Treasury (BTr), 56.7 percent of which came from dividends remitted by government-owned and controlled corporations (GOCCs).

Table 3. NG Revenue Performance, 2023-2024 (in PhP billion)

Particulars	Actual	FY Program	Jan-Apr (Actual)		
	2023	2024	2023	2024	Growth (%)
Tax Revenues	**3,429.3**	**3,820.3**	**1,132.5**	**1,282.1**	**13.2**
Tax effort (%)	*14.1*	*14.4*	*12.9*	*13.4*	
Bureau of Internal Revenue	2,517.0	2,848.9	841.2	970.3	15.3
Bureau of Customs	883.2	939.7	281.4	299.6	6.5
Other Offices	29.1	31.7	9.9	12.2	23.2
Non-tax Revenue	**394.2**	**407.5**	**126.9**	**188.8**	**48.8**
BTr Income	227.6		57.3	136.3	137.9
Fees and Charges	56.3		17.4	3.4	-80.6
Privatization	0.9		0.0	0.4	967.6
Income from Malampaya	17.8		6.6	2.5	-62.8
Other non-tax	91.6		45.5	46.3	1.8
Grants	**0.6**		**0.031**	**0.001**	**-96.8**
Total Revenues	**3,824.1**	**4,269.9**	**1,259.4**	**1,470.9**	**16.8**

Source: Dept. of Budget and Management, Bureau of Treasury

Government disbursement accelerated during the first four months of the year. As of April 2024, government disbursements totaled PhP1.7 trillion, accounting for 29.5 percent of the full-year programmed amount and representing a 16.2 percent increase from the same period last year. The Department of Budget and Management (DBM) has already released PhP4.958 trillion (86 percent) of the PhP5.768 trillion annual budget as of April. Of the released amount, PhP3.404 trillion went to implementing agencies, while PhP1.254 trillion and PhP248.6 billion went towards automatic appropriations and special purpose funds, respectively.

Cumulative interest payments grew by 38.4 percent due to foreign exchange rate fluctuations, with its programmed share of total disbursements slightly increasing to 11.9 percent from 11.7 percent in 2023. Additionally, in the DBM's Status of Allotment Releases last April, an additional Php231.3 million was released for the Retirement and Life Insurance Premiums (RLIP) of various government agencies[3] over the programmed amount of Php65.787 billion.

[3] These consisted of the shares of the National Government in the premium payments to the Government Service Insurance System (GSIS), for the life insurance and retirement benefit fund of government employees.

Table 4 NG Disbursement Performance, 2023 and 2024 (PhP billion)

Particulars	Actual 2023	FY Program 2024	Jan – April (Actual)		
			2023 a/	2024	Growth %
Current Operating Expenditures	3,890.5	4,180.5	1,105.0	1,276.6	15.5
Personnel Services	1,438.0	1,665.3	394.2	412.9	4.7
MOOE	916.6	876.2	248.5	290.8	17.0
Subsidy	163.5	192.3	30.3	47.3	56.3
Allotment to LGUs	712.3	761.7	236.3	251.7	6.5
Interest payments	628.3	670.5	188.2	260.5	38.4
Tax expenditure fund	31.7	14.5	7.5	13.3	78.2
Capital Outlays	1,418.9	1,420.2	352.7	423.2	20.0
Infra and other CO	1,204.6	1,176.4	284.0	335.7	18.2
Equity	0.5	1.5	0.1	0.2	80.6
Capital Transfers to LGUs	213.8	242.3	68.6	87.3	27.1
Net Lending	26.8	28.7	5.7	1.1	(80.6)
Total Disbursements	**5,336.2**	**5,629.4**	**1,463.5**	**1,700.9**	**16.2**

A/ Adjusted based on the full year 2023 BTr Cash Operations Report
Source: DBM, BESF2024

Total national government debt increased by 16.7 percent as of end-April despite a marked decline in guarantees. As of end-March 2024, the debt-to-GDP ratio was 60.2 percent compared to 61.0 percent in the same period last year. The Department of Finance projects a debt-to-GDP ratio of 59.7 percent by year-end. The declining debt trajectory is expected as the government gradually pays off its debts, particularly short- to medium-term debts incurred during the COVID-19 pandemic. The rise in the debt stock was partly boosted by the positive market sentiment which enticed private companies to invest in the capital market. Indeed, total debt securities (foreign and domestic) consisting of bonds and bills increased by PhP 861.5 billion or 7.2 percent year-on-year.

