

PHILIPPINES ECONOMIC UPDATE

Safe Water And Sanitation For All

DECEMBER 2023



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Philippine Economic Update December 2023



PREFACE

The Philippines Economic Update (PEU) summarizes key economic and social developments, important policy changes, and the evolution of external conditions over the past six months. It also presents findings from recent World Bank analyses, situating them in the context of the country's long-term development trends and assessing their implications for the country's medium-term economic outlook. The update covers issues ranging from macroeconomic management and financial-market dynamics to the complex challenges of poverty reduction and social development. It is intended to serve the needs of a wide audience, including policymakers, business leaders, private firms and investors, and analysts and professionals engaged in the social and economic development of the Philippines.

The PEU is a biannual publication of the World Bank's Macroeconomics, Trade and Investment (MTI) Global Practice (GP), prepared in partnership with the Finance, Competitiveness and Innovation (FCI); Poverty and Equity; Social Protection and Jobs (SPJ). Lars Christian Moller (Practice Manager for the MTI GP), Gonzalo Varela (Lead Economist and Program Leader), and Ralph van Doorn (Senior Economist) guided the preparation of this edition. The team consisted of Kevin Cruz (Economist and Task Team Leader), Karen Lazaro (Research Analyst), Ludigil Garces and Patrizia Benedicto (Consultants) from the MTI GP; Radu Tatu (Senior Financial Sector Specialist) and Ou Nie (Financial Sector Economist) from the FCI GP; Nadia Belghith (Senior Economist) and Sharon Piza (Economist) from the Poverty & Equity GP; Paula Cerutti (Senior Economist), Ruth Rodriguez (Senior Social Protection Specialist), Yoonyoung Cho (Senior Economist) and Ma. Laarni Revilla (Consultant) from the SPJ GP. A World Bank team from the Water GP, consisting of Ma. Fiorella Delos Reyes Fabella (Senior Economist), Aude-Sophie Rodella (Lead Water Economist), Georges Comair (Senior Economist), and Annabella Simbulan (Consultant) prepared the Special Focus Note on Ensuring Sustainable Water Supply and Sanitation, under the guidance of Maria Angelica Sotomayor (Practice Manager) and Lars Moller. The report was edited by Oscar Parlback (Consultant), and the graphic designer was Pol Villanueva (Consultant). Peer reviewers were Alief Aulia Rezza (Senior Economist), Indira Maulani Hapsari (Senior Economist) and Fan Zhang, Lead Economist, SWADR. Logistics and publication support were provided by Geraldine Asi (Team Assistant). The External Communications Team, consisting of Clarissa David, David Llorito, Stephanie Margallo, and Moira Enerva (Consultant) prepared the media release, dissemination plan, and web-based multimedia presentation.

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ABBREVIATIONS AND ACRONYMS

ASEAN	Association of Southeast Asian Nations	LICs	Low-income countries
BARMM	Bangsamoro Autonomous Region in Muslim Mindanao	LWUA	Local Water Utilities Administration
bbI	One stock tank barrel	MCM	Million cubic meters
BIR	Bureau of Internal Revenue	MICS	Multiple Indicators Cluster Survey
BOP	Balance of payments	MLGU	Municipal local government unit
BPS	Basis points	MTFE	Medium-term Fiscal Framework
BSP	Bangko Sentral ng Pilipinas	NCDs	Noncommunicable diseases
BTr	Bureau of Treasury	NCR	National Capital Region
CA	Current account	NGA	National government agency
CCDR	Country Climate Development Report	NNS	National Nutrition Survey
DBM	Department of Budget and Management	NOWD	Non-operational water districts
DENR	Department of the Environment and Natural Resources	NPL	Non-performing loan
DHS	Demographic Household Survey	ODA	Output-based aid
DOF	Department of Finance	ODC	Other depository corporations
DWR	Department of Water Resources	OFs	Overseas Filipinos
EAP	East Asia Pacific	PDP	Philippine Development Plan
EED	Environmental enteric dysfunction	PHC	Primary health care
EMDEs	Emerging Markets and Developing Economies	PhilHealth	Philippine Health Insurance Corporation
FCV	Fragility, conflict, and violence	PHP	Philippine Peso
FDI	Foreign Direct Investment	PPP	Purchasing power parity
FHSIS	Field Health Services Information System	ppts	Percentage points
FOB	Free on board	PSA	Philippine Statistics Authority
GDP	Gross Domestic Product	PWSSMP	Philippine Water Supply and Sanitation Masterplan
HWISE	Household Water Insecurity Experiences	SDG	Sustainable Development Goals
IWMP	Integrated Water Resources Management Plan	URAF	Unified Resource Allocation Framework
IWRM	Integrated Water Resource Management	UNICEF	United Nations International Children's Emergency Fund
IT-BPO	Information technology - business process outsourcing	VAT	Value-added tax
LFPR	Labor Force Participation Rate	WASH	Water, sanitation, and handwashing
LFS	Labor Force Survey	WD	Water district
LGC	Local Government Code	WHO	World Health Organization
LGU	Local government unit	WRC	Water Regulatory Commission
		WRMO	Water Resources Management Office
		WSP	Water service provider
		WSS	Water supply and sanitation



EXECUTIVE SUMMARY

Recent Economic Developments

Economic recovery slowed in the first three quarters of 2023 as domestic activity moderated, and weak external demand persisted. GDP growth decreased from 7.7 percent in Q1-Q3 2022 to 5.5 percent in Q1-Q3 2023, mirroring the growth slowdown in the region. Services was the main growth engine, led by the recovery of tourism activities. The growth contribution of industry declined, as weak external demand weighed on trade and manufacturing activities. Meanwhile, agriculture's growth contribution remained marginal due to the impact of weather-related disturbances, high input costs, and structural issues such as the underinvestment in irrigation and water security that have limited productivity growth in the sector. On the demand side, household consumption continued to fuel growth, although weighed by high inflation and weakening pent-up demand. The contribution of investment to growth declined due to high interest rates.

Headline inflation has remained above the BSP 2-4 percent target, averaging 6.4 percent in the first ten months of 2023 from 5.4 percent a year ago. High food inflation contributed to nearly half of headline inflation, while transportation inflation has declined steadily since peaking in July 2022 due to lower global crude oil prices. However, the increase in global commodity prices such as fuel and rice since July and August has put additional pressure on headline inflation, prompting the Bangko Sentral ng Pilipinas (BSP) to raise its key policy rate by an additional 25 basis points in October. To mitigate the impact of high inflation on vulnerable sectors, the government approved targeted assistance transfer programs such as the digital food stamp program to 'food poor' families, cash subsidies to farmers, and fuel subsidies to public utility vehicle operators.

The rebound in tourism and weaker merchandise imports narrowed the current account deficit from 6.1 percent of GDP in 2022H1 to 4.0 percent of GDP in 2023H1. This was driven in part by the decline in the goods

trade deficit. Goods exports declined amid weaker global demand while goods imports shrank at a faster pace due to lower global oil prices and the slowdown in domestic demand. In addition, the narrower current account deficit was supported by the movement of global consumption towards services. In particular, the recovery of tourism activities and robust growth of the Information Technology – Business Process Outsourcing sector contributed to the lower trade deficit. The current account deficit was financed by external borrowing by the national government and local banks. Gross international reserves rose to US\$98.7 billion (7.3 months of imports).

In line with its fiscal consolidation agenda, the government reduced public spending, narrowing the fiscal deficit. Public revenues remained above the government target at 16.5 percent of GDP in Q1-Q3 2023 despite a reduction in tax collection. Public spending totaled 22.2 percent of GDP in Q1-Q3 2023 (below planned expenditure), owing to lower subnational transfers, and delays in budget execution in recurrent spending. While spending on sectors such as water resources development were maintained in 2023, its budget for 2024 is estimated to decline by 0.1 percent of GDP due to ongoing fiscal consolidation. The fiscal deficit narrowed from 6.5 percent of GDP in Q1-Q3 2022 to 5.7 percent of GDP in Q1-Q3 2023. Meanwhile, the national government debt slightly eased to 60.2 percent of GDP as of end-September 2023.

Labor market outcomes were uneven as unemployment fell, but low-quality jobs and underemployment are on the rise. The labor force participation rate (LFPR) decreased from 66 percent in March 2023 to 64.7 percent in August 2023, driven by fewer women participating in the labor market. Meanwhile the unemployment rate declined from 4.7 percent in March to 4.4 percent in August 2023, led by job creation in the agriculture, manufacturing, and construction sectors. However, low-quality jobs continue to dominate the labor market. The share of elementary occupations associated with low and irregular pay remained high at 30.1 percent of total employment in August 2023, relatively



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unchanged from 29.9 percent in March 2023. The share of wage and salary workers among the employed slipped back to 62.6 percent in August after temporarily reaching an annual peak of 67.2 percent in July 2023. The share of self-employed (own account) and unpaid workers remained at around 27 percent and 8 percent, respectively, during the same period, indicating the continuous dependence of workers on informal and low-productivity jobs.

Outlook and Risks

The growth projection for the Philippines remains unchanged from the October 2023 East Asia Pacific (EAP) Economic Update. The economy is projected to grow by 5.6 percent in 2023, following the growth rebound in 2023Q3 and a pickup in government spending. Over the medium term, an improvement in domestic demand is expected to drive a modest increase in growth to an average of 5.8 percent in 2024-25. Services are expected to drive growth due to the ongoing recovery of the tourism sector and the consistent performance of the IT-BPO industry, which is likely to spur job creation, increase household incomes, and benefit consumption and tourism-adjacent industries. A modest increase in global trade growth, along with increased growth in the EAP region, would contribute to stronger trade and manufacturing growth in 2024-25. On the expenditure side, private consumption is expected to remain the main growth engine, supported by a robust labor market, steady remittance growth, and lower inflation. Investment growth is expected to slow in 2023, before picking up in 2024-25, in part due to recent investment reforms and a commitment to public investment despite ongoing fiscal consolidation.

The growth outlook is subject to downside risks. The threat of higher-than-expected global inflation, escalating geopolitical tensions, and tighter global financing conditions could dampen global activity and increase risks of financial stress. On the external front, the escalation of geopolitical tensions could lead to additional food and energy supply shocks, placing additional pressure on inflation. Moreover, trade restrictions on agricultural products could cause supply disruptions and lead to increased volatility in

commodity prices. In major advanced economies, still elevated core inflation could prompt central banks to keep interest rates higher for longer than expected. On the domestic front, the threat of weather-related shocks including the ongoing episode of El Niño may impact the domestic food supply and place upward pressure on food prices. The success of the government’s medium-term fiscal consolidation agenda hinges on its ability to pass key tax policy and administration reforms. While the government is currently on track to meet its fiscal consolidation target for 2023, challenges remain to ensure it can also meet targets over the medium term. While the initial success in reaching its fiscal targets relied primarily on reducing public spending, the government will have to generate additional tax revenues from new tax policy and administration measures beginning in 2024 to remain on track. The timely passage of these revenue measures is crucial to ensure that the authorities can protect investment spending on infrastructure, human capital, and social protection—key drivers of long-term growth.

To improve the long-term growth potential, it is imperative to address low productivity and structural challenges, including underinvestment in physical and human capital. Effective implementation of pro-investment reforms in renewable energy and sectors like trade, transport, and telecommunications would generate economy-wide productivity gains, estimated at 3.2 percent on average. Implementing reforms that encourage private sector participation in investments could enhance the growth potential, even within the constraints of limited fiscal space. Effective public spending in agriculture could also boost productivity and enhance the local food supply, thereby reducing the impact of food price shocks that disproportionately affect the poor. Finally, implementing reforms that strengthen the resilience of water supply and sanitation, education, human settlements, and health care systems could mitigate the effects of climate change, public health crises, and natural disasters in both the short and long term. Part III of the PEU examines the Philippines’ water supply and sanitation sector, offering policy recommendations for universal access to safe, sufficient, affordable, and sustainable services.



Special Focus – Water Security for Resilient and Inclusive Growth

The impacts of climate change are mostly felt through water: too much, too little, or too polluted. The Philippines already confronts these three challenges in different spatial combinations – floods, droughts, and heightening poverty and inequality dynamics, notably through infrastructure and quality of service access gaps in the water supply and sanitation (WSS) sector.

Due to its cross-sectoral impacts, water security is a socio-economic priority in the Philippines. Climate change makes it urgent. By some estimates, the Philippines will experience an average annual economic decline of 0.7 percent in annual GDP in the years up to 2050 because of water risks. Water risks from flooding, droughts, and poor water quality also represent a threat to food security. It will compound existing malnutrition and spatial inequities in the country. Water, sanitation, and hygiene services are essential to households, industries, and the maintenance and development of urban areas. More than 47 percent of the population lives in rapidly growing urban areas.

Water security and climate adaptation depend on four pillars: Achieving universal access to safe water supply and sanitation (pillar 1); improving irrigation models and productivity (pillar 2); reducing flood and drought risks through sustainable water resource management (pillar 3); and enhancing water security in fragility, conflict, and violence (FCV) areas through a holistic development approach for peace (pillar 4).

While all pillars are needed, the first is a building block for human capital, public health, and poverty reduction.

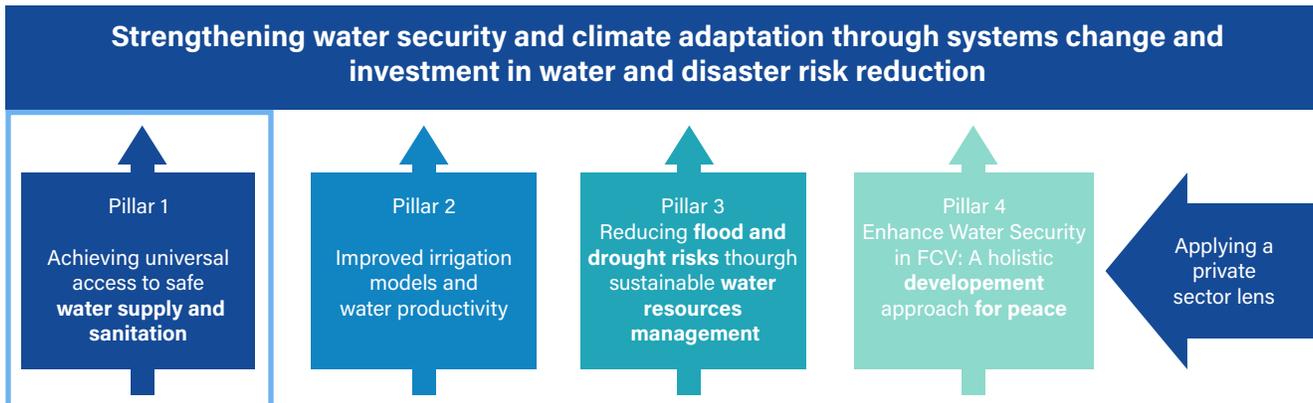
An integrated approach to water security is needed to adapt to climate change sustainably and inclusively. And securing adequate water and sanitation is its prerequisite. Recognizing the critical importance for its population and development, the government has prioritized universal access to water and sanitation. As of 2022, only 48 percent of the population receives safely managed water services and around 63 percent have access to safely managed sanitation services. By 2030, existing service gaps will grow on a business-as-usual scenario: close to 32 million people will need safe access to water and 35 million will need safe sanitation in urban areas.

The Philippines will need to speed up and scale up its efforts around the “three Is”- Institutions, Incentives and Investments.

These should help close the existing water and sanitation service gaps, address future access demand, and adapt to climate shocks.

On institutions: It is important to have clear policies and institutional arrangements with effective coordination, planning and management across sectors and levels of government, development, and enforcement of regulation. Given the current operating environment, policies and regulations for both water resource management (WRM) and WSS need to be reviewed in order to improve sector coordination and address its fragmented institutions. The goal is to improve the sector’s performance and its readiness to adapt to climate change and any

Four Pillars for Water Security and Climate Adaptation



Source: Global Challenge Program, approach paper for water security (2023) – forthcoming.



future large-scale public health emergency. These policies could include adoption of integrated water resource management (IWRM) for efficient and sustainable planning and use of water resources and a clear funding policy for the sector, among others. Institutional and policy reforms should also make the sector attractive for much needed private sector investment.

On incentives: Policy reforms need to be combined with a push in terms of regulation to better value and price water. The following may be considered: (1) prices that accurately reflect the true costs of service provision, operations and maintenance (O&M) and capital costs, as well as the environmental costs and subsidies that protect the poor; (2) set clear standards and monitor compliance of service levels for water service providers (WSPs); and (3) the national government and local government units

(LGUs) need to support WSPs on the road to creditworthiness.

On investments: Substantial investments, sector funding, and financing are needed to close the current gaps. It will also prepare the sector for climate change and increased demand. Public resources alone cannot meet those needs. Those resources need to be better leveraged with a more systematic approach to scaling up the water and sanitation sector financing. The government needs to focus on: (1) working on priority areas such as cities where almost 50 percent of the population lives, as well as poor and lagging areas; (2) using scarce public funds more efficiently; (3) tapping the private sector; (3) adopting a programmed approach to investment rollout; and (5) increasing water storage capacity for water source management.



PART

1

RECENT ECONOMIC AND POLICY DEVELOPMENTS

1.1 Recent Global Developments: Subdued Global Activity

Subdued global demand and a shift in consumption toward services weighed on global trade. Commodity prices have eased considerably but remain above pre-pandemic levels, contributing to elevated global inflation. The resulting restrictive financial conditions in addition to a weak external environment dampened growth of several EMDEs including the Philippines.

Global goods trade slowed in the first half (H1) of 2023 while services trade continued to strengthen. Global industrial production dampened in 2023H1, reflecting subdued global activity and a shift in demand from tradable goods to services (Figure 1). In addition, restrictive trade measures from increasing geopolitical tensions and inward-looking policies hindered trade even further (Figure 2). As a result, global supply chain pressures have abated, and global shipping conditions have improved. However, the anemic demand for goods impeded the growth of several emerging markets and developing economies (EMDEs), including the Philippines. Meanwhile, services trade continued to strengthen, driven by the sustained recovery of global tourism, which benefitted from the easing of pandemic-induced mobility restrictions.

While commodity prices have returned to levels recorded before Russia's invasion of Ukraine, they remain elevated (Figure 3). Energy prices have eased significantly since their peak in 2022Q3 due to lower natural gas and electricity consumption in Europe, benefitting net commodity importers like the Philippines. Oil prices declined to levels recorded before February 2022, but they have been volatile following announcements of oil production cuts and uncertainties around global growth prospects.¹ Meanwhile, metal prices eased on

the back of China's industrial deceleration and decelerating demand in advanced economies, Agricultural commodity prices have also eased in 2023 amid good production prospects for most crops and favorable weather conditions. However, rice prices have surged due to India's rice export ban implemented in July. Despite falling commodity prices, they remain above pre-pandemic levels, constraining consumption, especially across low-income countries (LICs).

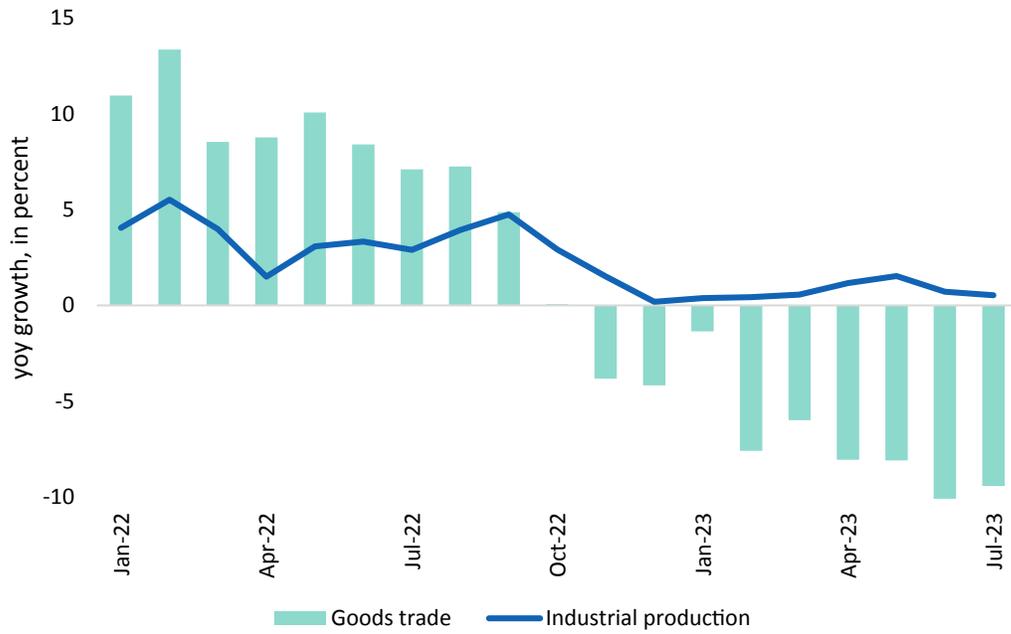
Global inflation remains elevated, and global financial conditions remain restrictive. Global inflation slowed in 2023H1 amid favorable base effects from falling commodity prices, especially for energy. However, recent core inflation measures suggest elevated inflationary expectations. In many EMDEs, including the Philippines, inflation has either stabilized at high levels or is increasing, in part due to a prolonged period of high inflation and wage adjustments. As a result, global financial conditions remain restrictive, prolonging costly external financing for EMDEs. Some EMDEs have remained resilient, mitigating market concerns by raising policy rates earlier and more aggressively than advanced economies. However, vulnerable EMDEs saw their risk premia increase substantially amid greater currency depreciation relative to other EMDEs, further limiting their fiscal options.

¹The average spot price of Brent crude oil declined from its peak of US\$120/bbl in June 2022 to US\$74.9/bbl in June 2023, the lowest price recorded in 2023.

