Mizuho Flash: Philippines

Economics & Strategy | Asia ex-Japan

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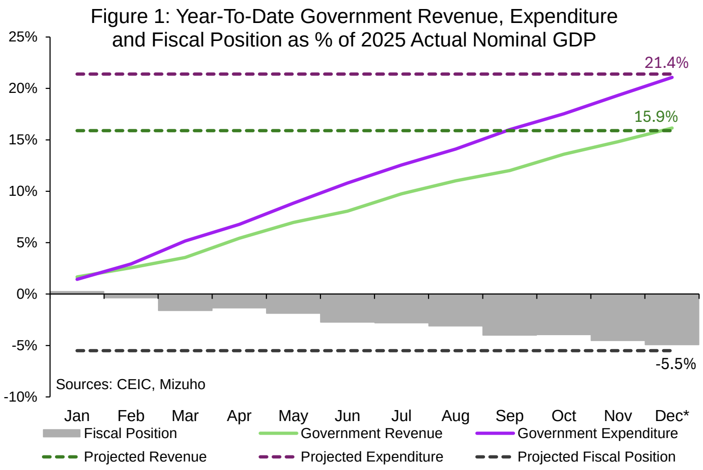
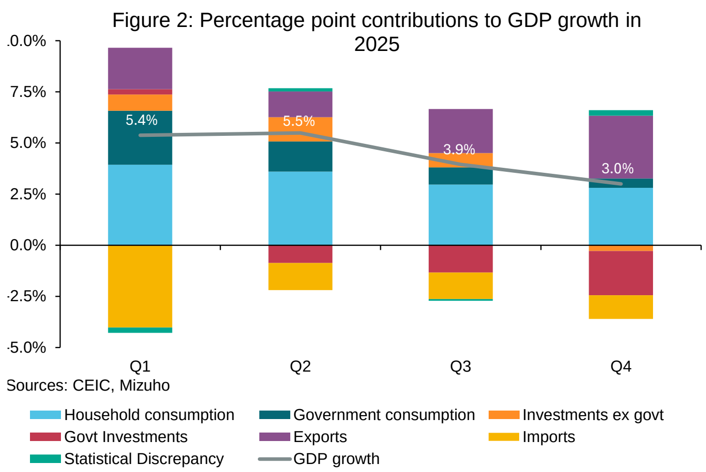
Philippines' Challenged Fiscal Consolidation

In a nutshell:

- Philippines' **2025 fiscal deficit** expected to narrow to 5.0% of GDP, below the official estimate of 5.5% of GDP. This reflects a mechanical effect of sharp spending contraction following the flood project scandal which had a larger impact on the deficit than on GDP.
- For **Budget 2026**, we expect some fiscal slippage resulting in a wider deficit of 5.5% of GDP which is above the official 5.3% target. This stems from better-than-expected revenue outturn being more than offset by likely overshoot in expenditure growth.
- On **revenue**, collection growth hinges on one-off privatisation efforts, signalling difficulties in raising revenues. That said, we expect some revenue upside on account of rather conservative official estimates of non-tax and privatisation revenue as well as the digital services tax.
- Higher **expenditure** in 2026 is mainly driven by higher allocations to Local Government Units to decentralise public service delivery. Department spending, the other major driver of government expenditure, remains flat amid post-scandal reallocation away from the Department of Public Works and Highways.
- Nonetheless, spending is likely to surpass initial projections given historical trend and the need for accelerated spending due to delays in 2025.
- Against this backdrop, a steeper yield curve is par for the course with BSP likely to cut rates given anaemic growth. That said, at the long end, considering the narrower deficit in 2025 and still cautious spending on projects in early 2026, upside pressures on yields may remain rather modest.
- In short, fiscal consolidation is possible but fraught with challenges.
- For the PHP, **near-term depreciation risks** may stem from political instability should the flood control be deemed as inadequately addressed. For now, impeachment of President Macros remains a rather remote tail risk. Meanwhile, the inability to embark on fiscal consolidation remain a key medium-term risk.

