



DLSU REPORT ON THE PHILIPPINE ECONOMY

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Authors: Jesus Felipe, Mariel Monica Sauler, Gerome Vedeja, Seth Paolo Paden

Deceleration continues—and the damage stays

With half of 2026 behind us, our view of the Philippine economy is clear. The latest indicators reinforce the assessment that we have a fragile economy. It is true that the energy shock is important but, at the same time, we lack levers to maneuver. If anything, we have become more pessimistic and, consequently, our revision is downward.

Our **June 2026** forecast in Table 1 projects the Philippine economy to grow by **3.08%**. This represents a slight downward adjustment from our May forecast (3.11%). While the difference is small, indicators suggest that the recent global and domestic shocks may be affecting the economy more persistently than previously thought. The quarterly trajectory throughout the year remains weak.

Table 1: Year-on-Year Growth Rates (%)
Actual (2025) and Forecasts (Q1-Q4 2026, 2027-2028)

	2025 ^a	2026				2026	2027	2028
		Q1 ^a	Q2	Q3	Q4			
GDP	4.4	2.8	2.50	2.20	4.81	3.08	3.40	3.60
Private Consumption	4.6	3.0	2.50	2.20	3.50	2.82	4.03	4.60
Government Expenditure	9.1	4.8	5.00	5.50	7.00	5.26	10.50	11.00
Gross Fixed Capital Formation	0.5	-2.7	-1.50	-2.50	3.00	-1.74	-1.82	-2.00
Exports	8.1	7.8	3.00	2.50	4.00	4.81	5.83	6.88
Imports	5.1	6.1	1.35	0.76	1.53	1.78	5.69	7.09
Agriculture	3.1	-0.2	0.50	-0.50	1.50	0.27	0.88	0.40
Industry	1.5	-0.1	1.00	2.80	5.50	2.24	1.25	1.25
Service	5.9	4.5	3.49	2.31	4.97	3.88	4.77	5.17

Source: Philippine Statistics Authority (actual), DLSU High-Frequency Model of the Philippine Economy (forecasts)

Notes:

- (i) a — Actual values (Philippine Statistics Authority)
- (ii) Forecasts in this monthly report combine our High-Frequency Model of the Philippine Economy with AI-driven analyses integrating observable data, news reports, and published analyst assessments. This is our first step toward adopting machine-learning (ML) methods. Our estimates at this stage are approximations and subject to judgment.

Jesus Felipe is Distinguished Professor in the Department of Economics, De La Salle University
 Mariel Monica Sauler is Associate Professor in the Department of Economics, De La Salle University
 Gerome Vedeja is Lecturer in the Department of Economics, De La Salle University
 Seth Paolo Paden is Research Assistant in the Department of Economics, De La Salle University

Growth in the first quarter, confirmed by the Philippine Statistics Authority (PSA) at **2.8%**, now looks less like the trough it appeared to be in May—and more like the beginning of a downward trend.

We expect a slower second quarter growth at **2.50%** and the third quarter to represent the true trough at **2.20%**. By then, the impact of the energy shock could be fully transmitted, the BSP rate hike cycle could reach the potential height of its demand-dampening effect, and the impending food crisis (due to fertiliser cost surge and upcoming El Niño) could begin contracting agricultural output. The final quarter growth shows potential recovery (**4.81%**), but this will ultimately depend on the government's ability to materialise its plan to catch up on infrastructure spending and other priority projects.

The US-Iran conflict has not subsided; instead, it has entered a volatile cycle of military escalation and diplomatic efforts. Factoring this global uncertainty and the continued domestic political crisis (as seen in the recent changes in the Senate leadership), we firmly believe that Philippine growth will lie materially below its potential growth for 2026. As we complete this report on June 15, we read that US and Iran have reached an agreement to end the war that started February 28. The agreement is expected to be signed June 19. The Strait of Hormuz will open immediately. The two parties will agree on the details (e.g., end of Iran's sanctions, Iran's nuclear program) during the next 60 days.