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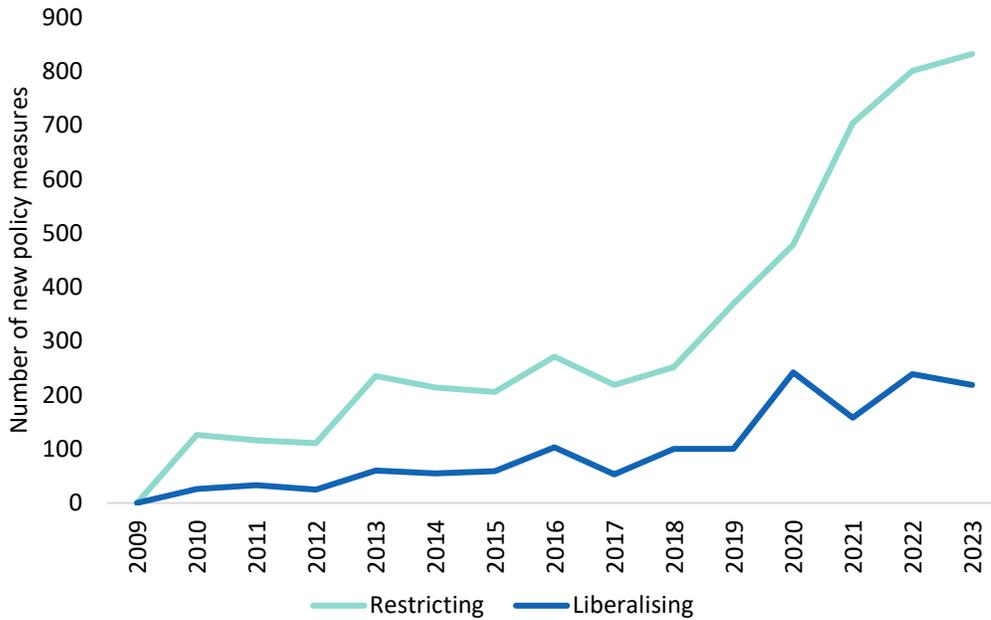


Figure 1. Global industrial production dampened in 2023H1.



Source: Haver Analytics.

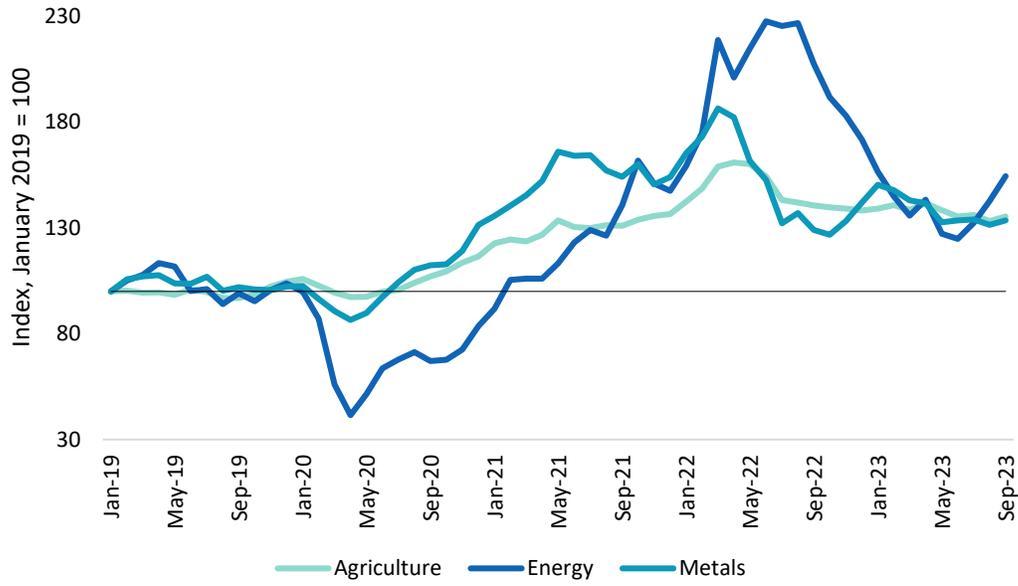
Figure 2. Restrictive trade measures weighed on trade.



Sources: Global Economic Prospects, Global Trade Alert.



Figure 3. Commodity prices have returned to levels before Russia’s invasion of Ukraine, but remain elevated.



Source: Haver Analytics.



Photo by: All themes



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1.2 Output and Demand: Outperforming Peers Despite Slower Growth Momentum

The Philippines tracked the growth slowdown in the region but outperformed peers. Growth momentum lost steam as high inflation and tight fiscal and monetary policy dampened domestic demand. Meanwhile, exports and manufacturing activities slowed due to persistent weakness in global growth.

Despite the slower growth momentum, the country outperformed regional peers in first three quarters of 2023 (Figure 4). GDP growth decreased from 7.7 percent in Q1-Q3 2022 to 5.5 percent in Q1-Q3 2023, mirroring the growth slowdown in the region. On a seasonally adjusted basis, output continues to exceed pre-pandemic levels in 2023Q3, but the pace of recovery was disrupted by weaker-than-expected growth in 2023Q2. Tight fiscal and monetary policy settings, high inflation, and dissipating pent-up demand weighed on domestic activity. Public spending growth slowed due to ongoing fiscal consolidation efforts, compounded by the government’s low budget execution that dragged on 2023Q2 growth. Moreover, weakening external demand amid slowing global activity and a shift in consumption toward services undermined merchandise exports and manufacturing. Structural challenges such as costly and unreliable power supply, insufficient infrastructure, and cumbersome trade regulations also contributed to the underperformance of merchandise exports and manufacturing.

Services were the primary growth driver in the first three quarters of 2023, followed by industry but to a lesser extent (Figure 5). Services were the main growth engine, fueled by the recovery of tourism and related industries. The contribution of services to growth fell by 1.1 ppts of GDP in Q1-Q3 2023 due to fading pent-up demand² and high inflation, but it remained above the pre-pandemic average (4.2 ppts in Q1-Q3 2016-2019). Moreover, the ongoing fiscal consolidation weighed on public administration services. Meanwhile, the contribution of industry to growth was halved to 1.1 ppts in Q1-Q3 2023,

as weakened external demand dampened manufacturing. The mining industry contributed negatively to growth due to lower metal prices and supply-side cost challenges. Moreover, tight financing conditions weighed on private-sector construction. Agriculture’s contribution to growth remained marginal at 0.1 ppts in Q1-Q3 2023 due to weather disturbances, and a drop in fish output in part due to high input costs and the entry of imported substitutes. Agriculture’s marginal contribution to growth continue to indicate enduring structural challenges in the sector, resulting from decades of underinvestment such as in irrigation and in water security that have limited productivity growth in the sector.

High inflation, high borrowing costs, and dissipating pent-up demand reduced domestic demand in the first three quarters of 2023 (Figure 6). Resilient household consumption continued to drive growth, buoyed by steady remittances, strong household lending, and favorable labor market conditions. The reduction of its contribution to growth to 4.1 ppts in Q1-Q3 2023 (6.3 ppts in Q1-Q3 2022) suggests a normalization to pre-pandemic contribution to growth (4.5 ppts on average in Q1-Q3 2016-2019) albeit tempered by elevated inflation and easing pent-up demand. However, the contribution of fixed investments to growth decreased from 2.5 ppts in Q1-Q3 2022 to 1.7 ppts in Q1-Q3 2023 and still below pre-pandemic average (2.3 ppts in Q1-Q3 2016-2019), as elevated interest rates slowed bank lending for most production activities, impacting private construction investments. Meanwhile, the government’s ongoing fiscal consolidation dampened the contribution to growth of government consumption.

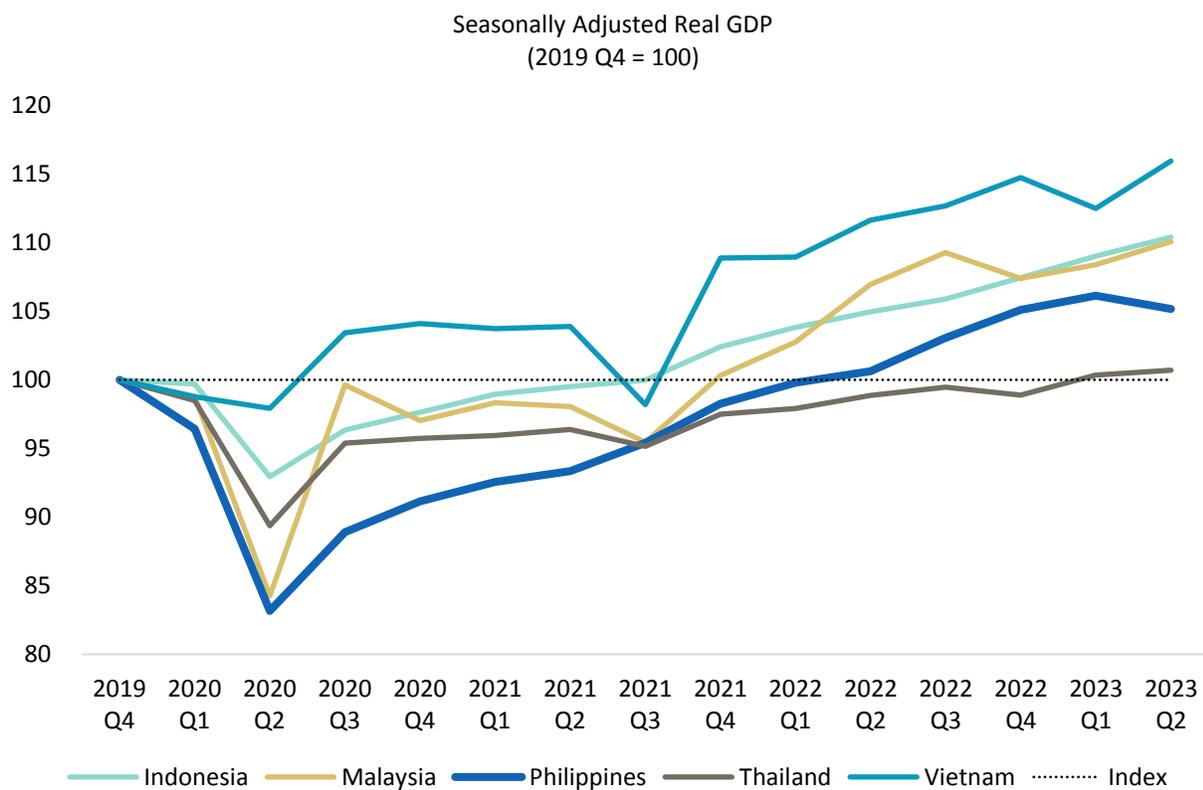
² Growth in household spending related to revenge spending (i.e., the economic phenomenon of increased spending following a period of challenges) such as recreation, restaurants and hotels, and miscellaneous goods and services slowed in Q1-Q3 2023 compared to Q1-Q3 2022.



Subdued global demand lowered the contribution to the growth of exports, as weak domestic demand reduced imports. The contribution to growth of exports fell by 2 pts of GDP in Q1-Q3 2023. Weak external demand weighed on electronics and agricultural exports, resulting in a negative contribution to growth of merchandise exports (-0.1 pts in Q1-Q3 2023). The contribution of services exports to growth remained positive thanks to the continued recovery of tourism and the resilient information technology - business process outsourcing (IT-BPO) sector, but the overall subdued external demand lowered its contribution to growth by 0.5 pts to 1.8 pts in Q1-Q3 2023. Weak domestic

investment and lackluster export activity resulted in goods imports contraction particularly capital goods and raw materials and intermediate goods. This translated to a reversal of its contribution to growth to 1.5 pts in Q1-Q3 2023 (-4.0 pts in Q1-Q3 2022). Meanwhile, imported services growth remained at a double-digit high, suggesting a general shift in consumption toward more services, including tourism and travel-related activities. However, imported services recorded a less negative contribution to growth, indicating the impact of overall weakness in domestic demand. As a result, the contribution of total imports to growth narrowed from -6.3 pts in Q1-Q3 2022 to -0.5 pts in Q1-Q3 2023.

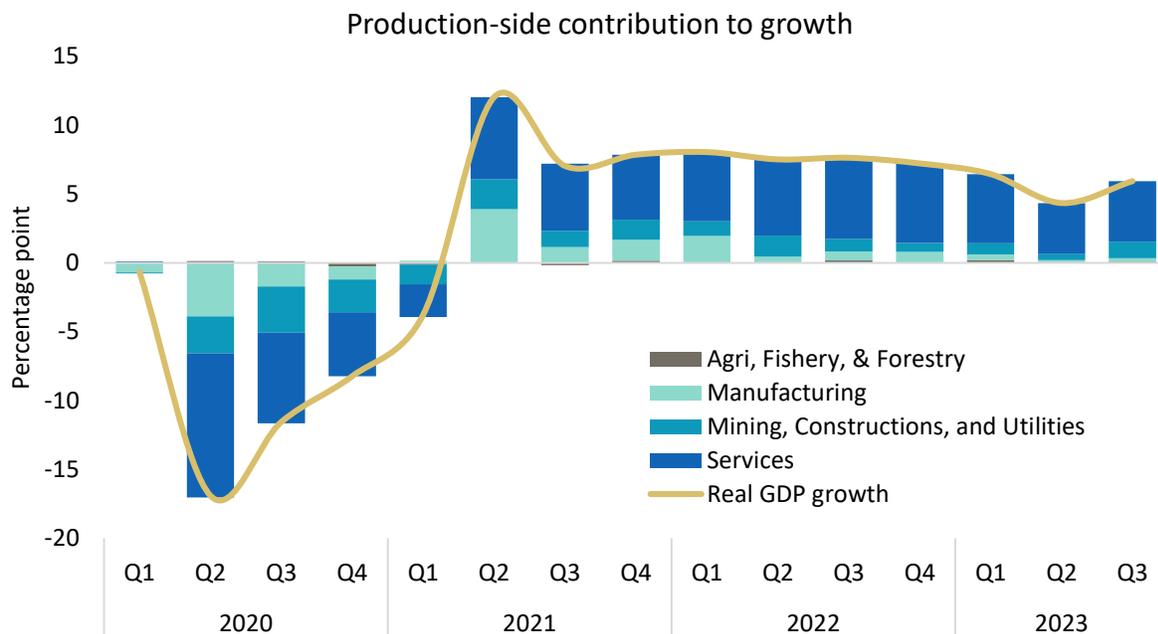
Figure 4. The unexpected 2023Q2 slowdown weighed on the Philippines' economic recovery momentum.



Source: Haver Analytics.

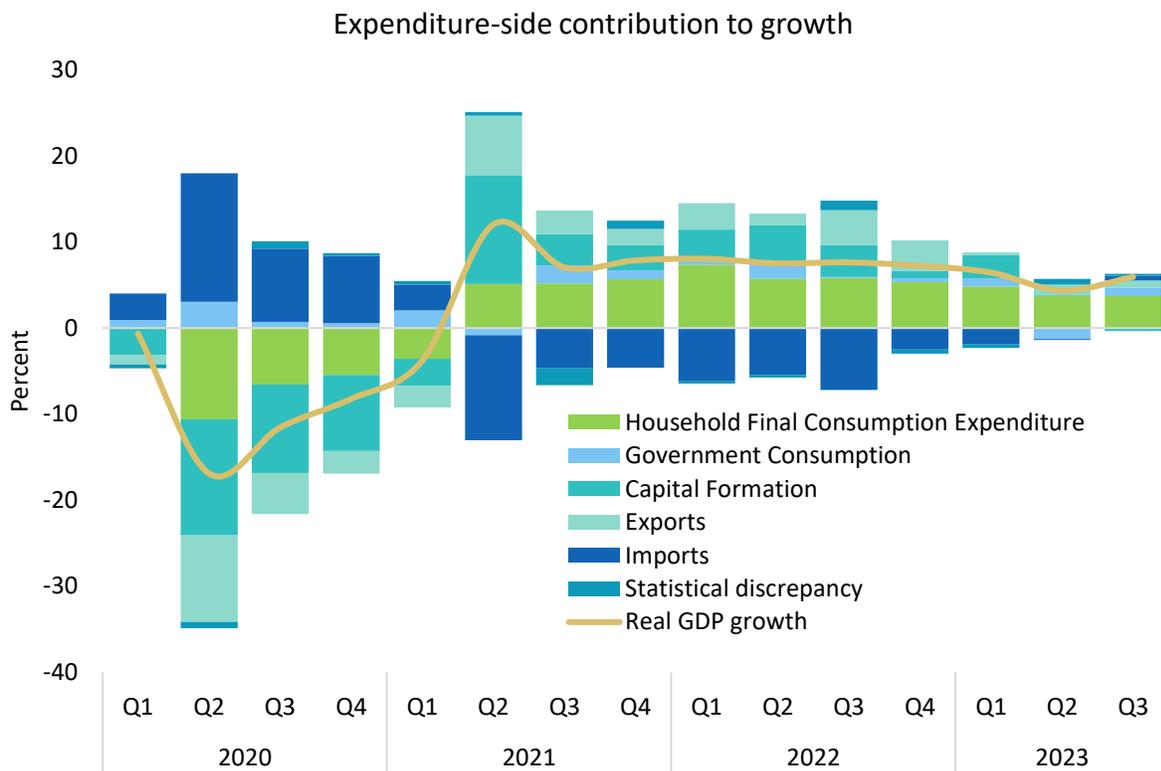


Figure 5. Services continued to primarily drive growth, supported by industry although to a lesser extent, in Q1-Q3 2023.



Source: Philippine Statistics Authority (PSA).

Figure 6. Weak domestic activity pressed on private consumption and investment as subdued global demand weighed on trade performance in Q1-Q3 2023.



Source: PSA.



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1.3 Inflation and Monetary Policy: Sustained Price Pressures

Inflation remained elevated in the first ten months of 2023. Bangko Sentral ng Pilipinas (BSP) introduced an off-cycle rate hike to anchor inflation expectations as headline inflation reversed from its downward trend in August and September. Nevertheless, the financial sector remains largely resilient and supportive of the economic recovery.

High inflation persisted as elevated import prices and local supply constraints raised food costs (Figure 7). Headline inflation has remained above the BSP’s 2–4 percent target, averaging 6.4 percent in the first ten months of 2023 (up from 5.4 percent during the same period in 2022). The country registered the highest year-to-date inflation in the Association of Southeast Asian Nations (ASEAN). Elevated global commodity prices and local food supply constraints raised food costs. As a big net importer of rice, increased import prices contributed to a large uptick in rice inflation, which reached a 14-year high in September (17.9 percent, year-on-year). Utilities and transport inflation rates were lower in the first ten months of 2023 as global energy prices moderated. Core inflation, which excludes volatile food and energy items, climbed to 7.0 percent in the first ten months of 2023 (3.4 percent during the same period in 2022). The broad-based increase in price pressures suggests a still positive output gap. Nevertheless, core inflation continued to decline from its peak in March. To mitigate the impact of high inflation on vulnerable sectors, the government approved targeted assistance transfer programs such as the digital food stamp program to ‘food poor’ families, cash subsidies to farmers, and fuel subsidies to public utility vehicle operators. To help contain the surge in rice prices, the government placed temporary price caps on regular rice varieties in September, which was complemented with cash support to affected rice retailers.

Amid sustained price pressures, the BSP delivered an off-cycle rate hike, raising the key policy rate to 6.5 percent. The BSP increased the key policy rate by a total of 75 basis points in 2023Q1 to ease price pressures from the demand-side and second-round effects from transport

fare and wage increases. As inflation began to moderate, the monetary authorities maintained the key policy rate at 6.25 percent for four consecutive decision meetings. However, to further anchor inflation expectations after inflation increased in August and September, the BSP raised the key policy rate by 25 basis points (bps) to 6.5 percent in October during an unscheduled monetary board meeting. Among ASEAN countries, the Philippines’ central bank’s 100 bps cumulative increases in the policy rate in the first ten months of 2023 were only topped by that of its counterpart in Thailand (150 bps). For example, the monetary authorities in Indonesia and Malaysia increased their policy rate by a total of 50 bps, and the policy rate was reduced by 150 bps in Vietnam.

The banking system remains generally resilient (Figure 8). Bank profitability continued to improve in 2023Q2 as the return-on-equity and return-on-asset ratios rose to 12.8 percent and 1.6 percent, respectively, higher than their pre-pandemic levels. The gross non-performing loan (NPL) ratio was 3.4 percent in August 2023, higher than the pre-pandemic level of 2 percent and slightly higher than the ASEAN average³, but lower than levels recorded during the pandemic. Most loan forbearance measures have expired, and the remaining measures cover only a small part of the total bank loan portfolio and are unlikely to have systemic implications.

The financial sector’s support for the economic recovery is strong after having fully recovered from the impact of the pandemic. High borrowing costs led to broad-based slowdown in lending to productive activities in August 2023 (5.6 percent year-on-year) driven by the decline in credit to manufacturing sector. Mining, financial and insurance, real estate, professional, public

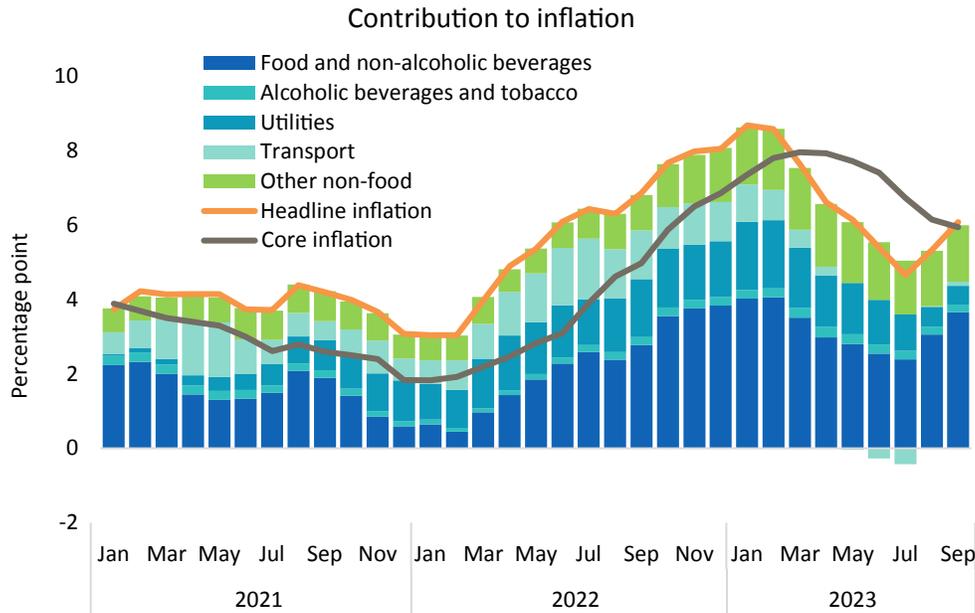
³ NPL ratio of the following select ASEAN countries averaged at 2.7 percent as of June 2023: Indonesia Thailand, Malaysia, Brunei, and Cambodia.



administration, and entertainment businesses recorded higher borrowing. Among regional peers, the Philippine corporate sector experienced higher borrowing costs, with the growth in S&P corporate bond index of the Philippines only behind that of Indonesia. Nevertheless, consumer loans continued to grow to support the increased cost of living due to rising inflation. Funding liquidity, the

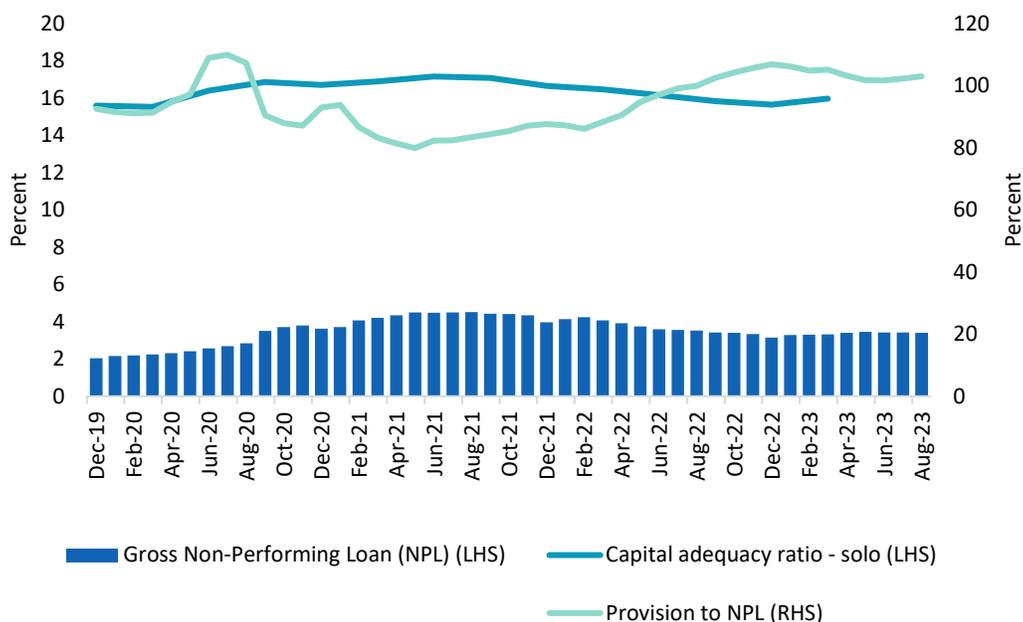
ability of banks to repay deposits and other short-term liabilities, is also ample and comparable with regional peers. In August 2023, the loan-to-deposit ratio was 72.4 percent, down from the 80.0 percent recorded before the pandemic, and liquid assets represented 51.5 percent of deposits and short-term funding, higher than pre-pandemic levels.