Table 5. NG Outstanding Debt, as of April 2023 and 2024
(in PhP billion)

Particulars	end-April 2023	end-April 2024	Growth %
Total Domestic Debt	9,654.4	10,500.5	8.8
Actual	9,457.8	10,308.5	9.0
Loans	0.156	0.156	0.0
Debt Securities	9,457.7	10,308.3	9.0
Guarantee	196.6	192.0	-2.4
Total External Debt	4,637.4	4,872.8	5.1
Actual	4,453.3	4,708.7	5.7
Loans	2,006.7	2,251.2	12.2
Debt Securities	2,446.6	2,457.5	0.4
Guarantee	184.1	164.1	-10.9
Total	**14,291.8**	**15,373.3**	**7.6**
Actual	13,911.1	15,017.2	7.9
Guarantee	380.7	356.1	-6.5

Source: Bureau of Treasury

As of April, actual debt of the national government increased by 7.9 percent to PhP15.0 trillion, year-on-year, 68.3 percent of which is accounted for by domestic debt. There was an increase of some Php91.5 billion in new obligations from the previous month (March) partly owing to the depreciation of the peso against the US dollar. The peso hit the PhP57 to 1USD mark in April 16, the first time in two years. Positive investor sentiment also contributed to the rise in debt stock as investments in debt securities rose by almost Php861.5 billion (7.2 percent) year-on-year.

External Accounts

A softer deceleration in exports has improved the country's trade position. Preliminary trade figures indicate that exports are poised to recover some of its momentum, while import performance remains weak. By the end May 2024, export revenues grew by 7.8% while import payments decreased by 1.7%, year-to-date. This resulted in a narrower trade deficit of US$20.6 billion, equivalent to a 13.1% decline. However, it should be noted that aggregate figures for exports and imports are still below their 2022 levels.

Outward shipments rebounded with higher orders of semiconductors (10.7%) and bananas (9.9%), making them among the few export commodities to exceed their 2022 cumulative performance. Notably, shipments to China recorded a steep 21.3% decline, partially offset by a surge in exports to Hong Kong. On the other hand, inward shipments continued to decline, dragged down by lower payments for capital goods (-5.7%) and raw materials and intermediate goods (-1.6%). However, imports of rice (76.8%) and corn (156.2%) increased, driven by lower tariff rates extended by Executive Order 62 s. 2024.

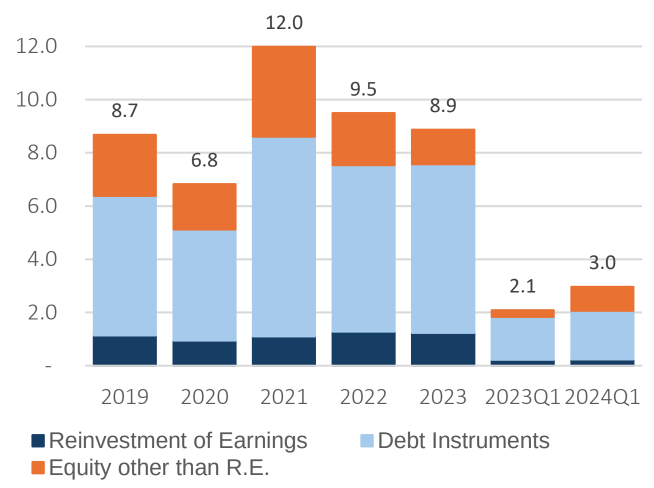
The World Trade Organization (WTO) projects a 2.6% expansion in global merchandise trade volume in 2024, emphasizing world trade's resilience despite protracted geopolitical tensions. This optimistic projection is anchored on an improving inflation outlook, which is expected to support demand for tradable goods and increased household consumption. However, the recent uptick in domestic inflation and slowing expansion, as signaled by the Manufacturing Purchasing Managers' Index (PMI) present downside risks to the forecast.