FY2025: Fiscal Consolidation at a Cost





- We expect Philippines' **2025 budget deficit to narrow to about 5% of GDP**, undershooting government's estimate of 5.5%. While revenue collections have remained largely in line with projections, expenditure is likely to come in lower than projected, reaching 19.3% of GDP as of November 2025 and will likely fall short of the projected 21.4% of GDP for the full year.
- This is largely due to a sharp pullback in government spending following the corruption scandal, with government

infrastructure expenditure declining by 17% in 2025. As a result, the fiscal deficit is expected to improve by 0.5% overall (lower-than-expected expenditure contributes 0.6% of GDP of improvement in fiscal deficit, offset by 0.1% of GDP worsening from lower actual nominal GDP in 2025).

- The step down in public infrastructure spending has weighed on economic activity, dragging Q3 and Q4 GDP growth down by 1.3%-pt and 2.2%-pt respectively, to 3.9% and 3.0% YoY.
- This represents a significant slowdown from the 5-6% growth rates registered over the past two years.
- In this context, the improvement in its short-term fiscal outlook is not definitively beneficial for Philippines' economy even though the potential improved governance is undoubtedly a positive.
- The pullback in public investment has dragged growth below trend, with potential spillovers to its medium-term growth outlook and revenue collections.

FY2026: Reallocation Not a Remedy

- For Budget 2026, President Marcos Jr signed it into law on 5 January 2026, characterising it as People-Oriented amid a backdrop of softening GDP growth following the flood control corruption scandal that happened in July 2025. The Budget is indeed rather people focused given reallocations to the education and healthcare sector.
- For 2026, we expect Philippines' fiscal position to worsen slightly to 5.5%, which is higher than the official target of 5.3%, as higher than projected expenditure offset better than estimated non-tax revenues.

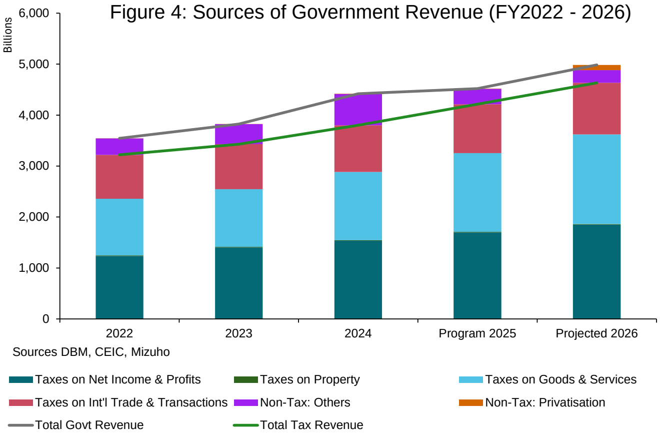
Figure 3: Philippines' Actual and Projected Fiscal Position (FY2024 – 2026)

In Billion Pesos	2024	2025				2026			
	Actual	Program	% YoY	Mizuho	% YoY	Projected	% YoY	Mizuho	% YoY
[A] Govt Revenue	**4,419.0**	**4,520.4**	**2.3%**	**4526.4**	**2.4%**	**4,983.5**	**10.2%**	**5,100.7**	**12.7%**
Tax Revenue	3,800.7	4,213.9	10.9%	4,219.5	11.0%	4,633.4	10.0%	4,679.7	10.9%
Non-tax Revenue	615.0	301.5	-51.0%	301.9	-50.9%	249.1	-17.4%	320.0	6.0%
Privatisation	3.3	5	51.5%	5	51.5%	101.0	1920.0%	101.0	1920.0%
[B] Govt Expenditure	**5,925.3**	**6,082.1**	**2.6%**	**5,904.9**	**-0.3%**	**6,630.0**	**9.0%**	**6,743.4**	**14.2%**
Current Operating Expenditure	4,330.2	4,468.9	3.2%	4,338.1	0.2%	5,020.7	12.3%	5,070.9	16.9%
Capital Outlays	1,588.2	1,584.5	-0.2%	1,538.1	-3.2%	1,580.6	-0.2%	1,643.8	6.9%
Net Lending	6.9	28.7	315.9%	28.7	315.9%	28.7	0.0%	28.7	0.0%
[A] - [B] Fiscal Balance	**(1,506.3)**	**(1,561.7)**		**(1,378.5)**		**(1,646.5)**		**(1,642.7)**	
% GDP	**-5.7%**	**-5.5%**		**-4.9%**		**-5.3%**		**-5.5%**	
Expenditure obligations	**6,273.1**	**6,326.3**	**0.8%**			**6,793.2**	**7.4%**		