Figure 7. Inflation remained elevated in the first ten months of 2023 due to persistently high food costs.



Sources: PSA and BSP.

Figure 8. Forward-looking indicators of the banking system's health indicate financial sector resilience.



Source: BSP.



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1.4 External Sector: Recovering Tourism and Narrowing Trade Deficit

The current account (CA) deficit narrowed in 2023H1 due to higher services exports linked to the rebound in tourism and a narrowing merchandise trade deficit. Meanwhile, net financial inflows rose due to increased national government borrowing from abroad. The smaller CA deficit and higher net financial inflows led to a balance-of-payments (BOP) surplus in 2023H1.

The rebound in tourism and weaker merchandise imports narrowed the CA deficit from 6.1 percent of GDP in 2022H1 to 4 percent of GDP in 2023H1. This was driven by the 40.6 percent growth in net receipts from services trade amid the recovery in tourism (409 percent, year-on-year) and robust growth in IT-BPO exports (9.3 percent, year-on-year). Meanwhile, the merchandise trade deficit decreased from 17.7 percent of GDP in 2022H1 to 16 percent of GDP in 2023H1 (Figure 9). During this period, merchandise exports declined amid weaker global demand, but merchandise imports shrank at a faster pace due to lower global oil prices and lower imports of raw materials for manufacturing linked to the slowdown in domestic growth. More recent data based on export and import declarations also support this trend, with the merchandise trade deficit further narrowing in 2023Q3. Remittances grew at a relatively soft 3.1 percent in 2023H1, although the amount that overseas Filipinos (OFs) sent home remained substantial at 6.5 percent of GDP in the same period.

Net financial inflows grew from 3.9 percent to 4.0 percent of GDP between 2022H1 and 2023H1 due to increased government borrowing from abroad. The increase was driven by 41.2 percent growth in other investment inflows, which was fueled by external borrowing of the national government and local banks (67.8 percent, year-on-year),⁴ as well as net withdrawals of foreign currency and deposits by domestic residents (25 percent, year-on-year). By contrast, net foreign direct investment (FDI) inflows declined from 2.5 percent of GDP in 2022H1 to 1.9 percent of GDP in 2023H1, as the slowdown in global growth

and tight global financial conditions weighed on investor sentiment. FDI inflows mainly consisted of investments in manufacturing, real estate, and financial and insurance. Portfolio investments recorded a marginal net outflow, a reversal from the previous year, due to the increase in residents' net investments in foreign debt securities. The narrower CA deficit and higher net financial inflows led to a BOP surplus of 1.1 percent of GDP in 2023H1, a reversal from a deficit of 1.6 percent of GDP in 2022H1 (Figure 10).

The Philippine peso has slightly weakened since the beginning of 2023. Despite the BOP surplus and the steady inflow of foreign exchange from OFs as well as IT-BPO and tourism-related services exports, the Philippine peso depreciated by 1.9 percent in the first ten months of 2023, amid the continued hawkish stance of the US Federal Reserve and the recent rise in global oil prices caused by the Organization of the Petroleum Exporting Countries' supply cuts. The peso generally tracked the movements of its peers, as other regional currencies such as the Indonesian rupiah, Thai baht, Malaysian ringgit, and Vietnamese dong have also weakened since the start of the year (Figure 11). Despite the weakness of the peso, the BSP reaffirmed its commitment to a market-based approach for the exchange rate and will only intervene during extreme volatility. In real effective terms, the peso has appreciated by 1.8 percent against the basket of currencies of its major trading partners.⁵ Meanwhile, gross international reserves grew by 2.6 percent in the first nine months of 2023, rising to US\$98.7 billion (7.3 months of imports).

⁴ National government borrowing includes the US\$600 million Philippines Second Financial Sector Reform Development Policy from the International Bank for Reconstruction and Development as well as the US\$500 million Competitive and Inclusive Agriculture Development Program (Subprogram 2) and the US\$500 million Post-COVID-19 Business and Employment Recovery Program (Subprogram 1) from the Asian Development bank.

⁵ The basket includes the currencies of the following trading partners: Australia, European Union (euro area), U.S., Japan, Hong Kong, Taiwan, Thailand, Indonesia, Malaysia, Singapore, South Korea, China, Saudi Arabia, and the U.A.E.



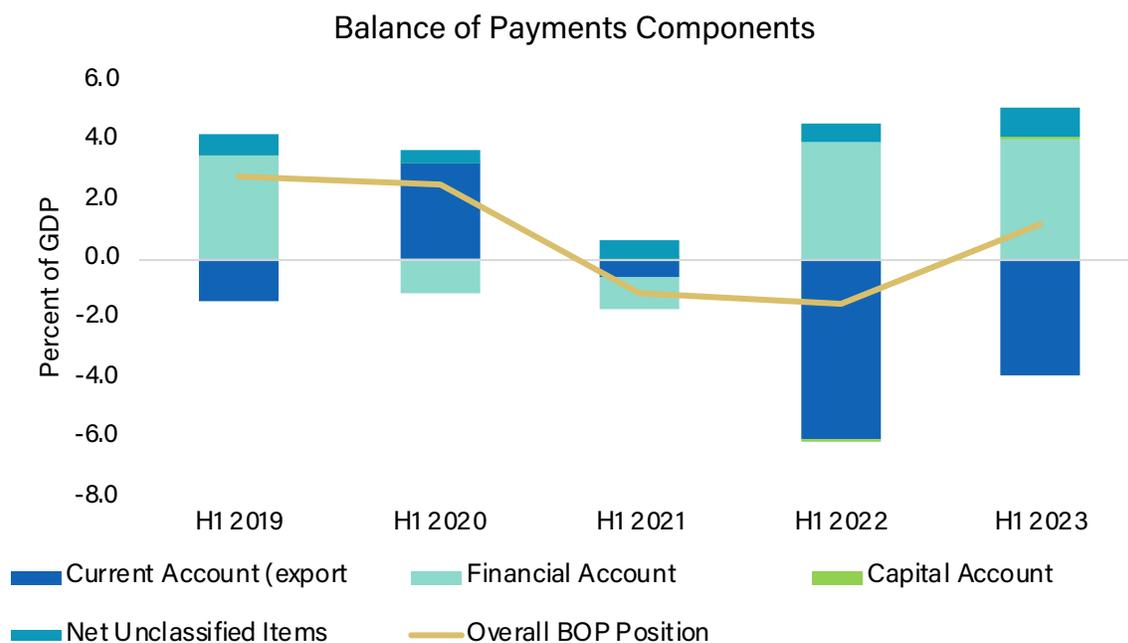
Figure 9. Imports declined amid the slowdown in domestic growth.



Source: PSA.

Note: The graph is based on exports and imports statistics from PSA (Free on board value), which can be different from trade data based on the BOP and national income accounts. FOB values are computed based on export and import declarations collected by the Bureau of Customs.

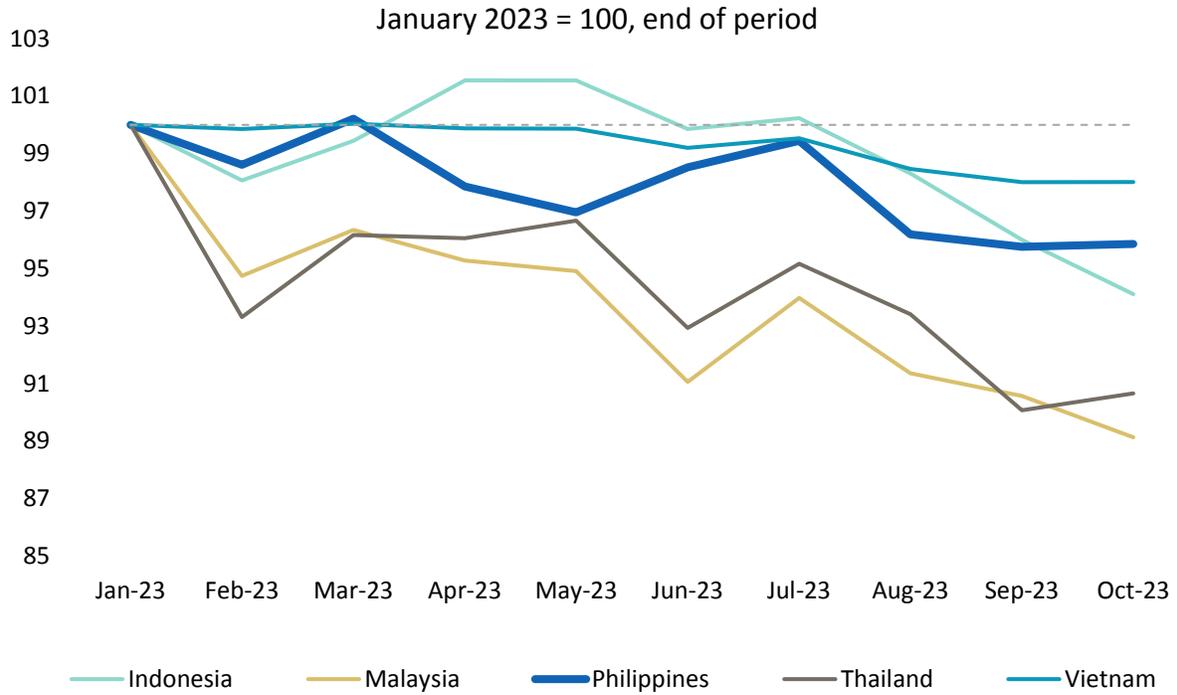
Figure 10. The BOP surplus was driven by the narrower CA deficit and higher financial inflows.



Source: BSP.



Figure 11. The Philippine peso, along with the currencies of regional peers, has depreciated since the beginning of 2023.



Sources: Haver Analytics, various central banks.



Photo by: mayura benjarattanapakee



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1.5 Fiscal Sector: Performing in Line with Consolidation Targets

The decline in public spending amid lower allotments to LGUs and national government disbursements narrowed the fiscal deficit in Q1-Q3 2023. As a result, the national government debt slightly eased to 60.2 percent of GDP by end-September 2023.

In line with its fiscal consolidation agenda, the government has reduced public spending, narrowing the fiscal deficit (Figure 12).

Public revenues remained above the target of the government’s program at 16.5 percent of GDP in Q1-Q3 2023 despite a reduction in tax collection, as non-tax revenues exceeded the program (Table 1). By contrast, public spending totaled 22.2 percent of GDP in Q1-Q3 2023 (below planned expenditure), owing to the ongoing fiscal consolidation, lower national tax allotments (NTAs) to Local Government Units (LGUs),⁶ and delays in budget execution. As a result, the fiscal deficit in the first three quarters remained narrower than the target for 2023. In line with the government’s fiscal consolidation program, the fiscal deficit fell from 6.5 percent of GDP in Q1-Q3 2022 to 5.7 percent of GDP in Q1-Q3 2023. Meanwhile, the national government debt slightly eased to 60.2 percent of GDP as of end-September 2023 (Figure 13). Debt, mostly long-term (78.9 percent), domestic (68.2 percent), and peso-denominated (68.0 percent), remains sustainable.

Revenue collection marginally declined due to slower GDP growth in Q1-Q3 2023. Revenue collection declined by 0.6 ppts of GDP, mostly due to the marginal decline in tax revenues from 15.3 percent of GDP in Q1-Q3 2022 to 14.7 percent of GDP in the same period in 2023. Bureau of Internal Revenue (BIR) collection fell from 11.1 percent in Q1-Q3 2022 to 10.8 percent of GDP in Q1-Q3 2023 due to a contraction in excise tax collections, and as value-added tax (VAT) collection payments shifted from monthly to quarterly as mandated by the 2019 TRAIN Law.⁷ As the deadline to make the shift was in early 2023,

the reduction in BIR collection is expected to be temporary. Meanwhile, import duties collected by the Bureau of Customs slightly declined to 3.8 percent of GDP in Q1-Q3 2023 (4.1 percent in Q1-Q3 2022) due to the drop in goods imports (goods imports contracted by 10.2 percent, year-on-year, in Q1-Q3 2023, a reversal from 24.7 percent growth in Q1-Q3 2022).

Public spending declined from 23.6 percent to 22.2 percent of GDP between Q1-Q3 2022 and Q1-Q3 2023 due to lower allotments to LGUs and disbursements falling short of target.

National tax transfers to LGUs fell by 1.3 ppts to 4.0 percent of GDP in Q1-Q3 2023, due to the lower tax revenue base in 2020 that resulted from the COVID-19 pandemic.⁸ Meanwhile, the decline in public spending was also driven by the implementation of the fiscal consolidation program and current operating expenditure falling short of the programmed target. Maintenance spending and subsidies to government corporations accounted for the largest share of the shortfall in recurrent spending due to delays in budget execution as a result of implementation challenges and delays due to procurement, billing, and payment. However, the government continued to support expansionary infrastructure spending, as spending on capital outlays increased by 12.3 percent, year-on-year, in the first three quarters of the year. To further improve disbursement performance and facilitate budget execution for the rest of the year, the Department of Budget and Management (DBM) has required agencies to implement catch-up plans to help attain the disbursement target of 21.3 percent of GDP for 2023.

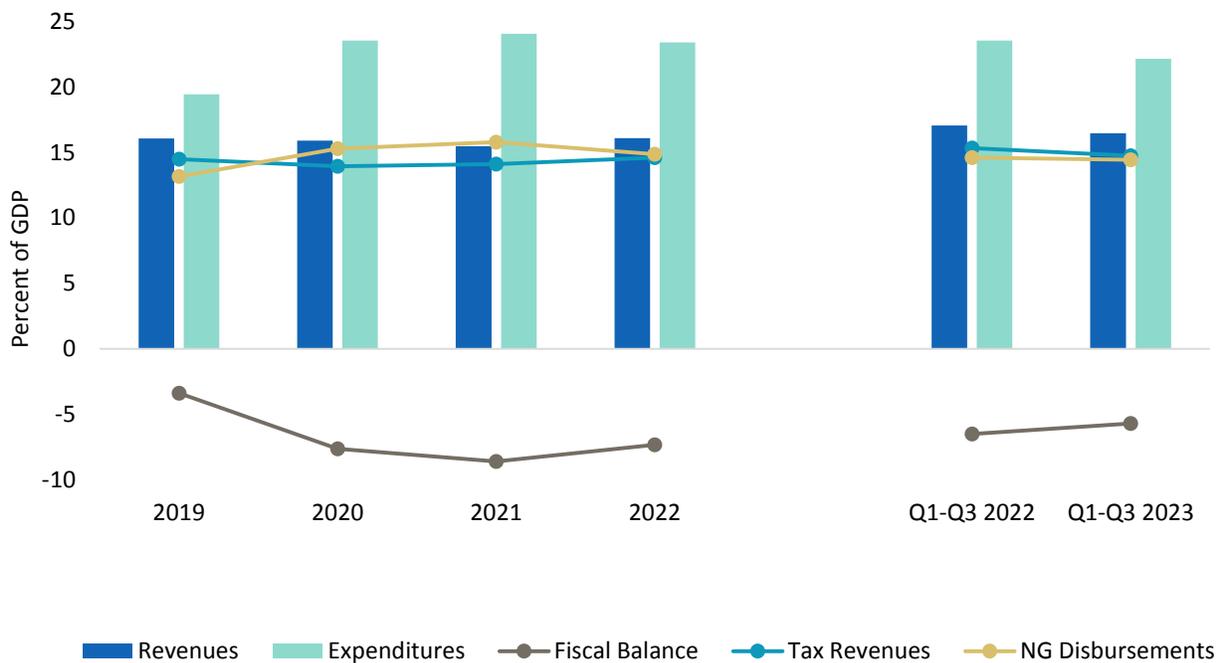
⁶The 2023 national tax allotment to LGUs was determined using tax collections in 2020, which saw revenues plummet due to the adverse impact of the COVID-19 pandemic on the economy.

⁷The Q3 2023 VAT payments deadline to the BIR is October 2023.

⁸National tax allotments to LGUs are computed based on tax collections three years prior to the current calendar year.

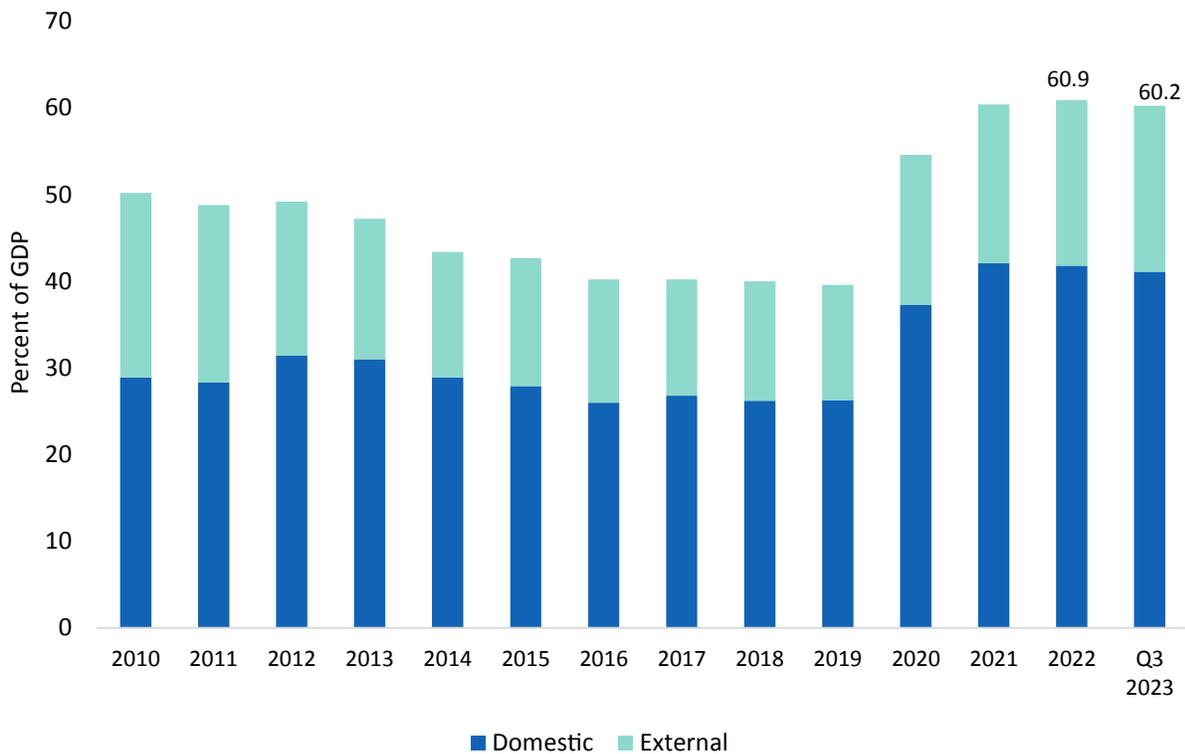


Figure 12. Lower revenues and expenditures narrowed the fiscal deficit.



Source: Bureau of the Treasury (BTr).

Figure 13. Public debt slightly eased while the fiscal deficit narrowed.



Source: BTr.



Table 1. Fiscal Performance, Q1-Q3 2023.

Particulars	Q1-Q3 2023			
	Program	Actual	Difference	Percent
<i>In percent of GDP, unless otherwise stated.</i>				
REVENUES	16.0	16.5	0.5	3.0
Tax Revenue	15.1	14.7	-0.3	-2.1
Bureau of Internal Revenue	11.2	10.8	-0.4	-3.9
Bureau of Customs	3.7	3.8	0.1	2.5
Other Offices	0.1	0.1	0.0	26.5
Non-Tax Revenue	0.9	1.7	0.8	85.2
Bureau of Treasury	0.3	0.9	0.6	194.2
Other Offices	0.6	0.8	0.2	30.0
EXPENDITURES	22.4	22.2	-0.2	-1.1
Current Operating Expenditures	17.5	17.0	-0.5	-2.9
Personnel Services	6.2	6.0	-0.2	-3.2
Maintenance and Other Operating Exp.	3.8	4.0	0.2	4.4
Subsidy	0.8	1.1	0.3	36.7
Allotment to LGUs	4.0	3.1	-0.9	-21.9
Interest Payments	2.6	2.8	0.2	8.3
Tax Expenditure	0.2	0.1	-0.1	-64.8
Capital Outlays	5.9	5.3	-0.7	-11.1
Infrastructure/Other Capital Outlays	4.6	4.3	-0.3	-7.1
Net Lending	0.1	0.1	0.0	13.4
Operating exp.	19.6	19.5	-0.1	-0.6
Interest Payments	2.8	2.7	-0.1	-4.0
SURPLUS/ (DEFICIT)	-6.4	-5.7	0.7	-11.1

Sources: BTr and DBM.