Meanwhile, trade in services continued to expand, posting double-digit growth by the end of the first quarter. Service exports were driven by travel (33.2%) and other business services (2.2%), with both sectors already exceeding their cumulative pre-pandemic figures. However, the country's services surplus continued to shrink as the growth in imports consistently outpaced that of exports.

The Philippine peso neared its historic low due to accelerating inflation and delayed rate cuts by the US Federal Reserve. The local currency traded towards the PhP59 level heading into July 2024, recording a 4.77% depreciation against the greenback. The Development Budget Coordination Committee (DBCC) projects the exchange rate to settle between PhP55-57 for 2024. The BSP reassured that the current depreciation is only temporary, citing a regional trend with the Thailand baht and Indonesia rupiah shedding 4.99% and 8.54%, respectively. The Fed's actions have renewed calls to reduce reliance on the US dollar with Indonesia, Malaysia, and Thailand agreeing to promote the use of local currencies in cross-border transactions. The Philippine peso strengthened in mid-March amid concerns over a softening US manufacturing industry. The exchange rates, however, have since been on a downtrend, falling to its lowest level in 20 months.

The central bank projects that inflation could peak by July before settling within the upper end of the government's target range. As such, interest rates are expected to remain steady, especially since inflation climbed to 3.9% in May. Despite this, the BSP maintains that it could reduce rates as early as August, noting that economic growth in the first quarter was hampered by high borrowing costs. Their optimism is based on expectations of slower inflation due to the reduction in rice tariffs. The impending rate cuts are expected to spur consumer spending which would increase demand for the domestic currency and thereby strengthen the Philippine Peso.

Figure 5. Net foreign Direct Investment, in US$ billion, 2019-2024Q1



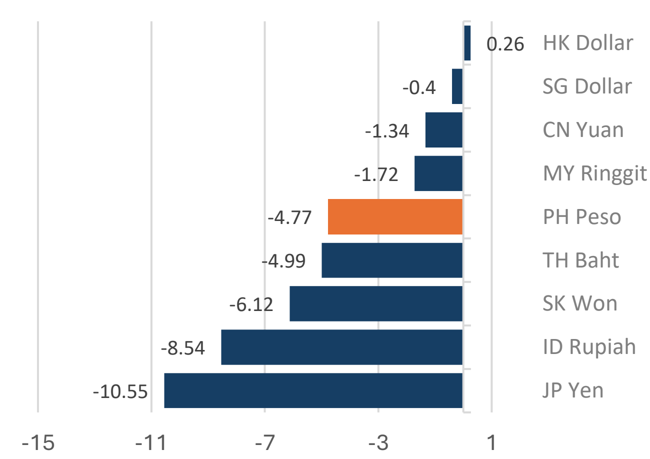
Source: Bangko Sentral ng Pilipinas

Cooling inflation will support investment flows but may be dampened by high borrowing costs. Investment performance started the year positively, with net FDIs growing by 18.7% to US$3.5 billion by the end of April 2024. The expansion was driven by equity placements from the Netherlands, which accounted for around 75% of equity inflows. The bulk of these investments went into finance and insurance activities, while a fifth was directed towards manufacturing.

The uptrend in ASEAN investments is expected to continue, driven by the restructuring of global supply chains and an improving policy environment. The Asian Development Bank (ADB) reported that the region's share of global FDI has expanded through main modes of international investment, including greenfield projects, international project finance deals, and cross-border mergers and acquisitions.[4] The report highlights the strong pull factor provided by regional integration initiatives such as ASEAN and RCEP, which enable firms to expand operations and access rapidly growing markets.

High borrowing costs, however, have constrained investors from maximizing these opportunities. Economic uncertainties, particularly the geopolitical tensions and the delayed US Fed cuts, have kept borrowing costs high or volatile, hampering investment activities. For instance, the tight financial conditions have already weighed down on FDI pledges as data on approved foreign investments show that it fell by 63.6% in the first quarter.