Medium-term growth is expected to pick up, though less strongly than our May forecast implied. We project **3.40%** in **2027** and **3.60%** in **2028**. We do not see faster growth under the current domestic and international conditions. Unless the US/Israel-Iran war ends soon (the two parties just agreed to end it) and the world economy recovers fast, and the domestic mood turns around, this state of affairs will remain until the end of this Administration. The 2027 figure is a pre-election year driven by government expenditure as various agencies build project pipelines ahead of the May 2028 elections. The 2028 forecast (substantially lower than our May forecast of 5.71%) reflects our revised view that the economy will not be able to grow faster. 2028 will be election year and we will see the usual pattern of high government spending during the first two quarters. However, both 2027 and 2028 remain well below the government's targets (5.5–6.5% for 2027, 6.0–7.0% for 2028), confirming that the damage from the compound shocks of 2026 will linger in the coming years.

Rationale behind the slight adjustment in forecast

The 3.08% growth rate sits below our May forecast of 3.11%. While the difference may seem small in aggregate terms, this revision is meaningful in mechanism. The confirmation of May 2026 CPI at 6.8% brings better news for the inflation path but does not fully reduce the real shock already embedded in tangible economic signals that we have picked up from several news sources.

The Middle East conflict and Hormuz closure remains the single largest negative shock that continues to breed uncertainty into domestic growth prospects. This drove diesel prices to climb by more than 172% and gasoline by 72.6%. With the Philippines importing over 90% of its petroleum requirements, the price passthrough becomes immediate and complete. Transport CPI rose to 21.4% in April. The purchasing power of the peso fell to a record-low ₱0.73 per 2018-base peso. The balance of payments deficit reached \$7.41 billion cumulatively through April (already 95% of the BSP's full-year forecast) with gross international reserves falling from \$113.3 billion in February to \$104.3 billion in April.

The recent BSP rate hike cycle also added a policy-induced contraction. The April 24 hike to 4.50%, the first since October 2023, reversed the 225-basis-point easing cycle. Governor Remolona confirmed that the Monetary Board was considering an off-cycle hike before the June 18 meeting, characterising the supply shock as 'big and persistent, not transitory.'

The fertilizer-food second wave is the most consequential lagged signal and the one with the widest uncertainty range. The DA has already revised its 2026 palay output downward. Rice inflation at 13.7% in April is the leading edge of a food price acceleration that is not yet fully reflected in Q2–Q3 activity data.

Furthermore, the ongoing political fiasco compounds the picture. On top of the flood control scandal that remains fully unresolved, the recent turbulence within the Senate due to many intertwined issues (e.g., abrupt leadership changes, Senator Bato dela Rosa in hiding due to an impending arrest by the International Criminal Court, convening as an impeachment court for Vice President Sara Duterte-Carpio's trial) could further provide a blow to the already-pessimistic economic outlook that may further constrain foreign investment inflows.

Overall, the complex interplay of global and domestic shocks continues to exacerbate the already-entrenched pessimism in the Philippine economic environment. And with the light at the end of the tunnel still too far from sight, we can expect economic expansion to take a back seat in 2026.

Private consumption

Household final consumption is projected to grow **2.82%** in full-year **2026**, the weakest annual reading in the post-pandemic era. The quarterly arc, specifically in **Q2 (2.50%)** and **Q3 (2.20%)**, exhibits a decelerating trend as the impact of the energy shock is fully transmitted into prices. The PSA even reported that inflation for the bottom 30% of income household actually reached 8.5% in April 2026. However, as inflation eased to 6.8% in May 2026, signs of recovery is expected in the last quarter of the year to **3.50%** as inflationary pressures descend.

The medium-term outlook for consumption is more encouraging than the 2026 trough suggests. We project **4.03%** in **2027** as real wages recover due to disinflation and pre-election support programmes augment household income. In addition, the **2028** figure (**4.60%**) reflects election-year cash transfer programmes, campaign-linked employment income, and a possible monetary easing as inflation stabilises. This projected recovery, however, is gradual. Scarred households that entered a sustained saving mode in 2026 do not immediately return to pre-shock spending even when the external pressure eases.