Photo by: Walter Eric Uy



1.6 Employment and Poverty: Slowing Job Creation

With slowing economic recovery, the labor market experienced a reduction in labor force participation and net job loss, particularly for women and youth.

The unemployment rate has declined in recent months despite the continued decline in labor force participation. The labor force participation rate (LFPR) decreased from 66 percent in March 2023 to 64.7 percent in August 2023, driven by fewer women participating in the labor market (from 55.9 to 52.9 percent in the same period) (Figure 14). Increasing women’s LFPR is one of key targets under the Philippine Development Plan (PDP) 2023–2028, as women remain at a disadvantage in emerging sectors (e.g., digital technology).⁹ Women’s labor supply decisions are also affected by household and childcare responsibilities.¹⁰ By contrast, men’s LFPR has been consistent at around 76 percent. While the national unemployment rate declined from 4.7 percent in March to 4.4 percent in August 2023 (Figure 15), youth unemployment reached 14 percent in July, the highest level recorded so far in 2023.

Between March and August 2023, there were significant job losses in the services sector, slightly offset by jobs added by agriculture and industry. Over the six-month period, net job losses totaled about half a million, a substantial shift from the net creation of nearly 1 million jobs during the previous six-month period. The services sector, particularly wholesale and retail, public administration and defense, and other service activities, contributed to the decline in the net number of jobs, amid increasing commodity prices, a slowdown in government spending, and weather-related disruptions.¹¹ Nevertheless, the agriculture sector absorbed about 378,000 jobs likely due to seasonal effects such as the

peak of rice planting and the start of the corn harvesting season.¹² Similarly, industrial activities picked up, with manufacturing and construction adding almost 0.5 million jobs during the same period. Despite the net job losses, the number of unemployed Filipinos still dropped by 200 thousand. This is indicative of movements out of the labor force or within the labor force (i.e., from employed to unemployed and vice versa).

Low-quality jobs continue to dominate the labor market. The share of elementary occupations associated with low and irregular pay remained high at 30.1 percent of total employment in August 2023, relatively unchanged from 29.9 percent in March 2023. Meanwhile, the number of technical occupations, including managers, professionals, technicians, and associate professionals, declined. The underemployment rate slightly increased from 11.2 to 11.7 percent, indicating that more workers express a desire for more hours of work or an additional job amid net job losses across sectors and persistently high inflation. The share of wage and salary workers among the employed slipped back to 62.6 percent in August after temporarily reaching an annual peak of 67.2 percent in July 2023. The trend of fewer wage and salary workers has been observed since before the pandemic (January 2020). The share of self-employed (own account) and unpaid workers remained at around 27 percent and 8 percent, respectively, during the same period,¹³ indicating the continuous dependence of workers on informal and low-productivity jobs.

⁹ L. Desiderio, 2023, Government targets more women in labor force, April 2, Available online: <https://www.philstar.com/business/2023/04/02/2256136/government-targets-more-women-labor-force>

¹⁰ World Bank, 2023, Philippine Jobs Report: Shaping a Better Future for the Filipino Workforce. Available online: <https://www.worldbank.org/en/country/philippines/publication/philippine-jobs-report-shaping-a-better-future-for-the-filipino-workforce>

¹¹ Department of Finance, 2023, Joint Statement by the Economic Managers on the Philippine Economic Performance for the Second Quarter of 2023, August 10, Available online: <https://www.dof.gov.ph/joint-statement-by-the-economic-managers-on-the-philippine-economic-performance-for-the-second-quarter-of-2023/>

¹² Department of Finance, 2023, Diokno: Labor market remains strong and resilient as unemployment declines further to 4.4% in August, October 6, Available online: <https://www.dof.gov.ph/diokno-labor-market-remains-strong-and-resilient-as-unemployment-declines-further-to-4-4-in-august/>

¹³ R. Rivas, 2023, Unemployment rate increases to 4.5% in June 2023, unpaid workers still rising, August 9, Available online: <https://www.rappler.com/business/unemployment-rate-philippines-june-2023/>



Figure 14. Female labor force participation exhibited a downward trend ...

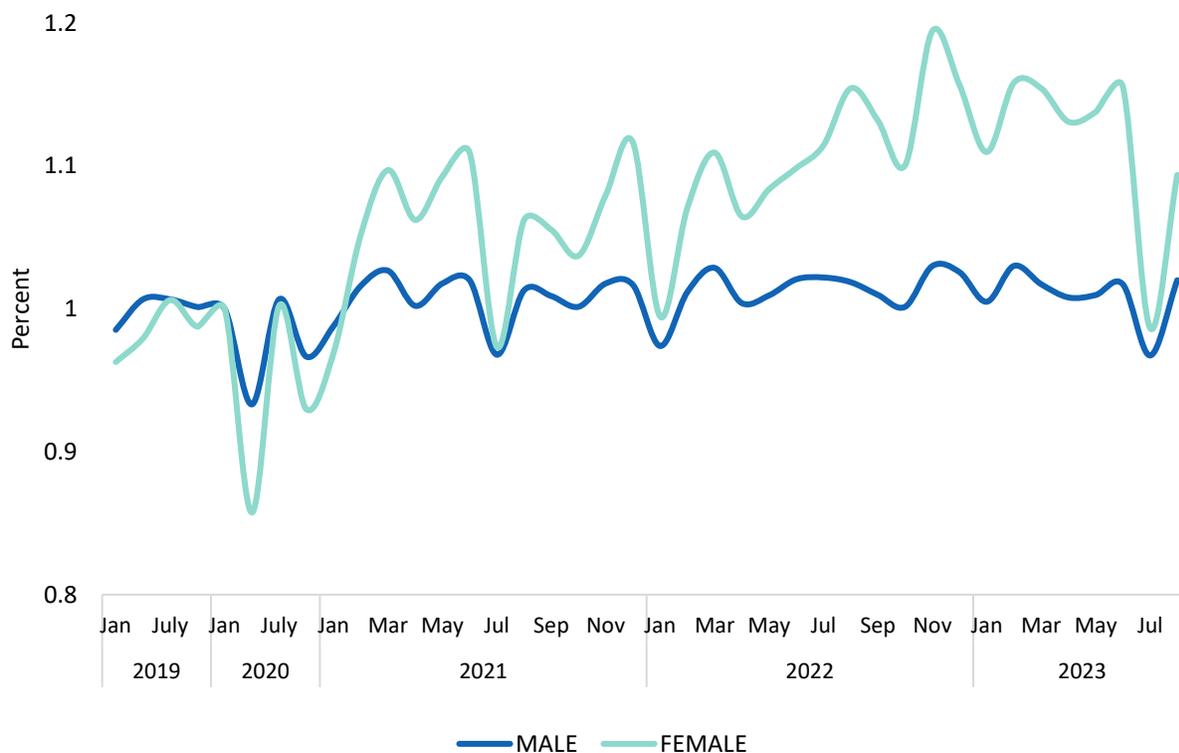
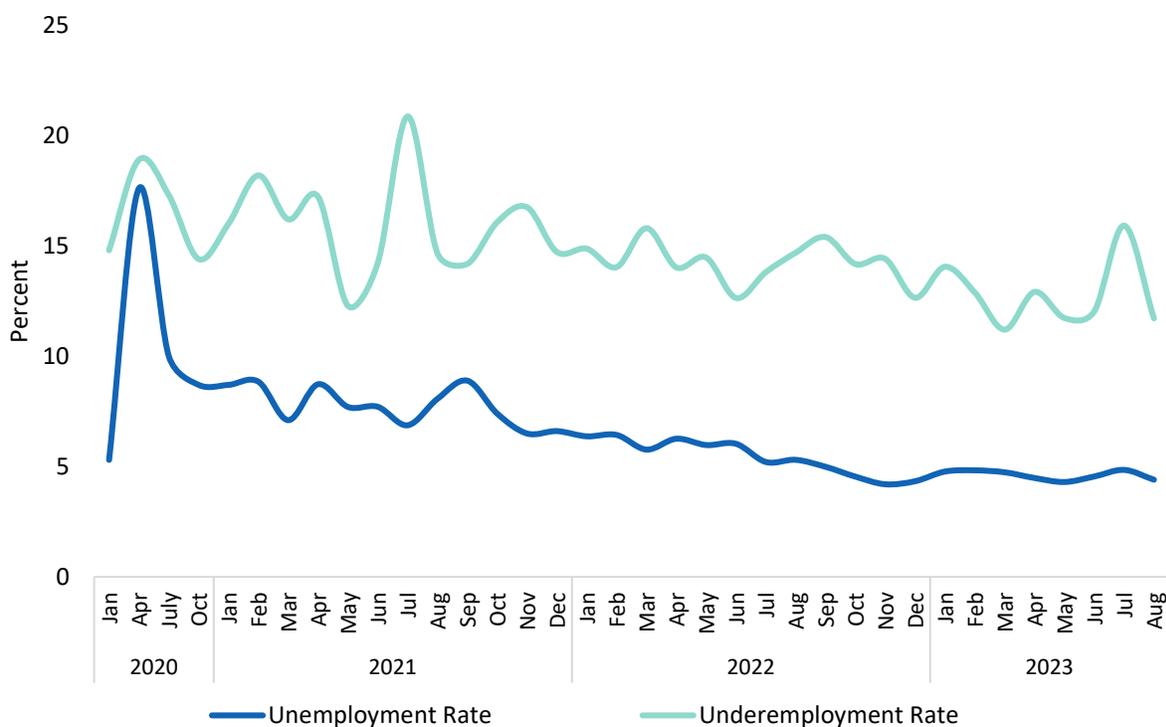


Figure 15. ... while the unemployment rate gradually decreased.



Source: PSA-Labor Force Survey (LFS) (various rounds).

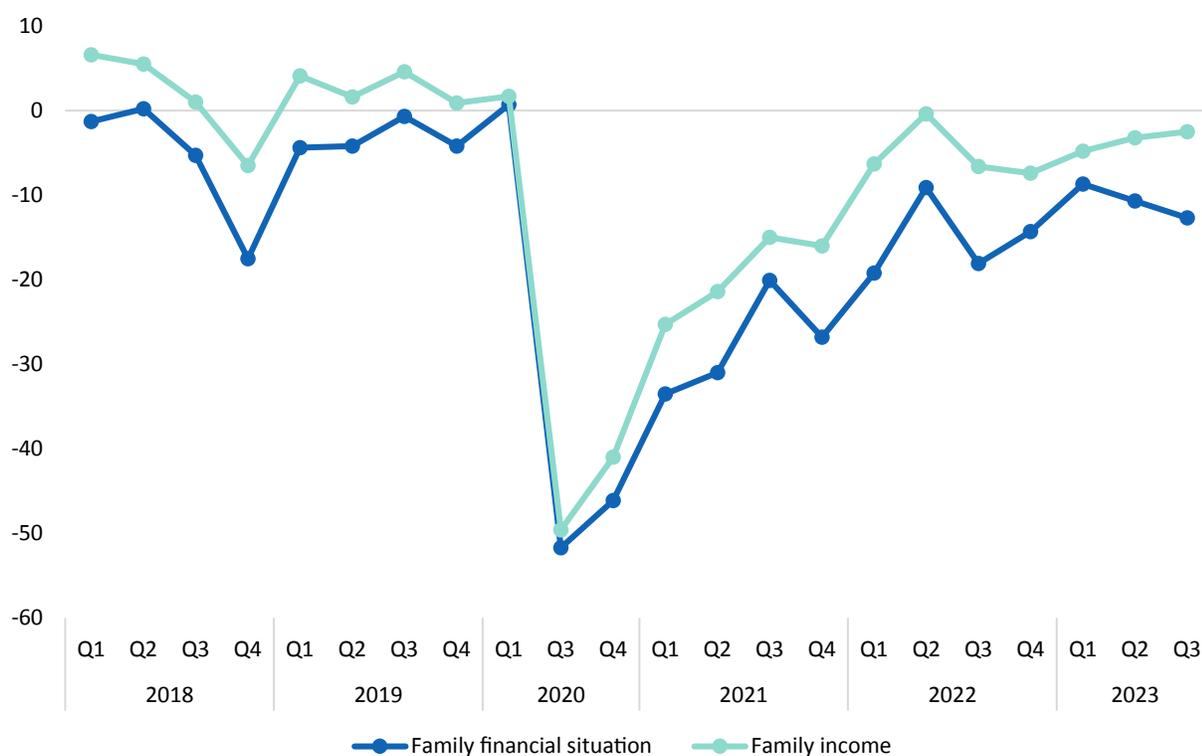
Note: Starting February 2021, the LFS is conducted monthly to produce more timely data. Data show a normalized LFPR (January 2020=1).



While households remain optimistic about their incomes, they also face financial pressures. Results from the 2023 Third Quarter Consumer Expectations Survey¹⁴ show that households' perceptions of their current welfare status continued to improve (Figure 16). The index of family income improved from -4.8 first quarter this year to -2.5 in the third quarter, supported by improving labor and employment conditions as the economy continued to recover, as well as by more household members contributing financially. However, more households

conveyed pessimism about their current financial situation, as the family situation index worsened from -8.7 to -12.7 in the same period. This was likely due to lingering pressures from rising food and fuel prices. Survey results also show that higher-income households are recovering faster than other households in terms of households' financial (from 1.4 in the first quarter to 7.4 in the third quarter) and income (from 4.9 to 3.5) situation as estimates for these indices are now net positive compared to net negative estimates for the lower income groups.

Figure 16. Households' perception of their welfare continues to improve.



Source: Third Quarter 2023 Consumer Expectations Survey, BSP.

¹⁴ A quarterly survey by the BSP of a random sample of about 5,000 households in the Philippines. Survey results provide advance indication of consumer sentiments for the current and next quarters as well as the next 12 selected economic indicators.



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PART 2

2.1 Growth Outlook

The country's medium-term prospects are expected to improve as the global economy rebounds, although growth in 2023 will continue to be dampened by persistently high inflation, subdued trade activity, tight financial conditions, and geopolitical uncertainties as well as restrictive trade policies. A gradual decline in inflation beginning in 2024, along with continued public investment, is expected to help fuel growth over the forecast horizon.

Global growth is expected to rebound slowly over the forecast horizon as inflation gradually moderates and the dampening effect of tight monetary policy on growth fades. Global growth in 2023 is projected to decline to 2.1 percent, before making a modest rebound to 2.4 percent in 2024. Widespread weaknesses in economic activity in 2023 will be especially pronounced in advanced economies, mainly driven in the short term by a combination of elevated inflation and global monetary policy tightening. The impact of inflation and monetary tightening is expected to peak this year, before gradually dissipating—although several upside risks to inflation remain. As a result, global trade growth is expected to be hampered in 2023 by subdued global demand and the continued shift of consumption toward services. As global consumption returns to its pre-pandemic mix between goods and services, trade is projected to grow by 2.8 percent in 2024, only slightly stronger than GDP growth. Meanwhile, fiscal policy is expected to have a limited net impact on global growth over the forecast horizon, with modest fiscal tightening in EMDEs generally offsetting support in advanced economies.

The 2023 growth outlook for the Philippines remains unchanged from the October 2023 East Asia Pacific (EAP) Economic Update.

The economy is projected to grow by 5.6 percent in 2023, following the growth rebound in 2023Q3 and a pickup in government spending. Growth is expected to increase further in Q4 2023 as government spending continues to ramp up,

while lower inflation, a healthy labor market, and an expected increase in remittances over the holidays will support robust private consumption growth. While the high-interest environment has not slowed consumer borrowing, lending to the private sector continues to moderate, contributing to softer private investment growth. Services are expected to drive growth in 2023 due to the ongoing recovery of the tourism sector and the consistent performance of the IT-BPO industry, which is likely to spur job creation, increase household incomes, and benefit consumption and tourism-adjacent industries in the services sector. However, weak external demand and restrictive trade policies will dampen manufacturing growth, while low productivity and natural disasters will continue to hinder agricultural growth.

Nevertheless, an improvement in domestic demand is expected to drive a modest increase in growth to an average of 5.8 percent in 2024-25 (Figure 17).

On the expenditure side, private consumption is expected to remain the country's main growth engine. Private consumption growth is projected to increase to an average of 6.1 percent in 2024-25, supported by a robust labor market, steady remittance growth, and an expected return of inflation to within the BSP's target range in 2024-25. However, a continuation of high-interest rates may cap the growth potential of consumption, discourage borrowing, and further postpone household spending. Meanwhile, an increase in fiscal transfers to LGUs due to a higher revenue



base, along with a modest increase in the growth of current spending, will accelerate government consumption growth in 2024-25.

Investment growth is expected to slow in 2023, before picking up in 2024-25, in part due to recent investment reforms and a commitment to public investment despite ongoing fiscal consolidation. Public investment will remain supportive of growth over the medium term despite fiscal consolidation, with public investment expected to reach above 5.0 percent of GDP in 2023–25. Moreover, the government remains committed to addressing climate change impacts as climate expenditures in both adaptation and mitigation are expected to increase to 2.0 percent of GDP in 2024. In addition, an increase in fiscal transfers, beginning in 2024, is expected to support public investment growth at the local government level. While tight financial conditions, a subdued global environment, and rising global uncertainties amid geopolitical tensions, are expected to weigh on private investment growth in 2023, the implementation of key reforms and improving business sentiment will buoy private investment over the medium term. In particular, the implementation of key reforms, such as the amendments to the Public Services

Act and to the implementation rules and regulations of the Renewable Energy Act, the Retail Trade Liberalization Act, and the Foreign Investment Act, are expected to encourage private investment in key sectors and strengthen the Philippines as an investment destination. Effective implementation of pro-investment reforms in renewable energy and sectors like trade, transport, and telecommunications would generate economy-wide productivity gains, estimated at 3.2 percent on average. In addition, the enactment of the new Public-Private Partnership Code is expected to further strengthen private sector participation in the government's infrastructure investment agenda.

On the supply side, the recovery of services will continue to drive growth, supported by the industry sector. Services will remain the main growth engine in 2023–25 as the recovery of household incomes and a healthy labor market continue to support domestic demand. Moreover, while the tourism industry is on track to beat the tourist arrival target in 2023, there are still significantly fewer tourists in the Philippines than before the pandemic, suggesting ample space for a full recovery. The tourism industry's recovery would benefit from the continued increase in global tourism demand, resulting in stronger

Table 2. Economic Indicators for the Baseline Projections.

	2020	2021	2022	2023f	2024f	2025f
Real GDP growth, at constant market prices	-9.5	5.7	7.6	5.6	5.8	5.8
Private Consumption	-5.8	3.1	6.0	4.1	4.3	4.5
Government Consumption	1.3	1.1	0.7	0.4	0.4	0.5
Capital Formation	-9.1	3.9	3.0	1.0	1.9	2.2
Exports, Goods and Services	-4.7	2.2	3.0	0.9	1.2	1.3
Imports, Goods and Services	-8.7	-4.5	-5.2	-0.8	-2.1	-2.7
Real GDP growth, at constat factor prices	-9.5	5.7	7.6	5.6	5.8	5.8
Agriculture	0.0	0.0	0.0	0.0	0.1	0.1
Industry	-4.0	2.5	2.0	1.2	1.7	1.8
Services	-5.5	3.3	5.6	4.3	3.9	4.0
Headline inflation	2.4	3.9	5.8	5.9	3.6	3.0
National government balance (% of GDP)	-7.6	-8.6	-7.3	-6.0	-5.1	-4.1
National government debt (% of GDP)	54.6	60.4	60.9	60.6	60.5	60.2
Current account balance (% of GDP)	3.2	-1.5	-4.5	-2.9	-2.7	-3.0

Sources: PSA, BTr, and World Bank staff estimates.

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growth in tourism-adjacent industries such as transportation, accommodation and food services, and retail trade services. In addition, the country's IT-BPO industry is likely to remain among the sector's main growth drivers, which in turn will benefit real estate services and the property sector. Meanwhile, a modest increase in global trade growth, along with increased growth in the EAP region, would contribute to stronger manufacturing growth in 2024-25. The public investment agenda is also expected to buoy construction growth and contribute to rising industry growth over the medium term. However, agricultural growth is projected to remain sluggish amid structural issues affecting the sector's productivity and the country's vulnerability to weather-related events.

While headline inflation is expected to remain elevated in 2023, it is projected to decline to within the target range in 2024. Headline inflation is expected to increase slightly from 5.8 percent in 2022 to 5.9 percent in 2023 due to an increase in global commodity prices in recent months, particularly for fuel and food, most notably for rice, which is a staple commodity in the country. However, headline inflation is projected to fall to 3.6 percent in 2024 due to stable global commodity prices and an improved food supply, as well as in part due to high base effects over the past two years. Following a year and a half of tight monetary policy, the return of headline inflation to within the target range in 2024Q1 is expected to keep the policy rate steady in the short term. Concerns over a possible resurgence of high inflation and tight monetary policies in advanced economies will continue to weigh on the BSP's decision to reduce interest rates.

The current-account deficit is projected to fall over the forecast horizon, led by the continued recovery in services exports, lower commodity prices, and stable remittance inflows. Merchandise exports are expected to moderate in 2023 due to the slowdown in global trade and the shift of consumption toward services. External demand prospects are set to improve in 2023-25. Moreover, the

government remains committed to addressing climate change impacts as climate expenditures in both adaptation and mitigation are expected to increase to 2.0 percent of GDP in 2024, as global growth and trade activity improves. In addition, the recovery of services exports due to higher tourism demand and the strong performance of the IT-BPO sector will help narrow the current-account deficit over the forecast horizon. Moreover, stable growth in remittances from overseas Filipinos will continue to support the current-account balance. As a result, the current-account deficit is projected to narrow to 2.9 percent of GDP in 2023, before narrowing further to an average of 2.8 percent in 2024-25 as external demand improves. The deficit is expected to be financed primarily by net FDI inflows as well as net portfolio inflows and international bond issuances.