Source: Philippines Department of Budget and Management (DBM), CEIC, Mizuho

Revenues: Temporary Boost, Digital and Gaming Upside

Figure 4: Sources of Government Revenue (FY2022 - 2026)



Sources DBM, CEIC, Mizuho

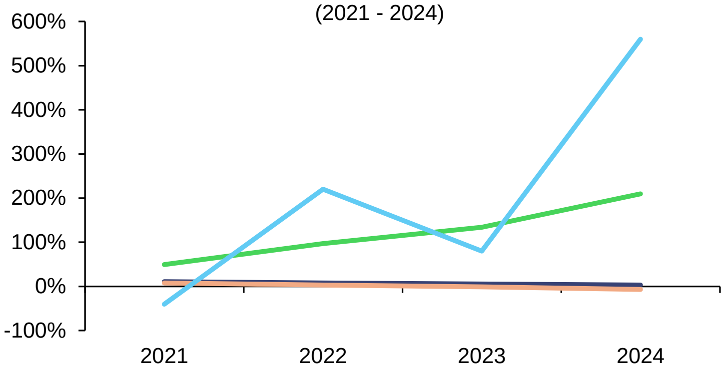
Figure 5: Sources of Revenue as % GDP (FY2022 - 2026)

In Billion Pesos	2022	2023	2024	Program 2025	Projected 2026
Revenues	**3,545.5**	**3,824.1**	**4,419.0**	**4,520.4**	**4,983.4**
Percent GDP	*16.1%*	*15.7%*	*16.7%*	*15.9%*	*16.2%*
Tax Revenues	3,220.3	3,429.3	3,800.7	4,213.9	4,633.4
Percent GDP	*14.6%*	*14.1%*	*14.4%*	*14.9%*	*15.0%*
Non-Tax Revenues	323.5	393.9	615.0	301.5	249.1
Percent GDP	*1.5%*	*1.6%*	*2.3%*	*1.1%*	*0.8%*
Privatisation	1.6	0.9	3.3	5.0	101.0
Percent GDP	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.3%*

Source: DBM, figures may not add up due to rounding

- Total revenue as share of GDP is expected to rise from 15.9% to 16.2%. Tax revenues are projected to keep pace with nominal GDP, contributing a modest 0.2%-pt to the ratio while the lower non-tax revenue (-0.3%-pt) is offset by higher revenue from privatisation (+0.3%-pt). The projected 0.3% of GDP boost to revenue comes from government's planning privatisation of three real estate assets.
- Excluding this one-off, **fiscal consolidation would be limited** as revenue-to-GDP ratio would slip to 15.9% which is unchanged from 2025, **reflecting the authorities' difficulties in improving collections**.
- We anticipate a stronger revenue outturn for FY2026, largely because non-tax and privatisation revenues tend to exceed budget assumptions. The government usually takes a conservative approach when estimating non-tax income that includes fees, dividends and other receipts, such as gaming related revenues, presenting a meaningful upside risk to revenues.
- Furthermore, **digital services tax collection** rolled out in H2 2025 could also pose further upside surprise to revenues. However, our projected overshoot will likely be more subdued compared to previous years, as the Philippine Amusement and Gaming Corporation (PAGCOR) that contributes part of its income to the government, has seen decline in its revenue following the ban on offshore gaming in 2025.

Figure 6: % deviation between actual and projected revenues (2021 - 2024)