Government expenditure

Government spending is forecast to grow **5.26%** in **2026**, with a quarterly profile that accelerates steadily through the year: **3.56%** in **Q1** (PSA actual), **5.00%** in **Q2**, **5.50%** in **Q3**, and **7.00%** in **Q4**. The Q1 actual figures (muted relative to the government's own disbursement ambitions) reflects some residues of the flood-control corruption scandal. Data from the Bureau of Treasury (BTr) mentions that expenditures rose 11.14% to ₱505.4 billion, driven by higher disbursement to local government units, payments for foreign-assisted railway projects, and the return of ₱60 billion in excess funds to PhilHealth. The national government should increase spending to catch up and drive short-term economic growth.

The medium-term government expenditure path is where the effects of the electoral calendar sets in. In **2027**, a pre-election year, we project spending at **10.5%**. Such forecast is broadly consistent

with the updated Philippine Development Plan 2023–2028 midterm matrices. By next year, agencies are already expected to build project pipelines in Q1, accelerate procurement in Q2, and achieve full pre-election disbursement momentum towards the second half of the year. This sustained spending throughout 2027 is not an assumption of fiscal recklessness; it is a forecast of behaviour that the Philippine political economy has demonstrated in every pre-election year on record.

In **2028**, the pattern is starker. Fiscal spending is expected to register double digits in the first two quarters as the incumbent administration maximizes visible public spending before the May 2028 elections, before dropping towards the second half as the new administration's spending authority transitions. The full-year average is anticipated to settle at **11.00%**.

Gross fixed capital

Gross fixed capital formation is unambiguously the weakest driver of economic expansion across the entire three-year horizon. It remains negative in every annual period: **-1.74%** in **2026**, **-1.82%** in **2027**, and **-2.00%** in **2028**. This persistent contraction is highly consequential because it implies that the economy's capital base (i.e., its productive capacity) is dwindling. A forecast that shows positive GDP growth alongside negative capital formation growth is describing a fundamentally consumption- and government spending-led expansion with a weak private investment engine.

The **Q1 2026** PSA actual of **-5.97%** set the tone with severity, suggesting that the business sector has indeed absorbed the corruption-induced damage in economic confidence. Public infrastructure spending also declined by 44% year-on-year in Q1 (PHP 147.8 billion, down from PHP 261.8 billion a year earlier). The quarterly path (**-1.50%** in **Q2**, **-2.50%** in **Q3**, **3.00%** in **Q4**) shows a gradual exit from deep contraction, with Q4 turning marginally positive as government infrastructure disbursements begin and some private construction activity picks up. Our full-year forecast of **-1.74%** also shows the first annual contraction in fixed capital formation since the pandemic.

Despite the brief uptick in Q4 2026, the medium-term path does not recover to positive territory. In **2027**, private investors could be deterred by pre-election uncertainty. Large capital commitments require multi-year policy visibility, a condition that electoral transitions cannot provide. Although some public infrastructure pre-positioning may begin as the Luzon Economic Corridor (LEC) partner-countries' commitments (with Australia, France, the United Kingdom, South Korea, among others) move from agreements to procurement, disbursements are too premature to drive positive growth in capital formation. Overall, we believe that a genuine private investment recovery (not just reduced contractions) is going to be a post-2028 story, dependent on the new administration's infrastructure programme and the trajectory of BSP rate normalisation into 2029.

Exports

Export growth for full-year **2026** is projected at **4.81%**, a deceleration from the 7.45% recorded in 2025 but considerably more resilient than other domestic demand components. The **Q1** actual growth of **9.74%** (with goods exports up 13.3% year-on-year) confirmed that the AI-driven semiconductor upcycle remains intact even as domestic conditions deteriorated. Electronic products account for half of total Philippine merchandise exports, typically around 50-55% in recent years, and the demand signals from global technology supply chains are insulated from both the Hormuz disruption and the BSP tightening cycle.

The quarterly path that follows Q1 (**3.00%** in **Q2**, **2.50%** in **Q3**, **4.00%** in **Q4**) reflects the Hormuz-related logistics disruptions and freight cost spikes that temporarily compress export volumes and

competitiveness. Though peso's depreciation to an all-time low of ₱61.75 provides some nominal price competitiveness, such gains are partially offset by the higher cost of imported intermediate inputs, particularly in electronics assembly. The recovery to 4.00% in Q4 as disruptions ease confirms that the export demand remains intact despite the logistics issues created by recent global shocks.