The continuation of fiscal consolidation is expected to reduce the fiscal deficit in 2023-25 (Figure 18). Although the fiscal deficit is projected to rise in Q4 2023, the increase will not derail the government's consolidation target for the year, as the deficit is currently 11 percent below the programmed target. Moving forward, the fiscal deficit is projected to fall from 6.0 percent of GDP in 2023 to 4.1 percent in 2025, supported by the continued economic recovery and the enactment of fiscal consolidation measures as outlined in the government's medium term fiscal framework (MTFF). Over the forecast horizon, efforts to reduce the fiscal deficit will be driven by policy measures to cut public spending. To reduce public spending, the authorities will focus on cutting current spending by over 1 ppt of GDP by 2025. Despite ongoing fiscal consolidation, the government remains committed to a budget that supports its inclusive growth agenda as social and economic services will continue to receive the largest share of the budget (Box 1). Meanwhile, public capital outlays are expected to remain above 5.0 percent of GDP in 2023-25, supported by increased private sector participation through public-private partnerships. In addition, robust revenue growth is also expected to help narrow the fiscal deficit. Expenditure cuts will be complemented by

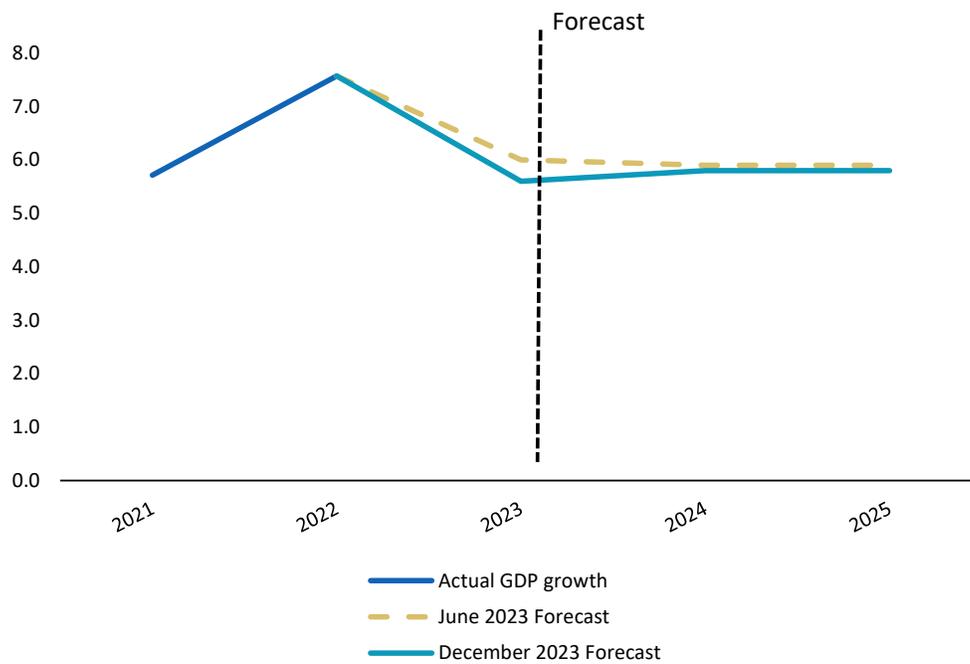


increasing revenues over the forecast horizon due to the continued economic recovery and as the government strengthens revenue collection through a series of tax policy and administration measures to help sustainably finance its inclusive growth agenda.¹⁵

Both fiscal consolidation and the growth recovery will likely keep debt levels sustainable over the medium term.¹⁶ The national government debt ratio is projected to decline over the forecast horizon, reaching around 60 percent of GDP by 2025, although financing needs remain elevated compared to

pre-pandemic levels. Currently, the country's financial system may still be relatively deep enough to accommodate the large financing needs, although excess liquidity may diminish over the medium term (Box 2). However, debt is set to remain sustainable, as the debt-to-GDP ratio is expected to revert to a downward trajectory beginning in 2023 due to fiscal consolidation and robust growth. Moreover, the composition of debt is expected to remain stable, with low shares of short-term debt and foreign-currency-denominated debt, in line with the government's debt management strategy.

Figure 17. Growth prospects remain positive over the medium term.



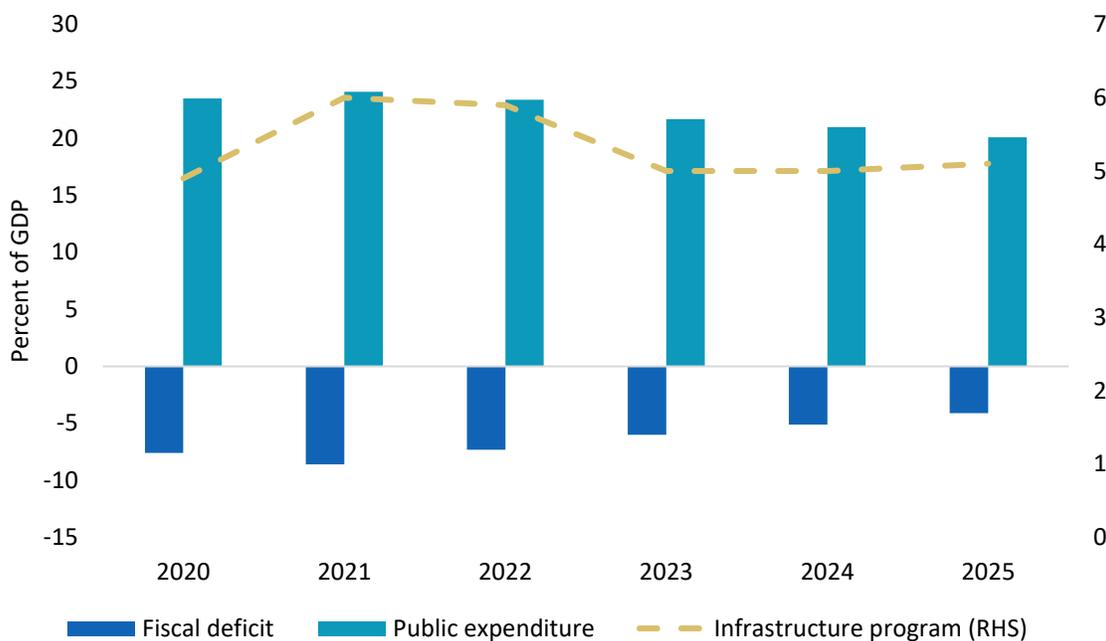
Sources: PSA, and World Bank staff calculations.

¹⁵ The proposed tax reform bills include: (i) the Passive Income and Financial Intermediary Taxation Act; (ii) a value-added tax on digital service providers; (iii) excise taxes on single-use plastics, pre-mixed alcohols, and sweetened beverages and junk food; (iv) a new mining fiscal regime; and (v) a motor vehicle road user tax.

¹⁶ In the debt sustainability analysis, national government debt comprises outstanding debt from domestic and external sources. Domestic borrowings are mainly in the form of Treasury bonds and Treasury bills, while external borrowings consist of bilateral and multilateral loans as well as commercial bonds such as U.S. dollar bonds, Eurobonds, Yen bonds, and peso-denominated bonds.



Figure 18. Despite consolidation, public investment is projected to remain above 5.0 percent of GDP.



Sources: BTr, and World Bank staff calculations.



Box 1. The Proposed 2024 Budget for the Philippine National Government

The proposed 2024 national budget (21.7 percent of GDP) represents only a small year-on-year increase (21.6 percent of GDP in 2023)¹⁷, as the government aims to make the economy future-proof and sustainable while supporting its medium-term fiscal consolidation agenda. The budget supports the implementation of the 2023–2028 PDP, which focuses on infrastructure, education, and health spending. While the budget is consistent with the government’s medium-term fiscal consolidation agenda, it maintains spending above 20 percent of GDP to support the economic recovery and long-term economic growth. To achieve both goals, the government commits to improving public spending efficiency, as reflected by the implementation of the Integrated Financial Management Information System to streamline cash management and transactions.¹⁸

Social and economic services continue to receive the largest budget allocations in 2024 (Figure 19). The government’s socioeconomic agenda focuses on social spending, accounting for 37.9 percent of the budget and totaling PHP2.2 trillion (8.2 percent of GDP). Spending on social services will continue to prioritize programs on education, social security, and health. Meanwhile, economic services make up 29.6 percent of the budget, equivalent to PHP1.7 trillion (6.4 percent of GDP). Spending on economic services will be primarily related to the government’s Build Better More infrastructure program, with a focus on transportation, communications, and agriculture. Compared to the 2023 budget, the combined spending on social and economic services in the 2024 budget declines by 0.2 percent of GDP amid the fiscal consolidation agenda, while spending on general public services increases by 0.1 percent of GDP.

The budgets of line ministries reflect the government’s socioeconomic agenda. Amid the government’s push to boost shared

prosperity, the Department of Education receives the largest share of the 2024 budget at 16 percent. Other social services also receive substantial allocations, as reflected in the budget shares of the Department of Health (5.3 percent) and the Department of Social Welfare and Development (3.6 percent). Meanwhile, spending on infrastructure remains a key government priority under the Build, Better, More infrastructure program. The budget of the Department of Public Works and Highways is expected to decline, but it still accounts for 14.3 percent of the 2024 budget. To support the implementation of major railway, airport, and road programs, the Department of Transportation’s budget has doubled to 3.7 percent of the 2024 budget. In line with the government’s focus on improving food security, the budget of the Department of Agriculture is set to rise by 4.5 percent to account for 3.1 percent of the 2024 budget.

Maintenance and operating expenditures account for the biggest share of the 2024 budget, while spending on wages and benefits of government workers grows the fastest. Maintenance and operating expenditures, which represent spending to support the operations of government agencies, total 8.1 percent of GDP—slightly down from 8.3 percent of GDP in 2023. By contrast, spending on personnel services increases from 6.1 percent of GDP in 2023 to 6.4 percent of GDP in 2024, driven by higher spending on benefits and pensions of civilian and military personnel. Meanwhile, the government’s commitment to infrastructure development is reflected in the 5.9 percent growth in capital outlays. However, spending on capital outlays is projected to be outpaced by GDP growth, resulting in a slight decline of spending as a share of GDP from 4.8 percent in the 2023 budget to 4.7 percent in 2024. Transfers to local government units will remain unchanged at 2.9 percent of GDP.

¹⁷ Obligation basis

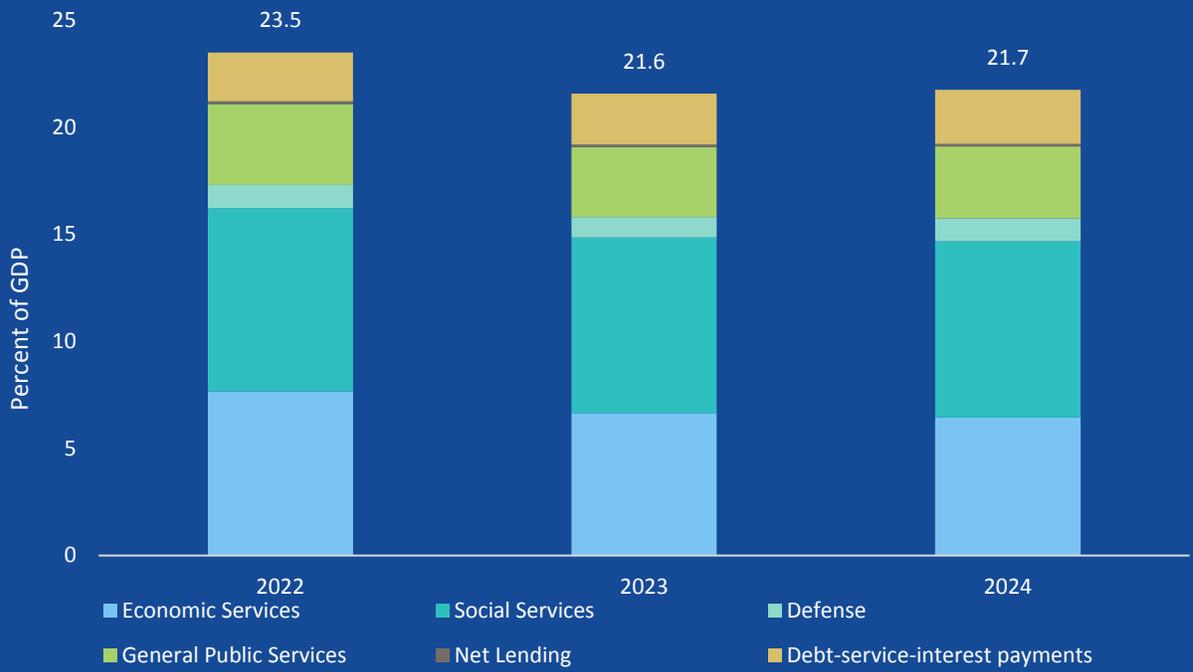
¹⁸ Executive Order No. 29 was signed by President Marcos on June 1, 2023.



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Figure 19. National Government Expenditure by Sector, 2022-2024 (Obligation Basis).



Source: DBM.



Photo by: junpinzon



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Box 2. The Capacity of the Philippines' Financial Markets to Finance Government Fiscal Needs

While the government is gradually narrowing the fiscal deficit, it continues facing large financing needs, which could crowd out private investment. As a result of prioritizing social spending and COVID-19 support, the fiscal deficit rose from an average of 2.0 percent of GDP in 2011–19 to 7.8 percent of GDP in 2020–22, expanding national government debt to 60.9 percent of GDP in 2022 (up from 39.6 percent in 2019), the highest level since 2005 (Table 3). The government committed to reducing the fiscal deficit to 3 percent by 2028 by adopting an extended Medium-Term Fiscal Framework (MTFF) through 2028. However, with an average deficit of 4.2 percent of GDP in 2023–28, this leads to public gross financing needs at least three-times as high as in 2019. Moreover, to mitigate foreign exchange risk, at least 75 percent of it will come from the domestic financial market. This could potentially crowd out financing for private investments when private sector demand for credit recovers to its pre-pandemic trend.

While there is currently ample liquidity in domestic capital and financial markets, it has been decreasing. At the start of the pandemic, lending to the public sector further increased as the government relied on the domestic market to finance its fiscal needs, which was facilitated by excess availability of funds, which banks parking a record amount of funds at the BSP (Figure 20). The interbank call rate has hovered close to the lower bound of the policy rate corridor (BSP overnight deposit rate) between 2020 and early 2023 suggesting ample liquidity in the market at the time. However, it has recently trended towards to center of the corridor showing liquidity is declining, although stable bid-cover ratios of government bonds suggest there is sufficient appetite for government bonds.¹⁹

Analysis of money supply numbers confirms these observations, as the use of BSP facilities to park funds has fallen from its peak of 11.9 percent of GDP in Q2 2021 to 6.7 percent of GDP in Q2 2023.

Increased competition for funds between the public sector and private sector may slow down the recovery. Bank deposits (ODC liabilities) are returning from their pandemic peak to the pre-pandemic trend, which means that the amount of funds that the domestic banking sector can lend is declining relative to GDP (Figure 21). Once bank lending to the private sector growth starts to pick up again, this will lead to increased competition for these funds. This risks crowding out lending to the private sector and may slow down private investment.

To avoid this scenario, it is important to stay on track with the fiscal consolidation, to use the available tools to ensure liquidity, and to develop the financial markets and provide more financing options for firms. Continued implementation of the medium-term fiscal consolidation plan will reduce fiscal financing needs. It would be preferable to reduce the deficit faster than the MTFF targets through well-designed tax reforms that minimize the impact on growth and poverty. To ensure ample market liquidity in the short term, the authorities may consider lowering the reserve requirements for banks, which remain the highest in the region, which would increase lending capacity, if the conditions allow. In the medium term, it will be important to further develop the financial markets to attract more deposits into the banking sector and to develop alternative sources of financing for firms, such as the corporate bond market.

¹⁹ The bid-to-cover ratio for Treasury bonds has increased since the pandemic, from 2.05 in 2021 to 2.20 in 2023, and a higher bid-to-cover ratio indicates strong demand for government securities.



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Table 3. The Medium-Term Fiscal Framework.

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
	in percent of GDP, unless otherwise stated.									
Revenue	16.1	15.9	15.5	16.1	15.2	15.9	16.2	16.6	16.9	17.3
Expenditure	19.5	23.5	24.1	23.4	21.3	21.0	20.3	20.1	20.2	20.4
Surplus/Deficit	-3.4	-7.6	-8.6	-7.3	-6.1	-5.1	-4.1	-3.5	-3.2	-3.0
Real GDP growth target (percent)	6.1	-9.5	5.7	7.6	6.0-7.0	6.5-8.0	6.5-8.0	6.5-8.0	6.5-8.0	6.5-8.0
Inflation rate (percent)	2.4	2.4	3.9	5.8	5.0-6.0	2.0-4.0	2.0-4.0	2.0-4.0	2.0-4.0	2.0-4.0

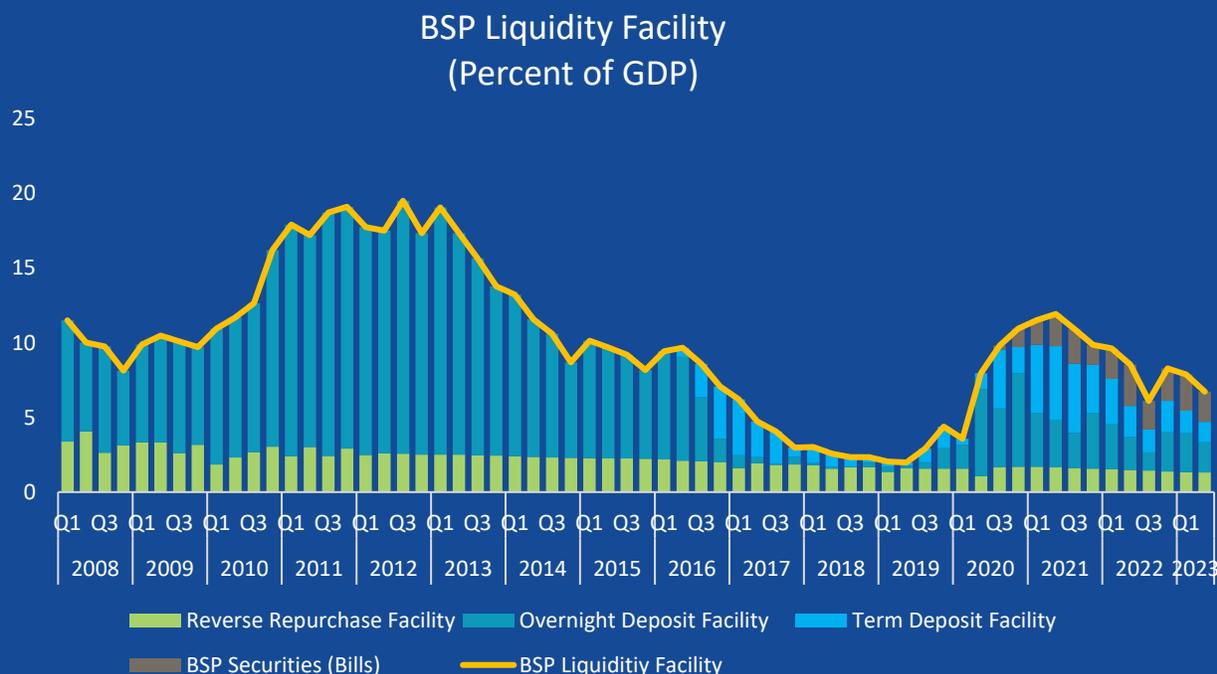
Sources: PSA, 185th Development Budget Coordination Committee (DBCC), and DBM.



Photo by: Wara1982

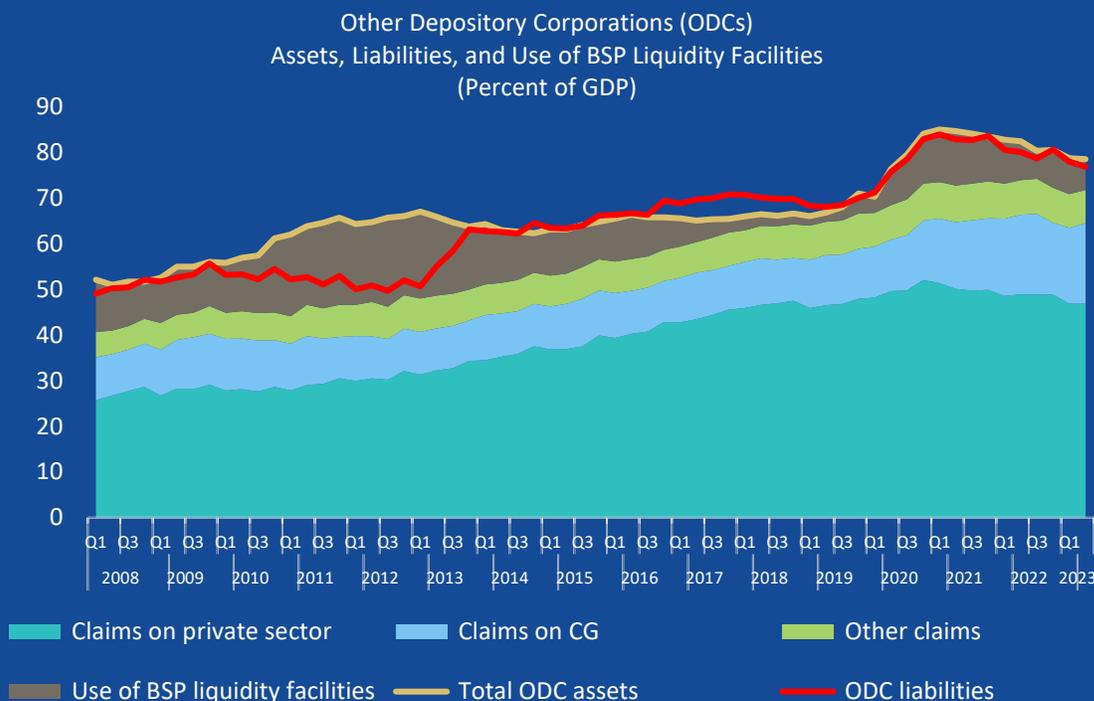


Figure 20. The BSP's liquidity facility remains elevated, albeit declining.



Source: BSP.

Figure 21. Lending to the private sector continues to fall as a share of GDP.



Sources: BSP and World Bank staff calculations.