Figure 6. Depreciation (-) / Appreciation (+) of Selected Asian Currencies vis-a-vis US Dollar, 2024 June, Period Average (%)



Source: Bangko Sentral ng Pilipinas

[4] https://seads.adb.org/solutions/investors-favor-southeast-asia-economic-landscape-changes

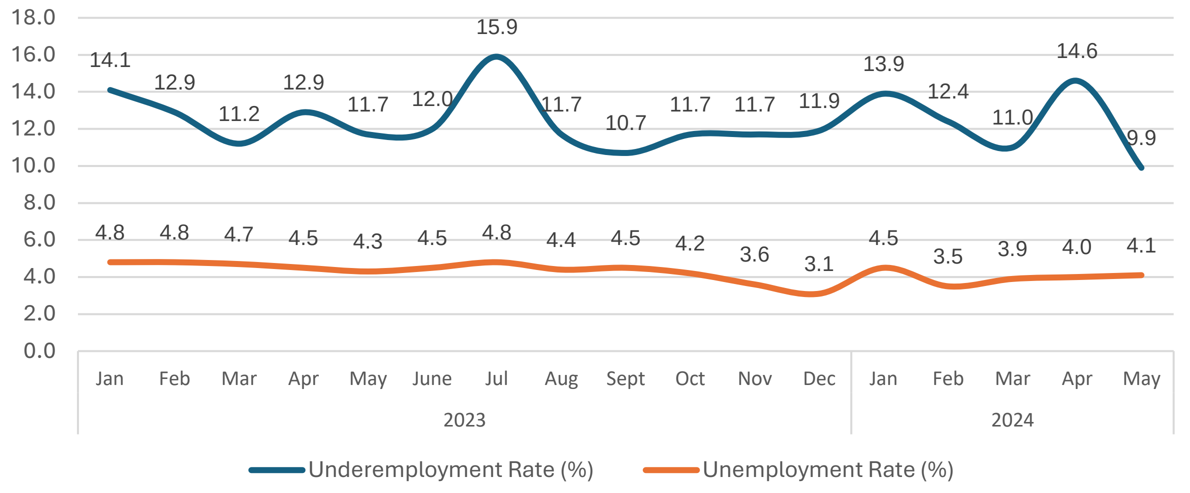
Record Overseas Filipino Worker (OFW) deployment is expected to boost remittances to new highs. Cash remittances increased by 2.8%, driven by transfers from overseas land-based workers. Solid growth was reported in traditional markets, particularly from the United States (2.4%), the Middle East (3.5%), and Europe (2.3%).

After posting a 55-year high in OFW deployment, the Department of Migrant Workers expects this trend to continue rising this 2024. Data from the DMW showed that a record 2.3 million migrant workers were deployed in the previous year. The Department has announced that at least 38 bilateral labor agreements are in the pipeline, signifying strong demand for Filipino workers. Remittances will also benefit from the lifting of the visa ban on domestic workers to Kuwait, given its sizeable domestic worker population, which accounts for nearly 10% of transfers from the Middle East.

Labor and Employment

The improving labor market highlights the need for quality jobs. Unemployment rates have remained stable, staying under 5% for at least 17 months. Data shows that more workers are transitioning from jobs in the agriculture sector (-13.3%) towards employment in the industry (14.5%) and services (3.5%) sectors. Specifically, more than 1 million jobs were lost in the agriculture and forestry group alone. The corresponding increases, however, more than made up for this loss with job creation concentrated in the administrative and support services (18.1%), along with the construction (17.1%) and manufacturing (9.9%) industries. While this is a welcome development for the labor market, some indicators point out that the quality of jobs may still be improved.

Figure 7. Employment rate (2023-May 2024)



Despite lower overall unemployment, an increase in unemployment was reported for the 15-24 age group which includes recent graduates from senior high school and college. Unemployment among those with post-secondary qualifications, in particular, rose by 47% as of May 2024. These figures suggest that some graduates are actively deciding against available jobs, possibly due to job quality or mismatches in skills and opportunities.

On the other hand, the underemployment rate fell to 9.9% in May 2024, recording its lowest since 2005. While underemployment has largely been prevalent in the services sector, recent data showed a marked improvement in the sector's job quality with a 5.1% decline in underemployment. Conversely, more workers in the agricultural sector are considering themselves underemployed (5.4%) due to the effects of El Niño on production. Data from the PSA indicate lower yield in crops, livestock, and fisheries.

Prospects, risks and policy implications

Prospects for economic growth remain positive although external headwinds are expected to weigh on this prospect. Despite elevated consumer prices and high interest rates, private household spending exhibits some resilience, supported by a strong labor market, credit growth, and steady remittances. The first quarter rebound in exports, primarily attributed to a cyclical upturn in electronics, could be sustained if business services and tourism continue to recover. The Philippines, however, cannot completely isolate itself from the adverse effects of external factors and must remain vigilant and brace itself for some headwinds.