The medium-term export outlook provides some source of optimism. We project a growth of **5.83%** in **2027** assuming post-Hormuz normalisation of shipping lanes combined with the continued strength in the global AI-driven semiconductor cycle and the gradual increase of announced Japanese manufacturing investments, including expansions by MinebeaMitsumi, Furukawa Electric, and Sumitomo Electric. The **2028** figure (**6.88%**) reflects the Philippines' steady role in global semiconductor and digital infrastructure supply chains.

Imports

Full-year import growth for **2026** is projected at **1.78%**, a figure that substantially understates the nominal pressure the Philippines is absorbing from its energy import dependence. The quarterly path (**1.35%** in **Q2**, **0.76%** in **Q3**, **1.53%** in **Q4**) reflects that Filipinos spend far more on imports in dollar terms, but buy less of other goods due to household budgets being stretched. The April 2026 preliminary trade data from PSA showed nominal imports at \$13 billion. However, note that this dollar value surge reflects price, not volume.

The medium-term import trajectory is considerably stronger: **5.69%** in **2027** and **7.09%** in **2028**. The acceleration reflects two convergent forces: (1) recovering domestic demand pulling in consumer and capital goods and (2) the eventual normalisation of the oil import price base from its 2026 peak. The 2028 import surge is partly an election-year phenomenon: pre-election retail and government spending draw in consumer goods, while capital goods imports rise with infrastructure project activities.

Agriculture, forestry, and fishing

Agriculture is forecast to grow a barely positive **0.27%** in full-year **2026**, a dramatic retreat from the 3.14% recorded in 2025 and the sector's weakest performance since the pandemic. The quarterly profile is sharply non-linear: **-0.41%** in **Q1** (PSA actual), recovering to **0.50%** in **Q2**, contracting again to **-0.50%** in **Q3**, and recovering modestly to **1.50%** in **Q4**.

The Q3 contraction is not incidental. Agricultural outputs are anticipated to decline because of the Hormuz fertiliser shock that disrupted approximately a third of global fertiliser transit. With this, the Department of Agriculture (DA) has already revised its 2026 palay output forecast downward to 19.87 million metric tonnes from a pre-conflict target of 20.28 million. The International Rice Research Institute (IRRI) also warned explicitly that a growing percentage of rice farmers are opting not to plant the next cropping season, a sign of forward supply constraint that extends well beyond 2026.

The Q1 PSA actual of **-0.41%** confirmed this vulnerability prior to the crisis. According to PSA, palay farmgate prices rose 29.2% year-on-year in April, reflecting the dual pressure of reduced inventories from the prior import ban and rising input costs. Rice inflation reached 13.7% in April, its second consecutive month of acceleration. Agriculture's 9% GDP weight limits the direct headline impact, but the food inflation transmission the macroeconomic effect considerably.

Medium-term agricultural recovery is projected at **0.88%** in **2027** as fertiliser supply partially restores via alternative transit routes and El Niño conditions ease. However, this growth is expected to weaken again in **2028** to **0.40%**.

Industry

Industry is forecast to grow **2.24%** in full-year **2026**. The quarterly path moves from contraction in **Q1 (-0.33%**, PSA actual) to a slight recovery in **Q2 (1.00%)**, a more meaningful uptick in **Q3 (2.80%)**, and a strong **Q4 (5.50%)** driven by some fiscal acceleration spilling into construction and utility activity. The Q3 figure of 2.80% warrants particular attention. This demonstrates an upward revision from an earlier estimate of 0.80%, reflecting energy sector expansion (with BSP data showing increased lending in the electricity, gas, and air-conditioning sectors by 26.7% year-on-year in March 2026).

The energy vulnerability of Philippine industries is acute, however. Diesel prices at approximately +172% above pre-conflict levels directly raise input costs for food processing, cement, chemicals, and all logistics-dependent manufacturing. Average capacity utilisation also declined through the first quarter, signalling that firms were not merely cost-squeezed but were actively pulling back production. The semiconductor assembly and test subsector remains the critical positive buffer: AI-cycle demand from global technology firms is structurally durable and insulated from domestic cost pressures.