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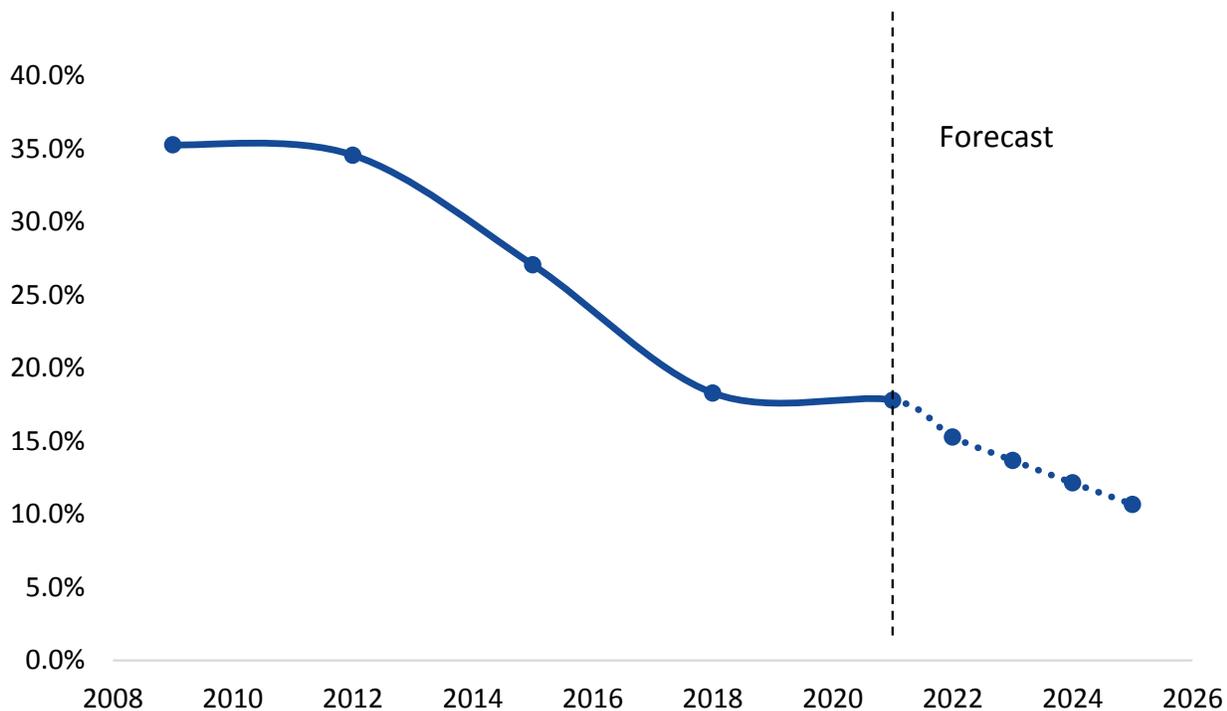
2.2 Poverty and Shared Prosperity

Economic growth and labor market improvements are likely to lead to an increase in household incomes. The projected growth of the economy, coupled with job generation, is expected to further improve household welfare. The poverty incidence,²⁰ using the World Bank's poverty line for lower-middle-income countries of US\$3.65/day (2017 PPP), is projected to decrease from 17.8 percent in 2021 to 13.7 percent in 2023, before falling further to 10.7 percent in 2025 (Figure 22). However, these projections could be tempered by elevated inflation and the escalation of perennial climate disturbances. Household income growth due to labor market gains are offset by these risk factors, with poor households being especially affected.

The implementation of proactive government measures is crucial to protect the purchasing power of poor and vulnerable households.

Given the incessant threat of inflation and climate shocks, the authorities need to continue adopting policies and interventions to mitigate shocks and ensure a sufficient energy and food supply. In September, the government approved the release of a PHP3 billion for the Fuel Subsidy Program, which aims to benefit 1.36 million qualified beneficiaries affected by escalating fuel prices. In addition, the government recently piloted its food stamp program, *Walang Gutom 2027*, which aims to improve food security and reduce hunger among low-income households. The program provides beneficiaries with monthly transfers of PHP3,000, which can be used to purchase selected food items from accredited retailers.

Figure 22. Actual and projected poverty rates (\$3.65-a-day poverty line.)



Source: World Bank staff estimates.

²⁰ Calculations based on EAPPOV harmonization, using 2021-FIES. Actual data: 2021. Nowcast: 2022. Forecasts are from 2023 to 2025. Projection using neutral distribution (2021) with pass-through = 1 based on GDP per capita in constant LCU.



2.3 Risks and Policy Challenges

The threat of persistently high inflation amid volatility in global commodity prices, tighter financial conditions, and geopolitical uncertainty presents the most challenging external risk to the Philippines. To mitigate this risk, the authorities must balance policies aimed at rebuilding economic buffers and strengthening the economic recovery with reforms aimed at enhancing long-term growth and supporting the poor and vulnerable amid limited policy space.

While several adverse risks have eased since the June 2023 Philippines Economic Update, risks to the global growth outlook remain tilted to the downside. Since June 2023, episodes of global financial instability have been swiftly contained, and the resolution of the US debt ceiling standoff curbed potential spillovers to output, employment, and financial market stability. However, concerns regarding slower global economic activity and high global inflation remain. The risk of softer global demand, rising global trade protectionism and policy uncertainty, and an intensification of geopolitical tensions could dampen global growth and trade. Within the region, a further slowdown of growth in China due to a sharper-than-expected downturn in its property sector would weigh on trade, given strong trade linkages between China and other regional economies, and could create negative spillovers that would weigh on economic activity. In addition, slower manufacturing growth in China would negatively impact regional processing trade, including the Philippines' electronics manufactures.

The threat of higher-than-expected global inflation, escalating geopolitical tensions, and tighter global financing conditions could dampen global activity and increase risks of financial stress. The escalation of geopolitical tensions, including the conflict in the Middle East as well as Russia's invasion of Ukraine, could lead to additional food and energy supply shocks, placing additional pressure on inflation. Moreover, trade restrictions on agricultural products could cause supply disruptions and lead to increased volatility in commodity prices. In major advanced economies, still elevated core inflation could prompt central banks to keep interest rates higher for longer than expected. This would further weaken external demand and weigh on exports. It would also add further downward pressure on regional exchange rates, making it more difficult for

central banks to ease monetary policy to support economic activity. Debt levels also continue to rise globally, increasing exposure to higher borrowing costs.

Containing high inflation and providing assistance to vulnerable sectors remains the country's main domestic policy challenge.

Although the baseline forecast assumes inflation will moderate to within the BSP's target range in 2024, risks remain tilted to the upside. The main upside risks to inflation include: (i) global commodity price volatility amid escalating geopolitical tensions and increasing trade restrictions; (ii) the persistent threat of climate shocks, including the current episode of El Nino, to the domestic food supply; (iii) higher input costs owing to second-round price effects of higher energy and food prices on transportation, wages, and rent; and (iv) currency depreciation. Addressing inflationary pressure means continuing the government's strategy of using both monetary and non-monetary policy measures such as increasing imports, lowering tariffs for key commodities, and ensuring better supply and demand management for food items. The government must also continue to help mitigate the impact of high inflation on vulnerable sectors through targeted social protection and transfer programs. Higher-than-expected inflation will dampen private consumption and make it more difficult for the BSP to ease monetary policy to support domestic activity.

Effective communication and increased transparency related to setting monetary policy would help keep inflation expectations in check.

The BSP's data-driven approach to monetary policy setting will continue to anchor inflation expectations. The latest increase in the policy rate by 25 bps in late October is appropriate to maintain price stability, given the recent spike in headline inflation, and the downward trajectory in core



inflation over the past half year. Moving forward, clear and effective communication of monetary policy decisions would help limit the impact of further tightening on the economy.

The success of the government’s medium-term fiscal consolidation agenda hinges on its ability to pass key tax policy and administration reforms. While the government is currently on track to meet its fiscal consolidation target for 2023, challenges remain to ensure it can also meet targets over the medium term. While the initial success in reaching its fiscal targets relied primarily on reducing public spending, the government will have to generate additional tax revenues from new tax policy and administration measures beginning in 2024 to remain on track. The government expects an additional PHP120.5 billion in tax revenues beginning in 2024 from its proposed revenue measures that are currently in the legislative pipeline. The timely passage of these revenue measures is crucial to ensure that the authorities can protect investment spending on infrastructure, human capital, and social protection—key drivers of long-term growth. In addition, the timely issuance of amendments to Executive Order 138 on the full fiscal devolution of functions to LGUs will increase fiscal transfers to local authorities over the forecast horizon and help reduce pressure on the national government to financially assist LGUs.

To improve the Philippines’ long-term growth potential, it is imperative to address low productivity and structural challenges, including underinvestment in physical and human capital. Effective implementation of pro-investment reforms in renewable energy and sectors like trade, transport, and telecommunications would generate economy-wide productivity gains, estimated at 3.2 percent on average.²¹ Moreover, implementing reforms that encourage private sector participation in physical and human capital investments could enhance the country’s growth potential, even within the constraints of limited fiscal space. Effective public spending in agriculture could also boost productivity and enhance the local food supply, thereby reducing the impact of food price shocks that disproportionately affect the poor. Finally, implementing reforms that strengthen the resilience of education, human settlements, and health care systems could mitigate the effects of climate change, public health crises, and natural

disasters in both the short and long term. Box 3 discusses these issues in more detail.

Ensuring access to quality and affordable primary health care (PHC) services is one of the most cost-effective ways to enhance health outcomes and increase the country’s long-term growth potential. While Filipinos have become healthier in recent decades, the improvements are modest compared to regional peers and their counterparts in countries with similar income classifications. As a result, the Philippines will likely fall short of meeting some of the Sustainable Development Goals (SDGs). Amid limited fiscal space, prioritizing investments in primary health care has the potential to cost-effectively improve health outcomes. Improving access to and the quality of PHC services will require: (i) a commitment by national and local government authorities to invest in building, upgrading, and equipping PHC facilities; (ii) an expansion of Philippine Health Insurance Corporation’s (PhilHealth) primary care benefits; and (iii) continuous capacity building, an expansion of digital service delivery, and efforts to strengthen the monitoring of provider performance and quality care.

Strengthening water security is the cornerstone of resilient and inclusive development and climate adaptation. Water resource cuts across and supports sectors that are critical to the economy – food security, energy production, and urban growth, among others. Moreover, climate change is making water security a socio-economic priority, with a global recognition of the costs of water risks for economic growth in low, middle, and high-income countries. While access has improved at the national level, the poorest who live in rural areas have the lowest quality of service access to water, heightening spatial inequalities, and perpetuating the cycle of poverty. To address existing gaps in service delivery, and strengthen long-term and inclusive growth, the Philippines will need to speed up and scale up its efforts around investments, institutions, and incentives. Doing so will not only close the existing gaps, but also address future access demand, and adapt to climate threats. Part 3 of the PEU investigates the state of the Philippines’ water supply and sanitation sector and provides policy recommendations to help achieve universal access to safe, sufficient, affordable, and sustainable water supply, hygiene, and sanitation.

²¹ World Bank (2023).



Box 3. Prioritizing Investments in Primary Health Care for Universal Health Coverage

While Filipinos have seen modest improvements in their health, they also face a growing disease burden. Life expectancy at birth increased from 69 years in 2000 to 72 years in 2020, before it dropped back to 69 years in 2021 due to the COVID-19 pandemic. In the Philippines, health outcomes have improved at a slower pace than in other lower-middle-income and ASEAN countries, with large gaps remaining relative to upper-middle-income countries. The country also faces a growing burden of noncommunicable diseases (NCDs) and communicable diseases. In 2019, 69.4 percent of deaths were caused by NCDs, a significant increase from 2000. Additionally, there has been a re-emergence of vaccine-preventable diseases, with falling child immunization rates due to governance challenges, missed opportunities, low demand, and disruptions caused by COVID-19.²²

Despite a significant increase in total health expenditure in recent decades, the country is facing challenges due to relatively low public health spending, particularly by LGUs. The country's total health expenditure as a proportion of GDP increased from 4.0 percent in 2014 to 4.6 percent in 2019, before reaching 6.3 percent in 2021 during the COVID-19 pandemic. However, total health expenditure fell to 5.5 percent in 2022, mostly caused by the reduction of public spending at the central level (Figure 23 and Figure 24). Public spending on health has consistently been below 50 percent of current health expenditures, which places a significant financial burden on the population, and spending by LGUs has only accounted for around 20 percent of total health spending. As a result, a significant portion of public health expenditure is not being allocated by LGUs, despite the mandated devolution of health services to local authorities.

Improving access to quality and affordable PHC services is crucial for achieving universal health coverage. Achieving universal health

coverage involves ensuring that all people have access to a full range of quality health services when and where they need them, without imposing a financial hardship. A strong PHC system, as the foundation of universal health coverage, should have health facilities located in communities that provide a comprehensive list of essential health services (e.g., services related to NCD management and immunization) and address more than 80 percent of people's common health needs throughout their lives.

Furthermore, increasing accessibility, affordability, and the quality of PHC services is important to efficiently improve health outcomes. Better and more accessible PHC could avoid unnecessary procedures and reduce the use of costly hospital and emergency resources through better preventive care. Additionally, health systems with strong PHC may achieve higher levels of allocative efficiency, as the unit costs for treating patients with the same condition in PHC are lower than those observed in emergency departments and hospitals. Therefore, improving access to quality and affordable PHC services could lead to better health outcomes with less spending. Moreover, the PHC system should be capable of timely identifying outbreaks by maintaining a high level of monitoring based on clinical indicators and having access to precise and timely laboratory tests. Reporting promptly and comprehensively to public health authorities allows for the immediate monitoring of disease trends within the community. This, in turn, enables public health authorities to inform healthcare providers about emerging trends and enhance the detection of cases.

The Philippines faces several challenges in accessing quality and affordable PHC services related to:

- **Accessibility:** Approximately 50 percent of Filipinos have access to rural health units or health centers within a 30-minute travel

²² UNICEF. 2022. "Philippines is top 5 country in the world with zero dose children." <https://www.unicef.org/philippines/press-releases/philippines-top-5-country-world-zero-dose-children>



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time, with significant geographic variation. Additionally, the country is facing challenges in hiring and retaining quality health workers and ensuring the availability of essential medicines, vaccines, and diagnostics in primary care facilities, particularly in remote areas.

- **Affordability:** Despite the PhilHealth’s efforts to expand primary care benefits over the past two decades, the current primary care benefit package, Konsulta, faces several challenges. These include inadequate coverage of essential health services, an insufficient number of Konsulta-accredited providers (as many health providers struggle to meet the service and human resource standards required for accreditation), and a cumbersome registration and payment process.

- **Quality:** Currently, there is no routine monitoring of provider performance and clinical quality in the Philippines. Additionally, evidence-based standards, performance indicators for quality care, and corresponding targets have not been established in PHC.

To address these challenges, the national government and LGUs should consider:

- **Enhancing community-based PHC services:** To ensure equitable access to essential health services, it is imperative for the national government and LGUs to invest in building, upgrading, and equipping primary care facilities. Additionally, there should be a focus on ensuring the availability of quality health workers and essential medicines. Even though LGUs are responsible for the provision of PHC services, there is substantial variation in their technical, financial, and managerial capacity. Therefore, the Department of Health (DOH) should continue to provide and enhance support for underserved areas in the coming years, taking into consideration equity and ensuring a smooth transition during the devolution process.

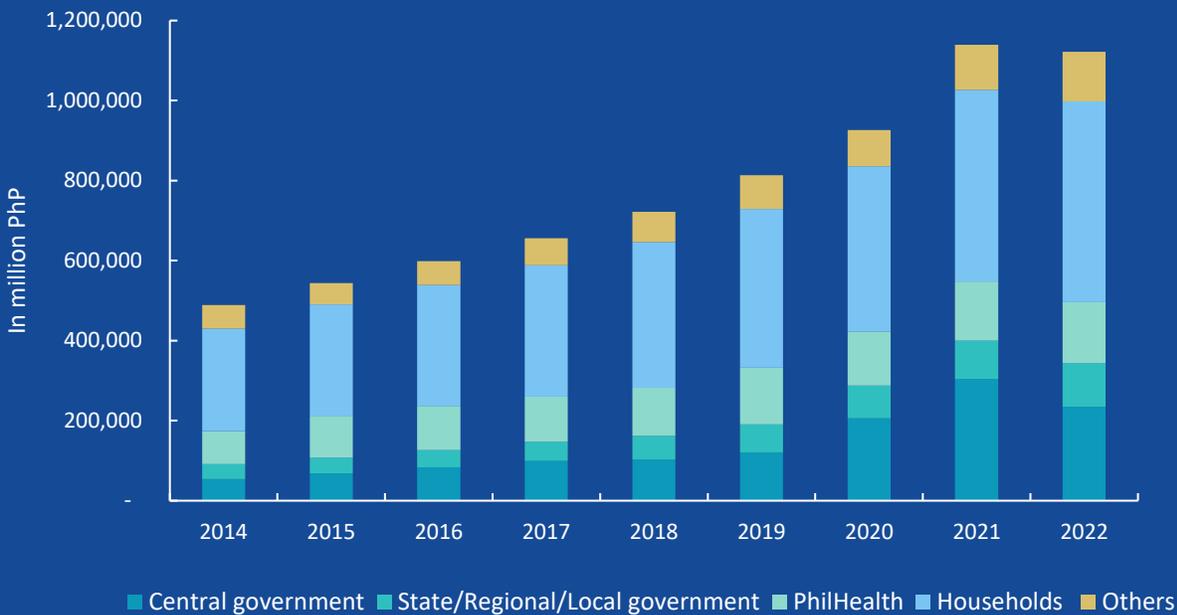
- **Expanding PhilHealth’s primary care benefits:** More efforts are needed to accelerate

the implementation of the Konsulta package. This can be achieved by supporting health providers to meet the service and human resource standards required for Konsulta accreditation. Additionally, streamlining the process required for Konsulta registration and payment is essential. In the long term, PhilHealth should develop and implement a more comprehensive primary care benefit package that includes expanded coverage of essential medicines. This will ensure that a wider range of healthcare needs are addressed and that individuals receive the necessary care for their specific conditions.

Improving the quality of PHC: A strong PHC system should not only provide access to services for the population but also ensure that these services are of sufficient quality to be effective. The DOH should establish evidence-based standards, indicators, and targets for PHC services. It is important to institutionalize the monitoring of the quality of care and promote continuous quality improvement. Furthermore, the DOH should not only develop guidelines and implementation manuals but also provide support for their implementation at the subnational level. It is also crucial to strengthen capacity-building programs for PHC workers, which can be achieved by improving the curriculums of these programs to ensure they address the specific challenges and requirements of PHC in the Philippines. However, these reforms and interventions must be rigorously implemented to ensure their desired impact. For example, local government authorities could: (i) provide incentives to the directors of health facilities to monitor the quality of care, which in turn could encourage them to prioritize and improve the quality of services provided; (ii) incentivize health workers to actively engage in capacity building activities, which could enhance their skills and knowledge; and (iii) introduce telemedicine and tele-mentoring to connect different levels of health providers and improve overall health care capacity.

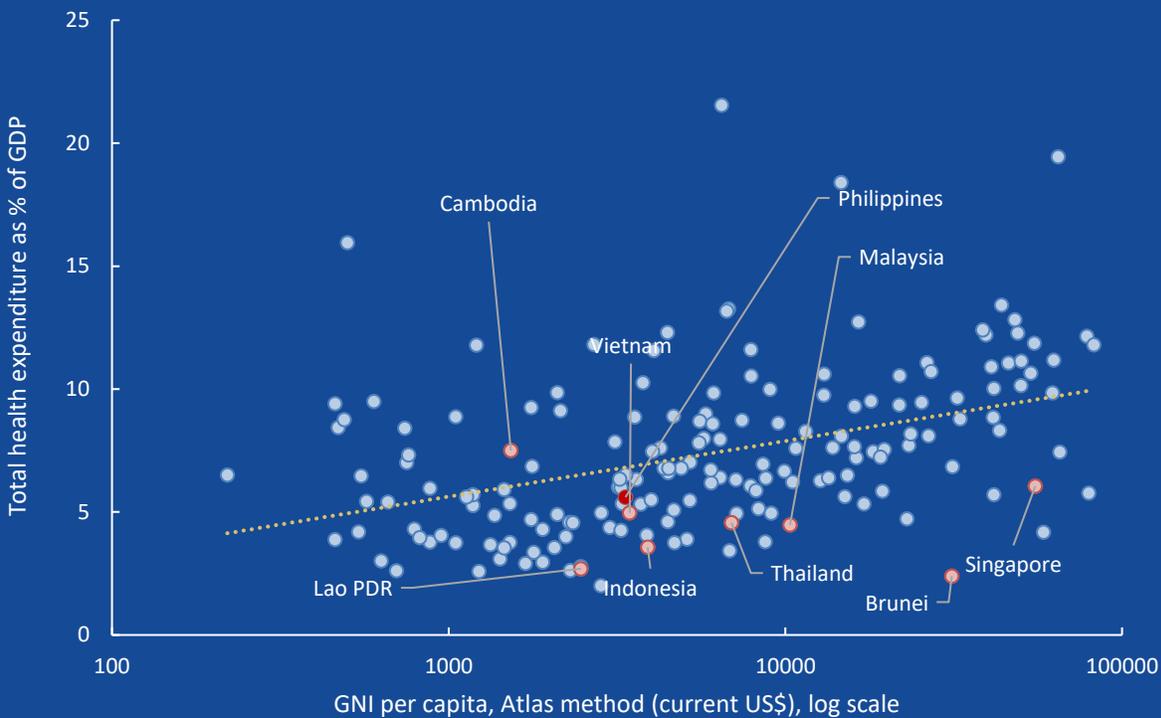


Figure 23. Current Health Expenditure by Source, 2000–2022.



Source: Philippines National Health Account, 2022. <https://psa.gov.ph/statistics/pnha/tables>.

Figure 24. Total Health Expenditure by Country, 2020.



Source: World Health Organization Global Health Expenditure Database.

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PART 3

WATER SECURITY FOR RESILIENT AND INCLUSIVE GROWTH: SECURING THE BASICS, RISING TO THE CHALLENGES

Water security is key to Philippine development and resilience. The impacts of climate change are mostly felt through water: too much, too little, or too polluted. The Philippines already confronts these three challenges in different spatial combinations – floods, droughts, and heightening poverty and inequality dynamics, notably through infrastructure and quality of service access gaps in the water supply and sanitation (WSS) sector. Because of climate change, this issue is urgent and demands attention. To adapt to climate change, an integrated approach is needed. Achieving universal access to safely managed water supply and sanitation, is important because it is key to human development, public health, and poverty reduction. The Philippines needs to address the “three Is”: Institutions, Incentives, and Investments to close the water and sanitation service gaps, address future demand, and build resilience against climate shocks.