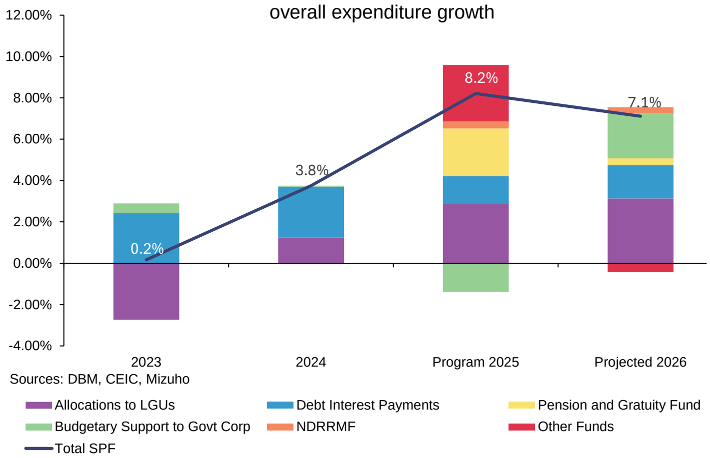


Sources: DBM, Mizuho

Expenditure: Near- and Long-Term Needs

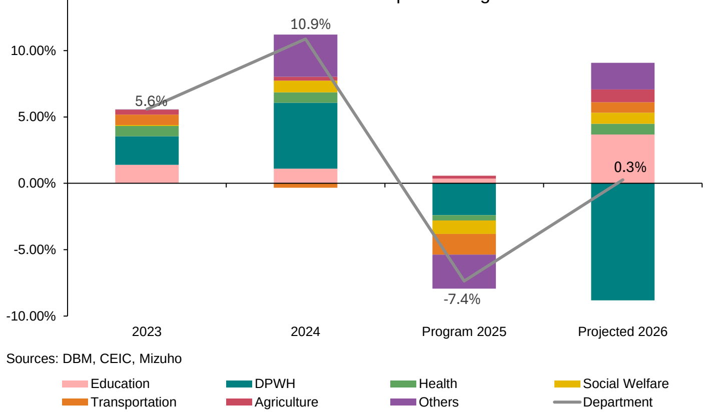
- On the expenditure side, obligations are expected to grow 7.4% YoY, driven mainly by allocations to Special Purpose Funds (SPF), which contributed 7.1%-pt while department budget contributed a modest 0.3%-pt.

Figure 7: Special Purpose Funds as percentage point contribution to overall expenditure growth



Sources: DBM, CEIC, Mizuho

Figure 8: Department spending/budget as percentage point contribution to overall expenditure growth



Sources: DBM, CEIC, Mizuho

Special Purpose Funds

- For SPF, contribution to expenditure growth is mainly driven by Allocations to Local Government Units (LGUs) (+3.1%-pt) and Budgetary Support to Government Corporations (BSGC)[1] (+2.2%-pt).
- The higher budget allocation for LGUs is potentially constructive as the decentralisation of public service delivery can improve governance and better meet local needs. Complemented with strong oversight, it can reduce leakages and improve the multiplier effects of government spending over time.
- The allocation to the National Disaster Risk Reduction and Management Fund (NDRRMF) also contributed 0.3%-pt of expenditure growth, to fund aid, relief and rehabilitation for disaster-affected communities.

Department Spending

- Within departmental spending, there is a continued cut to the budget of the DPWH[2], with its budget declining 51.2% YoY to ₱530.9 billion, a drag of 8.8%-pt to expenditure growth.
- The reduction in DPWH's budget was reallocated to other agencies to fund priority programmes, and this is reflected in the following departments' contributions to expenditure growth: Education[3] (+3.7%-pt), Agriculture[4] (+1%-pt), Social Welfare and Development, Transport and Health (each +0.8%-pt).
- The reallocation of spending from DPWH towards social and sectoral departments will provide much needed support for more inclusive development.
- In the longer term, **disaster-related risks will still need to be adequately addressed** via government investments in infrastructure and confidence restored via an improved procurement and governance process, even as aid relief will be required via the higher allocation to the NDRRMF.

- On balance, considering historical trend of overshooting expenditure and the potential for catchup spending following the delays in 2025, a faster pace of disbursements is very likely. That said, this is likely a modest overshoot of around 2%, given the substantial reduction of 59% in unprogrammed appropriations to ₱150.9bn which limits the scope for executive discretionary spending.

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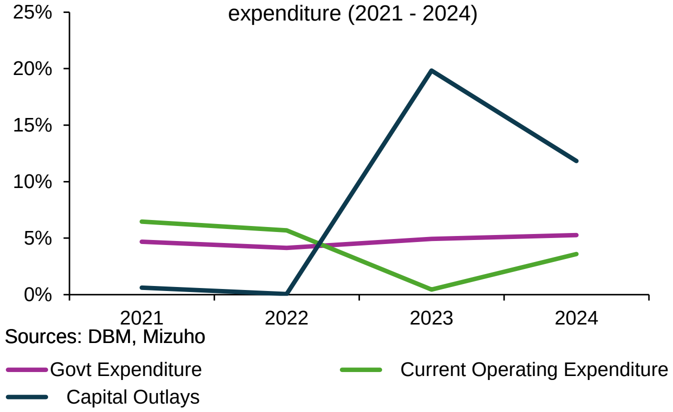
[1] The higher BSGC budget is largely driven by an increased allocation of budget to PhilHealth (+₱130bn). Part of the increase is due to a restoration of ₱60bn following a Supreme Court's ruling that deemed the earlier transfer of these funds to the National Treasury to support unprogrammed appropriations in 2024 as unconstitutional. The remaining increase is to fund the expansion of PhilHealth's coverage and benefits, with the aim of making quality healthcare more accessible for all.