For **2027** and **2028**, industry is forecasted to grow by **1.25%** annually in both years. Capital formation remaining negative precludes any construction-led industrial recovery. In this case, manufacturing gains are limited to semiconductor/electronics, especially with the Pax Silica anticipated to boost semiconductor manufacturing capacity.

Services

The services sector remains the economy's structural anchor. Full-year **2026** growth is projected at **3.88%**, below the 5.82% recorded in 2025, but the strongest outturn across the three supply-side sectors. The **Q1** PSA actual of **4.75%** confirmed that BPO and IT-BPM revenues, financial intermediation, and public administration were holding the economy together while agriculture contracted and industry stalled. Bank lending grew 10.7% year-on-year to ₱14.6 trillion in March according to BSP (a seven-month high) with consumer loans up 20.5%, confirming that financial services activity remained robust even as rate hikes began.

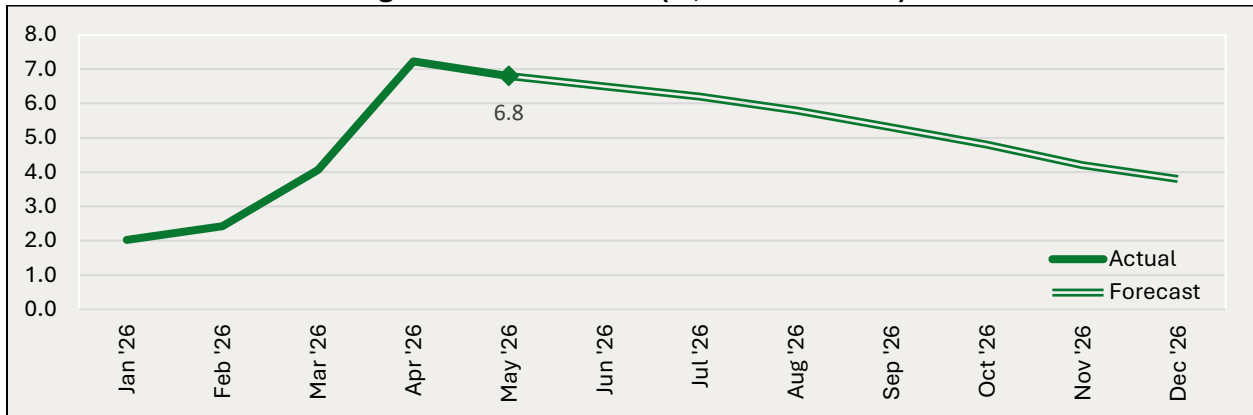
The **Q2–Q3** deceleration (**3.49%** and **2.31%**, respectively) reflects the demand compression from 7.2% (April) and 6.8% (May) inflation weighing on consumer-facing services. Retail, food service, transport, and real estate pre-selling all soften as households prioritise essential over discretionary spending. Growth softens to 2.31% in Q3 before recovering to **4.97%** in **Q4**, as purchasing power partially recovers and worker remittances flow into the domestic economy to support holiday spending.

In **2027**, services growth is broadly stable through the year, sustained by BPO sector expansion (i.e., PEZA's Melbourne investment mission generated pipeline commitments from Australian firms in data centres, AI-linked services, and digital infrastructure). The annual reading of **4.77%** confirms that services remain the primary growth engine on the supply side. In **2028**, the sector is expected to post a strong annual reading at **5.17%**, driven by election-year retail and transport activity, digital finance expansion across retail, real estate, and energy sectors, and the Intelligent City initiative in Makati.

Inflation

Inflation has climbed sharply since the start of 2026, reaching 7.2% in April. In our May forecast, we expected this upward momentum to continue, projecting inflation to peak at around 8% by August. More recent data, however, point to an earlier turning point: inflation eased to 6.8% in May, and our updated forecasts now suggest a gradual decline in prices over the remainder of the year. We now expect average inflation for 2026 to be 4.9%.

Figure 1. Inflation Rate (% , CPI 2018 = 100)



Source: Authors