3.1 Water Security as the Cornerstone of Resilient and Inclusive Development and Climate Adaptation

Water underpins the development of the Philippines through its role in key sectors of the economy, with 42 percent of the country's jobs being in sectors that use water intensively.²³ Water resource cuts across and supports sectors that are critical to the economy – food security, energy production, and urban growth, among others. At 42 percent, lower bound estimates of jobs more directly depending

on water availability show the importance of the sector – from labor markets to economic growth. The biggest labor market in the country, crop and animal production, is dependent on water. Economic growth drivers such as tourism and semiconductors industries, which represent the country's leading export and are also known to be water-intensive²⁴, need adequate and reliable water. This is to respond to service demand and

²³ Among the top water dependent sectors that provide employment (42%) are crop and animal production, construction of buildings, food and beverage activities, fishing and aquaculture, manufacture of food products, human health activities, and manufacturing of wearing apparel. Other employment-generating sectors that are not as water dependent are retail trade, public administration and defense, land transport and transport via pipelines, education, and office administrative, among others. Data are based on FAO-AQUASTAT which obtains water withdrawal values from national ministries or other governmental agencies.

²⁴ Frost and Hua (2019).



to prevent social and environmental externalities on water quality for instance. Levels of water pollution are very high in many places due to the lack of wastewater treatment²⁵. This affects the health of communities and ecosystems.

Climate change is making water security a socio-economic priority, with a global recognition of the costs of water risks for economic growth in low, middle, and high-income countries.²⁶ By some estimates, the Philippines will experience an average economic decline of 0.7 percent in annual GDP in the years up to 2050 because of water risks.²⁷ The recent Philippines Country Climate Development Report (CCDR) also highlights the exposure of the agriculture sector to climate shocks. By 2030, corn, followed by sugarcane and rice, can be expected to see the most significant decline in yield. Climatic changes will worsen water stress in regions such as Northwest Luzon, Central-Southern Luzon, and Cagayan, which are already facing deficits in irrigation water.²⁸ These represent a threat to food security, urban growth, and health.

An integrated approach to water security is needed to adapt to climate change sustainably and inclusively. An integrated approach means a coordinated process in the planning, development, and management of water, from water resource management to water uses such as water supply and irrigation. Doing so addresses the problem of fragmented institutional arrangements that contribute to inadequate and uneven water-related services. This integrated approach is shown in Figure 25 which shows that water security and climate adaptation depend on four pillars: achieving

universal access to safe water supply and sanitation (pillar 1); improving irrigation models and productivity (pillar 2); reducing flood and drought risks through sustainable water resource management (pillar 3); and enhancing water security in fragility, conflict, and violence (FCV) areas through a holistic development approach for peace (pillar 4) (Figure 25). While all pillars are interconnected and need to be addressed simultaneously, the first is a building block for human capital, public health, and poverty reduction.

Growing evidence emphasizes that the benefits of addressing water and sanitation access and services gaps outweigh the costs four to seven times. Various studies have highlighted the costs of poor water supply and sanitation in many countries (World Bank WASH Poverty Diagnostic, 2017). At the same time, different works looking at the benefit-cost analysis of investing in universal water, sanitation, and handwashing (WASH) have shown that the benefits exceed costs four to seven times - even where key societal impacts such as on gender equality are not accounted for²⁹ In the case of the Philippines, there is no updated information on GDP loss from poor water supply and sanitation but previous work estimated such loss at 1.3 percent (Hutton et al., 2007).

While access has improved at the national level, the poorest who live in rural areas have the lowest quality of service access to water. The role of inadequate water supply and sanitation in perpetuating the cycle of poverty is well-known. This is why both are part of the indicators measuring multi-dimensional

²⁵ One well-known example is the Pasig River. A 2021 study (Lourens et al., 2021) found the river to be one of the leading contributors to ocean plastic pollution. The high level of waste and plastic pollution, is also an issue in case of torrential rains or typhoons, blocking flood pumping stations such as the Tripa de Gallina, the largest pumping station in Metro Manila

²⁶ See World Bank research on water shocks (wet and dry): Uncharted waters (Damania et al., 2017); Water quality: Unknown Quality (Damania et al. 2019); The economics of groundwater: Hidden Wealth of Nations (Rodella et al, 2023); and the impacts of droughts on GDP: Droughts and Deficits (Zaveri et al, 2023).

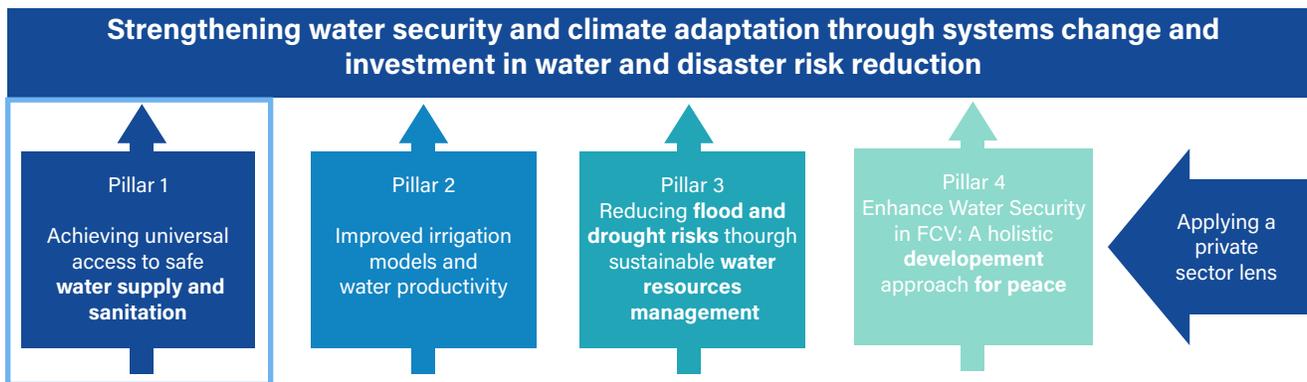
²⁷ GHD and Cambridge Econometrics (2022): Aquanomics: The economics of water risk and future resilience.

²⁸ One well-known example is the Pasig River. A 2021 study (Lourens et al. 2021) found the river to be one of the leading contributors to ocean plastic pollution. The high level of waste and plastic pollution, is also an issue in case of torrential rains or typhoons, blocking flood pumping stations such as the Tripa de Gallina, the largest pumping station in Metro Manila.

²⁹ OECD. (2011).



Figure 25. Four Pillars for Water Security and Climate Adaptation



Source: Global Challenge Program, approach paper for water security (2023) – forthcoming.

poverty.³⁰ But it is only when looking at the coverage and quality of access across the wealth distribution that the gaps become evident and informative for policy and infrastructure prioritization. While the situation has improved across wealth and income levels in the long-run (2000-2020), the richest two quintiles have higher and better quality in their WSS access compared to the poor and poorest (Figure 26). Looking at piped water access hints at the dynamics at

play: while over 80 percent of urban residents have access, quality of service and efficiency to improved piped water, just a little over 50 percent of rural ones do.³¹ The persisting gaps in the quality of access by those two quintiles is likely to be driven by the difficulty of reaching those populations. This is the problem of the last mile, whereby the easiest population to cover have already been covered.



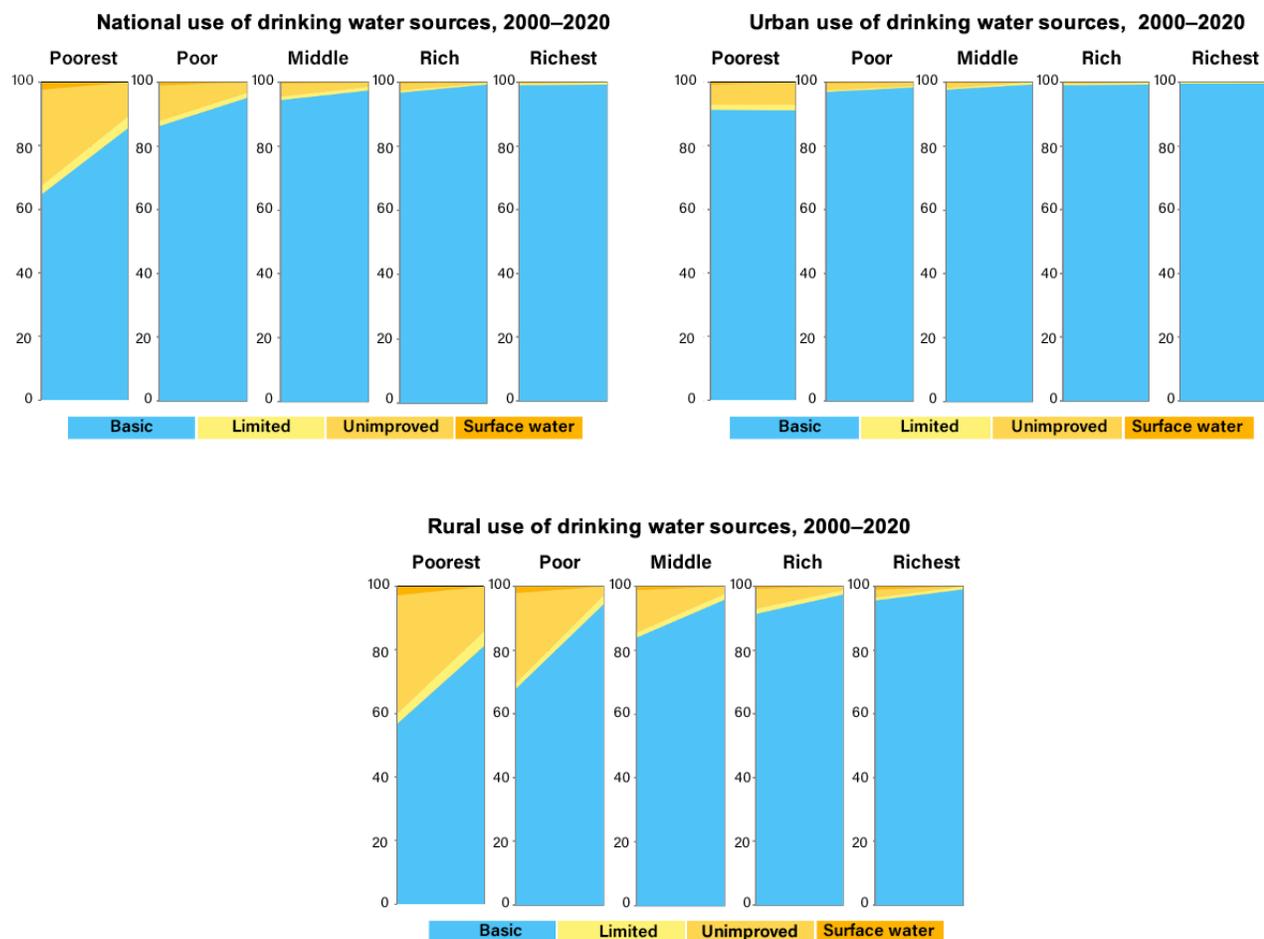
Photo by: Kiki Nugraha Indra S

³⁰ The World Bank has developed its own multi-dimensional poverty indicator, building on the Multidimensional Poverty Index (MPI) developed by the United Nations Development Program (UNDP) and Oxford University. The Multidimensional Poverty Measure (MPM) seeks to understand poverty beyond monetary deprivations (which remain the focal point of the World Bank’s monitoring of global poverty) by including access to education and basic infrastructure along with the monetary headcount ratio at the \$2.15 international poverty line. The MPM and MPI differ in one important aspect: the MPM includes monetary poverty less than \$2.15 per day, the New International Poverty Line at 2017 PPP (Purchasing Power Parity), as one of the dimensions. Under this broader definition of poverty, many more people come into view as poor. In the case of the Philippines, sanitation and water are the leading deprivations contributing to multi-dimensional poverty.

³¹ JMP (2022).

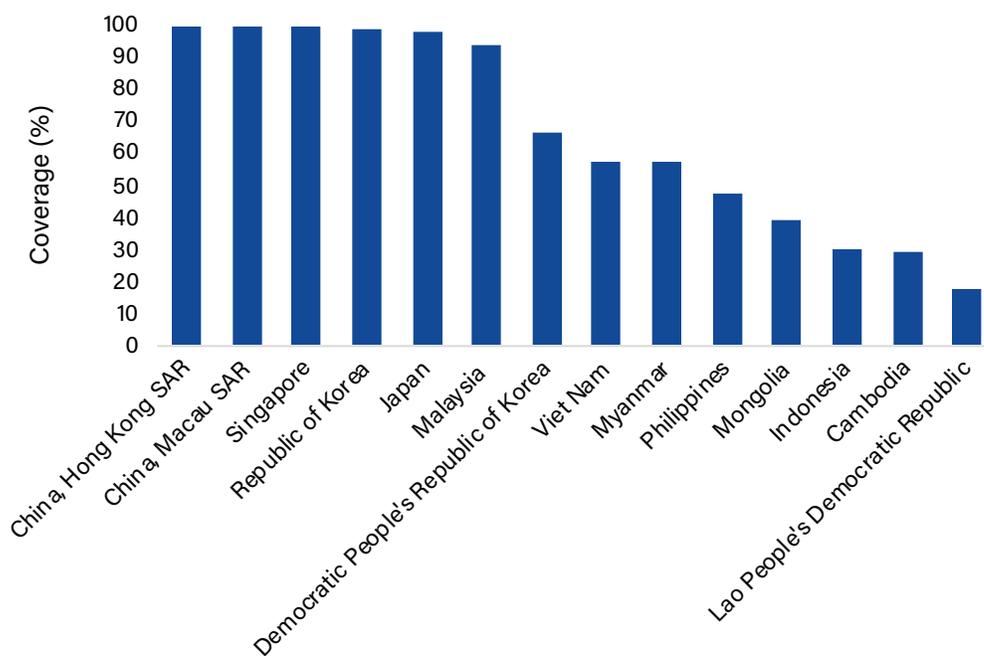


Figure 26. Quality of Water Access across Wealth Quintiles (2000-2020)



Source: Global Challenge Program, approach paper for water security (2023) - forthcoming

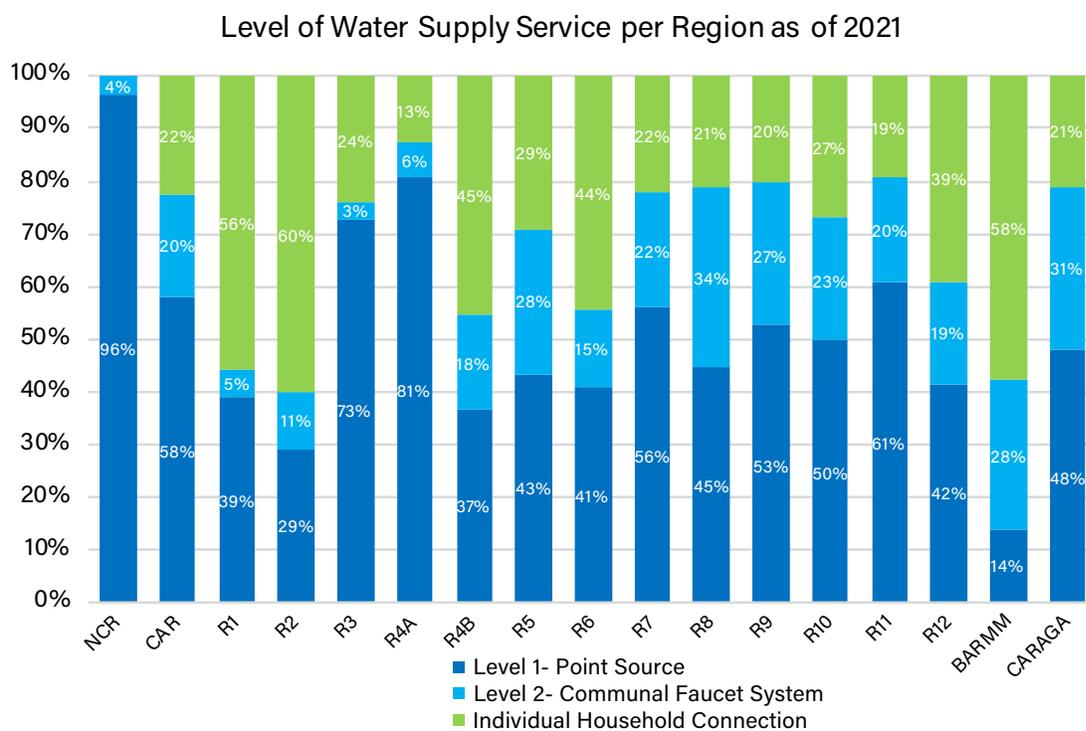
Figure 27. Safely Managed Water Supply in Eastern and Southeastern Asia



Source: JMP UNICEF/ WHO (2022)



Figure 28. Levels of Water Supply Service per Region (2021)



Source: Field Health Services Information System (FHSIS) (2021).

The water access divide also reflects and heightens spatial inequality. In some areas, there are no water service providers (WSPs), or they are operating inefficiently. This situation results in areas having water access for only a few hours a day and water quality problems. According to the latest harmonized data from the United Nations Children’s Fund (UNICEF) and World Health Organization (WHO) Joint Monitoring Programme (JMP, 2022), the baseline coverage for safely managed water supply in the country is about 48 percent; this is substantially below the global and regional EAP average of 74 percent (Figure 27). The Bangsamoro Autonomous Region in Muslim Mindanao (BARMM) has the highest poverty rate at 29.8 percent³² and the lowest access to piped water services at 14 percent (Figure 28). Even within provinces, there are important

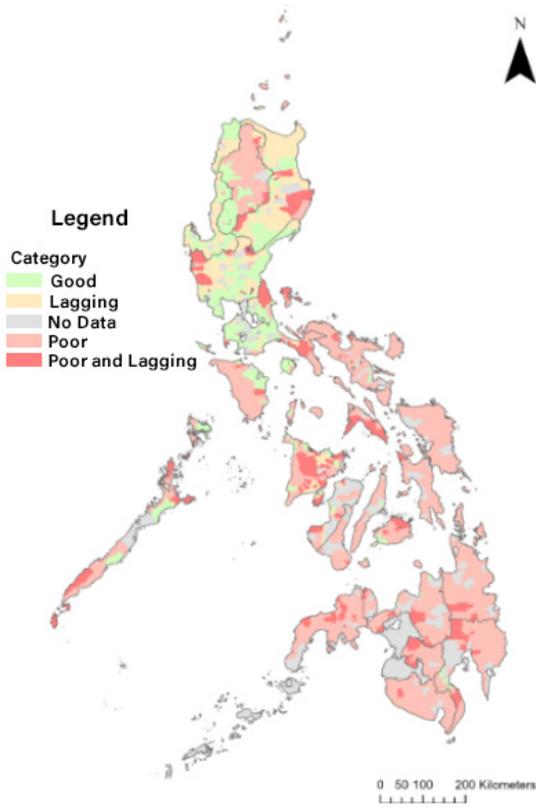
contrasts in terms of access. Municipal local government units (MLGUs) that are considered ‘good’ (i.e., with poverty incidence below 20 percent and access to safe water supply of more than 50 percent) are mostly in Luzon; most of the poor (i.e., with poverty incidence higher than 20 percent) and both poor and lagging areas (i.e., poverty incidence higher than 20 percent and access to safe water supply below 50 percent) are in the Visayas and Mindanao (Figure 29). The total estimated population in poor and lagging areas is around 4.3 million³³; this excludes BARMM as well as cities. It is also important to underline that while access gaps in urban areas may be smaller than in rural areas, they impact many people given the country’s high urbanization rate. More people need access to safe water to meet universal access.

³² Preliminary Full Year 2021 Official Poverty Statistics, Philippine Statistics Authority, https://psa.gov.ph/system/files/phdsd/2023-01/Preliminary%25202021%2520Full%2520Year%2520Poverty%2520Statistics%2520Publication_25Aug2022.pdf.

³³ Based on 2015 population data



Figure 29. Poverty and Safe Water Supply Access in the Philippines at the Local Government Unit level.³⁴



Source: World Bank (2023).

Sanitation coverage in the country remains low, especially among the poorest and rural areas. This compounds the impacts of unsafe water access. The baseline coverage on safely managed sanitation is about 63 percent.³⁵ This is higher than the 54 percent global average, but lower than the 69 percent regional average. Open defecation is still practiced by more than three and a half million people.³⁶ Indeed, the water access level of the poorest households is mirrored and compounded by the lack of sanitation (Figure 30). Similar to water access, while sanitation access has improved in aggregate, challenges remain for the poorest with 20 percent of rural households still relying on open defecation (11 percent in urban areas);

additionally, there is just about 50 percent using basic sanitation in both urban and rural areas. The situation of the second poorest wealth quintile (poor) stagnated the most, even compared to the poorest wealth quintile, with a slight erosion of the access to basic sanitation. Moreover, pollution-related issues abound because of poor sanitation in urban areas; this, in turn, affect limited water resources (Box 4). By 2030, existing service gaps will grow with close to 32 million people needing safe access to water, and 35 million needing safe sanitation in urban areas.³⁷ This is a silent public health emergency rendered more salient by the increased risk of contamination due to climate shocks, particularly floods.