[2] DPWH's budget did not include any provision for new locally funded flood projects, but there is budget for continued maintenance of existing flood-related infrastructure and programmes.

[3] For Education, the budget supports the creation of over 60k teaching and non-teaching positions in public schools to increase the quality of teaching and the expansion of funding for the School-Based Feeding Program and Basic Education Facilities Program

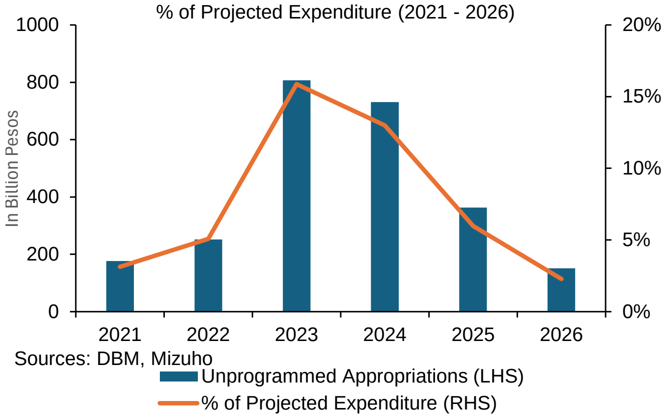
[4] For Agriculture, the higher budget is directed towards investments in Farm-to-Market Roads to enhance rural infrastructure, improve market access and reduce transportation costs for farmers.

Figure 9: % deviation between actual and projected expenditure (2021 - 2024)



Sources: DBM, Mizuho

Figure 10: Approved Unprogrammed Appropriations, and as % of Projected Expenditure (2021 - 2026)



Sources: DBM, Mizuho

Deficit: Prior Relief & Optimistic Assumptions

- Overall, we expect the fiscal deficit to widen to 5.5% of GDP, above the official target of 5.3% due to higher expenditure only being partially mitigated by higher than projected revenues, and a 0.1%-pt increase stemming from our expectations for a more conservative nominal GDP forecast.
- We maintain a more conservative outlook for 2026 nominal GDP compared to official government targets. To be clear, this **caution is in part a statistical one** which is informed by base effects following two consecutive quarters of below-trend growth (H2 2025), with 2025 actual nominal GDP falling short of official estimates by 2.6%, resulting in a much higher bar to reach the official 2026 nominal GDP levels.
- Despite factoring a government investment spending rebound in Q2, our nominal GDP estimate will still fall 2.5% below the official forecast. The smaller nominal GDP adds 0.1%-pt to the fiscal deficit.
- On aggregate, even as some fiscal slippages are expected, the wider deficit in 2026 will be somewhat soothed by the restrain in 2025.
- That said, in the medium term, **collection efficacy and revenue measures will be closely watched** as the restrictive stance on DPWH is certainly not a remedy for wider fiscal consolidation. Governance improvements in expenditure spending will also be essential to shore up confidence in broader investment spending and reduce risks of further unrest given that protests over the corruption scandal have not eased.

Paths: Steeper Curve, Shaky PHP

- All in, a mild steepening of the yield curve remains the base case. Front end yields continue to face downside risks in H1 amid prospects of the BSP cutting rates to support growth to compensate for the lack of fiscal impulse.
- As fiscal spending is likely to resume towards mid-2026, long-end yields may face upside pressures in H2. Worries of lower potential growth entrenching itself may also engender the need for additional risk premium and buoy long end yields.
- As for the PHP, potential political instability from the handling of the flood control project scandal remains a key risk in the near term even though impeachment attempts on President Marcos are unlikely to be successful.
- In the medium term, continued fiscal slippage will worsen twin deficit woes to restrain the extent of PHP recovery even amid backdrop of softer USD.