First, extreme climate events and increasing geopolitical tensions will ensure the persistence of upward inflationary pressures. The continued presence of upward inflationary pressures is likely to delay monetary policy normalization, further dampening private domestic demand. The Bangko Sentral is committed to the flexible exchange rate system and a credible inflation targeting framework, which act as buffers to external economic shocks. Given that the Philippines is relatively less exposed to volatile capital markets, government should focus its efforts on containing surges in food prices. For instance, rising rice prices disproportionately impact poor households, highlighting the need for targeted measures and/or support to address food security concerns. The issuance of Administrative Order No. 20, which streamlines the procedure for the importation of agricultural products, as well as Executive Order No. 62, which lowers tariffs on imported rice from 35 percent to 15 percent, are steps in the right direction. The significant increase in the annual budget of the Department of Agriculture (DA) aims to enhance crop productivity and efficiency in logistics and transportation in the agriculture sector. Further evaluation and assessment though would have to be done to determine whether such increase in the DA's budget ultimately results in higher productivity and reduced food prices.

Second, other external factors such as fragmentation in global trade, trade protectionism, as well as slower-than-expected growth in China could disrupt global trade and investment activity. Domestic policies on investments would have to constantly be improved to spur investment growth in the domestic market, which could compensate for the potential disruption in foreign investments. For decades the Philippine economy has been dependent on private household consumption rather than being investment-led. It has been overtaken by its ASEAN neighbors in terms of attracting foreign investments despite maintaining its investment-grade sovereign credit rating and sound macroeconomic fundamentals. Poor infrastructure, high power costs, weak institutional frameworks that result in inconsistent policies, as well as poor governance (i.e., corruption) are often cited as factors that disincentivize investments. In recent years, the Philippines made progress in improving the investment climate by enacting the following legislation: Ease of Doing Business Act, Amendment to the Public Service Act, Retail Trade Liberalization Act, amendments to the Foreign Investment Act, and the Corporate Recovery and Tax Incentives for Enterprises Act. Nonetheless, much of these legislations were geared towards attracting foreign direct investments rather than incentivizing the growth of micro-, small, and medium enterprises (MSMEs) which make up a much larger number of local enterprises. MSMEs continue to face challenges in accessing affordable credit and paying taxes. The government should assess the effectiveness of the Credit Surety Fund Cooperative Act and the Personal Property Security Act in channeling loanable funds to MSMEs and supporting their performance. Additionally, leveraging digital payment systems could address some of the challenges faced by MSMEs.

Third, fiscal consolidation has become more challenging. In a high inflation environment, government might need to expand social support programs or extend subsidies or cut taxes, thereby decreasing revenues (e.g., decrease tariff rates on agricultural products). Government might want to consider new tax policy or administrative measures to improve resource mobilization. Recently, the Real Property Valuation and Assessment Reform Act was signed into law, improving the valuation of real properties (by using a common valuation standard) so that both property owners and government can unlock the potential of their assets. Additional revenues (of local government units) may then be utilized to accelerate infrastructure and social services. Last May, the Senate likewise approved Senate Bill 2528 that seeks to impose 12% value-added tax (VAT) on digital services delivered by either resident or nonresident digital service providers. The measure is estimated to bring in an additional PhP83.8 billion in revenues. Another tax measure on the table is the Rationalization of the Mining Fiscal Regime, which seeks to simplify the tax system and ensure the government's fair share in mining revenues. On the expenditure side, inefficient spending and increasing value for money in government procurement will be essential for fiscal consolidation. The amendment to the Government Procurement Reform Act, ratified by both houses of Congress last May, includes provisions for disclosing beneficial ownership, which is crucial for promoting transparency and preserving integrity in government procurement.

This Economic Report was prepared by the Macroeconomics Group with inputs from its Sector Head, under the supervision of SEPO's Directors and the overall guidance of its Director General. The views and opinions expressed herein are those of the SEPO and do not necessarily reflect those of the Senate, of its leadership, or of its individual members. For comments and suggestions, please e-mail