³⁴ Based on 2015 PSA poverty data and 2015 DILG database on water supply access per LGU. These are the latest available access numbers on a per LGU level

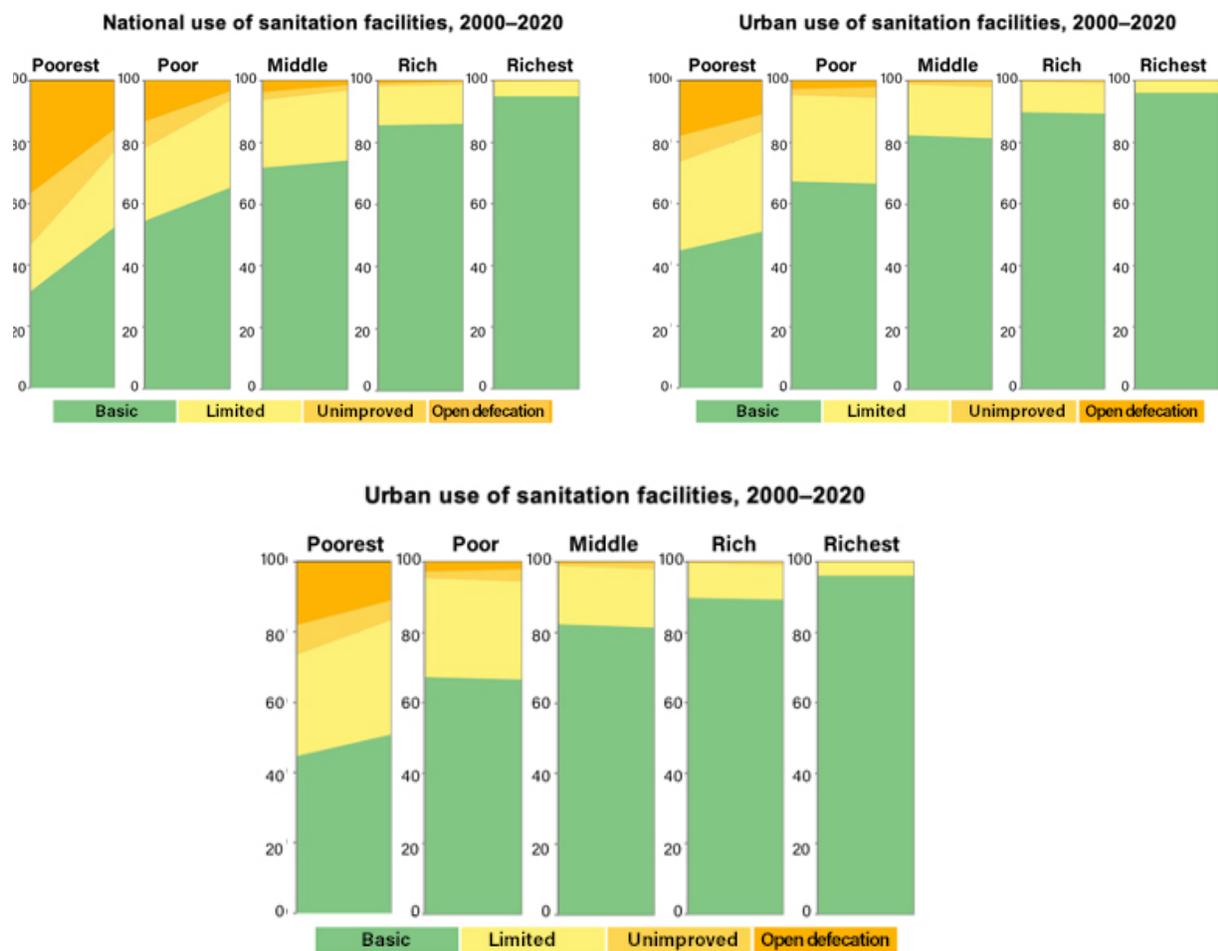
³⁵ WHO/UNICEF Joint Monitoring Program for Water Supply, Sanitation and Hygiene, “Progress on household drinking water, sanitation and hygiene 2000–2020: Five years into the SDGs”, page 119 and 139, <https://www.who.int/publications/i/item/9789240030848>.

³⁶ The Philippine Approach to Sustainable Sanitation (PhATSS) program was developed by the DOH and UNICEF to help the LGUs move communities from open defecation status to sustainable sanitation status.

³⁷ Estimates based on population without access to safely managed water and sanitation (JMP UNICEF/ WHO) and urban population estimates (UN SEA, 2018).



Figure 30. Quality of Sanitation Access based on Wealth Quintiles (2000-2020).



Source: JMP (2022) using DHS data



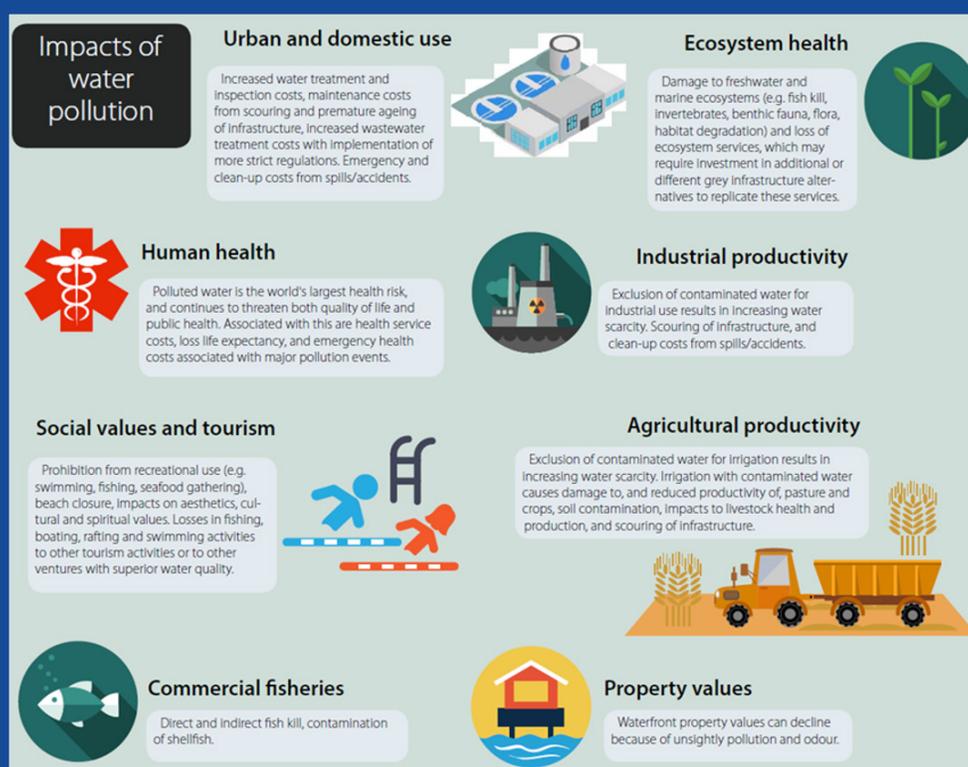
Box 4. Seeing (and Measuring) the Unseen: Water Quality

Water quality is a critical dimension of water security. There is growing awareness of the impacts and costs of poor water quality.³⁸ While water quality impacts many dimensions (Figure 31), the importance of water quality for public health cannot be overstated. This is the case of the recent study on undernutrition in the Philippines (World Bank, 2020). It is typically proxied by the access type. While a better level of service can be expected to correlate to better water quality, this is not necessarily true in all contexts, and piped access does not guarantee that the water is not exposed to contamination.³⁹

There is growing recognition that the lack of water quality data at the household level has been an impediment to capturing the benefits

of water access expansion.⁴⁰ More focus is placed on the number of people served than the quality of service. More and more household surveys such as the Demographic Health Survey (DHS) and the Multiple Indicators Cluster Survey (MICS/ UNICEF) now integrate a module testing water quality for fecal contamination (E. coli) and in some cases, other geogenic contaminants (ex. arsenic). Unfortunately, the latest DHS for the Philippines (2022) does not have such a water quality module. Beyond water quality testing, other initiatives aimed at better capturing household water security have been developed. An example is the Household Water Insecurity Experiences (HWISE) which seeks to capture non-material dimensions of households' water insecurity through a few targeted questions.⁴¹

Figure 31. Impacts of Water Pollution across Sectors



Source: OECD (2017)

³⁸ Research by the World Bank shows that the impact of poor water quality of surface waters for downstream regions can translate into reductions in economic growth between 0.8 and 2.0 percent of economic growth (Quality Unknown, 2019).

³⁹ For instance, households relying on groundwater as their water source may be exposed to E. coli or other types of anthropogenic contamination without adequate sanitation and wastewater treatment. In the event of floods, particularly in urban areas, water sources are even more exposed to contamination, for instance, from urban waste and heavy metals (Rodella et al., 2023; Ravenscroft and Lytton et al., 2022). In the context of networked water, water quality is usually better and better monitored. Still, intermittent service or uneven pressure in the system can contribute to the deterioration of its quality at the point of delivery.

⁴⁰ Bain et al. (2021).

⁴¹ <https://hwise-rcn.org/>.



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Poor WASH, which is prevalent in the country's poorest areas, is linked to malnutrition. In the Philippines, one in every four children under 5 years old is shorter for their age; moreover, the country ranks fifth with the highest stunting prevalence among countries in the East Asia and Pacific Region.⁴² Growing literature has shown how poor WASH contributes to malnutrition by transmitting pathogens and infections that inhibit nutritional uptake through diarrhea, parasites, and enteric inflammation and dysfunction (Cumming and Cairncross 2016; World Bank WASH Poverty Diagnostic, 2017).⁴³ Health data in the country show that areas with high stunting rates also have the largest WASH access gaps and the

highest prevalence of households that rely on open defecation.⁴⁴ The difference between what is considered basic access and safe access is reflective of certain issues. Water quality and other contamination from poor access and service quality are not captured by indicators on improved and basic access to water and sanitation. Beyond households, safe access to health and school infrastructure also deserves attention. The Philippines ranks low in the EAP region on access to basic drinking water in schools. Only 45 percent of schools in the Philippines enjoy basic access to drinking water. This places the country at the bottom of its peers. Also, over a quarter of schools have no water service (JMP).



Photo by: Kaijiratan

⁴²As of 2023, the rate of stunting in children under five is at 26.7 percent (Philippines, Department of Health, 2023), above the regional and global average (22.3% as of 2022 according to the WHO/UNICEF/ WB harmonized joint child malnutrition estimates).

⁴³A recent World Bank on undernutrition in the Philippines (2020) underlined the difficulty of analyzing in detail the role of WASH in malnutrition. It noted that healthy WASH conditions and behaviors in a young child's feeding and play areas can prevent diarrhea and infections and are likely to reduce environmental enteric dysfunction (EED). The latter is associated with (and a likely cause of) chronic undernutrition. EED is a chronic infection of the small intestine caused by extended exposure to fecal pathogens. By reducing a child's ability to absorb nutrients, EED can lead to undernutrition and stunting of growth. It is greatly exacerbated by unhygienic environments in which infants and young children live and grow. See Mbuya et al. (2020).

⁴⁴The highest stunting rates based on the 2015 National Nutrition Survey (NNS) are found in the Autonomous Region in Muslim Mindanao (45%), Southwestern Tagalog Region (41%), Bicol Region (40%), Western Visayas (40%), Soccsargen (40%), Zamboanga Peninsula (38%), and Central Visayas (37%). The COVID-19 crisis has been widely recognized to have worsened hunger and malnutrition in many countries, including the Philippines.



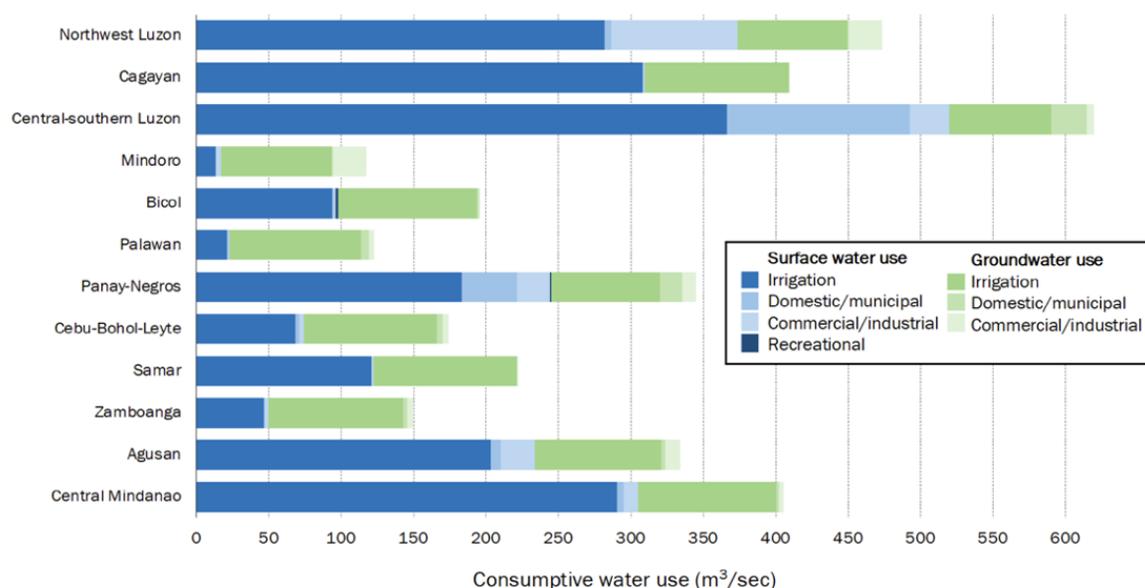
3.2 Understanding the WSS Gaps: Institutions, Incentives, and Investments

Uneven distribution water resource distribution and use will worsen due to climate impacts and increased water demand in some areas of the country. Even if the Philippines has overall ample water resources, the availability of water per person could be at high risk due to climate change and population increase in 2050.⁴⁵ Agriculture is the largest water user in the country; it accounts for 73 percent of total yearly withdrawals in 2018. This is followed by industry at 17 percent, and municipal supply at 10 percent (FAO-AQUASTAT). Hydrological regions⁴⁶ that depend on surface water as part of their drinking water supply are the urban areas. This includes Metro Manila in Central Luzon and growing city centers in Cebu, Panay-Negros, and Agusan-Davao regions (Figure 32). There are often conflicts between competing uses especially in major urban areas. This is particularly true in the Central-Southern Luzon basins supplying the

National Capital Region (NCR). Water stress already affects two key economic powerhouses of the country, Metro Manila, and Metro Cebu (Box 5). Given this scenario, water use needs to be more efficient. For example, there are water utilities with high non-revenue water (NRW). Reducing these losses is critical to efficient resource utilization.

The Philippines has made reaching universal access to safely managed WSS services by 2030⁴⁷ a priority. To do this, the country will need to speed up and scale up its efforts around the three “Is” – Institutions, Incentives, and Investments. These will close the existing water and sanitation service gaps, address future access demand, and adapt to climate threats. The next section discusses the challenges in those three areas, and how to reach universal access to water and sanitation.

Figure 32. The Extent and Composition of How Water is Consumed varies per Region



Notes: Based on water extractions permitted by the NWRB

Source: Country Climate and Development Report (2022)

⁴⁵ Per capita water availability in 2050 computed population growth with the availability of water in 2050 (World Bank data; See https://www.datawrapper.de/_/u2QXm/).

⁴⁶ A hydrological region is a unit of division of the country that has similar climate, rock type, general land cover, other watershed characteristics, and water use profile. It is useful for collecting hydrologic data on the same basis from year to year, thus facilitating historical analysis.

⁴⁷ Sustainable Development Goal 6



Box 5. Water Stress in Metro Manila and Metro Cebu

Metro Manila (15 million inhabitants) and Metro Cebu (2.9 million) are both experiencing water stress, as demand has outpaced available supply. In Metro Manila, based on the Metropolitan Waterworks and Sewerage System (MWSS) Water Source Infrastructure Roadmap as of 2022, the total water demand (maximum day demand plus a 15 percent buffer) exceeded the existing supply by more than 600 million liters per day (mld) in 2020. Metro Manila water supply is targeting more abstraction from outside sources such as Laguna Lake, Kaliwa River, Wawa River, and Kanan/Agos River. The forecast is that supply will be equal to demand in 2024;

a surplus will be available in 2025 when the Kaliwa Dam becomes operational. For Metro Cebu, the gap between water demand and supply has been a huge problem in the past decades. In 2011, water demand was at 454 mld and water supply at 179 mld. The gap has worsened to more than 300 mld in 2020. The city is looking at various options: developing desalination water treatment systems in different areas of its network; increasing production from its existing supply systems; and exploring bulk supply from outside sources (Metro Cebu Water District, Strategic Plan 2021-2030; Philippines: Country Climate Development Report, World Bank, 2022).



Photo by: aldarinho



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3.2.1 Institutions: Need for Greater Integration and Efficiency

The large investment rollout needed to achieve water security will require an integrated water sector – from water resource management to water supply and sanitation. On the water resource management side, the sector fragmentation has hindered the implementation of an Integrated Water Resource Management (IWRM) and river basin approach⁴⁸ to water resource planning.

As a result, policy making is disjointed and has resulted to uncoordinated planning, allocation, and management of water resources. This has led to siloed programs and projects and, in some cases, water disputes among the LGUs. The IWRM at the river basin level is a precondition to ensuring WSS' sustained availability, quality, and quantity of raw water resources. This planning will ensure that river sources are used and allocated properly among different uses in the long-term. It will also ensure the sustainability of the rivers and the preparation for increased threat of climate hazards, from droughts to floods. The sector fragmentation has also led to uncoordinated investments with no national agency responsible and accountable for achieving universal WSS coverage. There are more than 30 water-related government agencies, with overlapping mandates and functions (Figure 33). The Philippines needs to effectively implement a more unified approach from the national to the local level, across the water sub-sectors.

This will help align plans, programs, and projects. Providing efficient and sustainable WSS services will require stronger partnerships between the national agencies and local governments.

The authorities have already taken important steps toward this goal. But they will need to step up implementation and match it with the corresponding needs for capacity and funding. In April 2023, the Water Resources Management Office (WRMO) was created under the Department of the Environment and Natural Resources (DENR) to perform this coordination responsibility. The WRMO serves as the interim coordinating body in the water sector pending the creation of the Department of Water Resources (DWR) and Water Regulatory Commission (WRC)⁴⁹. The WRMO is mandated to integrate and harmonize all government efforts – plans, policies, investment programming, and regulatory activities to ensure the availability, efficient use, and sustainable management of water resources. It is expected to implement IWRM⁵⁰ and embody its operationalization in an Integrated Water Resources Management Plan (IWMP). The WRMO mandate could address the disjointed nature of the sector with many overlaps, missing or conflicting policies, and unclear institutional arrangements.

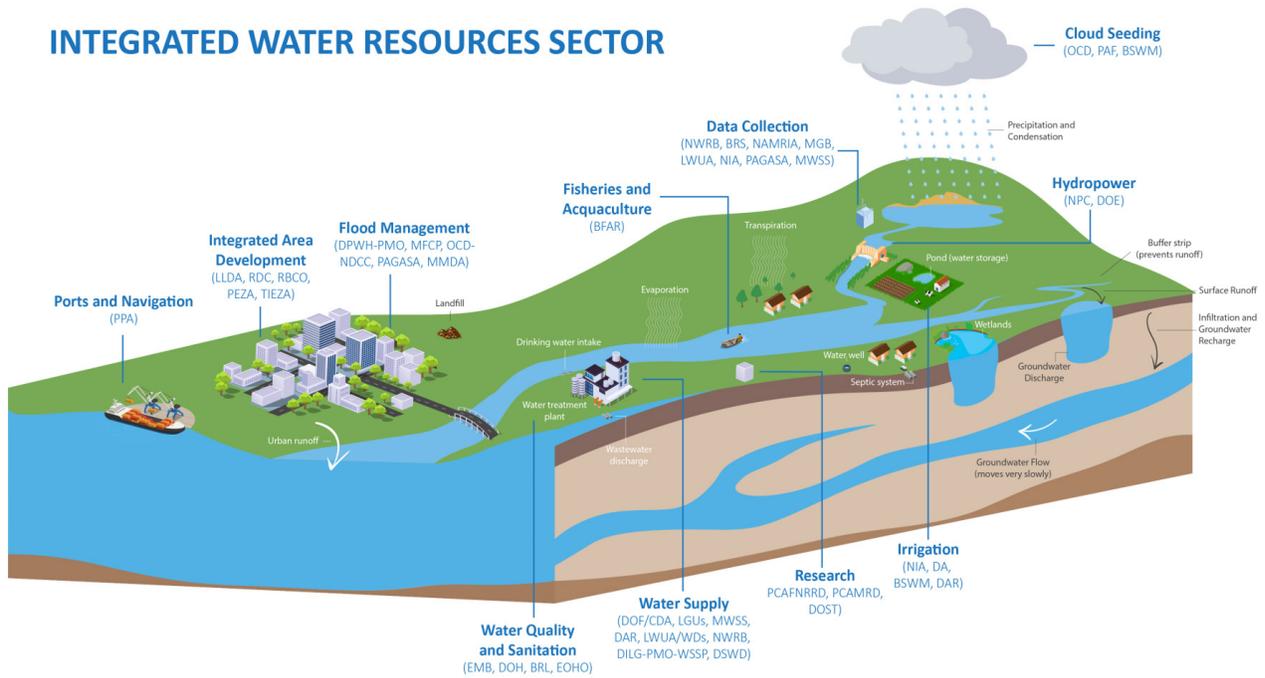
⁴⁸ A river basin approach considers all aspects of water resources within a river basin, including surface water, groundwater and land use. It facilitates the implementation of IWRM by involving downstream and upstream basin wide issues and incorporating environmental and socio-economic aspects (UNESCO, 2009).

⁴⁹ Pending in Congress

⁵⁰ IWRM is a process which promotes the coordinated development and management of water, land, and related resources to maximize economic and social welfare in an equitable manner without compromising the sustainability of vital ecosystems and the environment. IWRM is a cross-sectoral policy approach designed to replace the traditional, fragmented sectoral approach to water resources and management that has led to poor services and unsustainable resource use. (Global Water Partnership, 2011, <https://www.gwp.org/en/GWP-CEE/about/why/what-is-iwrml/>).



Figure 33. The fragmented nature of the Philippines' Water Sector



Source: World Bank (2023).



Photo by: ambient_pix

International Container Terminal Services, Inc.

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3.2.2 Incentives: Need for Better Valuing Water and Regulating WSS Services

At the national level, better valuing water means reforming policies and subsidies that may be distorting the use of the resource; also redeploying corresponding resources to achieve water security. Water can be an economic good – a critical input for nearly all forms of economic production. It is also a merit good – a commodity that should be made available based on need rather than willingness to pay, as it is vital to human health.⁵¹ A recent study on repurposing environmentally harmful subsidies showed that across the world, governments are spending trillions on inefficient subsidies that are making climate change worse. These resources could be better used to help solve the problem.⁵² Situations of regressive subsidies are common in the water supply sub-sector. In the case of WSS service provision in the Philippines, LGUs have the mandate to set prices of water supply services through the Local Government Code (LGC). But tariff setting is unclear and LGUs have varying tariff-setting mechanisms; it is also subject to political rather than economic constraints. LGU-run utilities are generally subsidizing water tariffs. In a World Bank 2023 survey of 47 LGU-run utilities, 68 percent of respondents are operating at a loss. Many LGU-run utilities are facing financial challenges due to high production costs and low revenue. This limits their ability to invest in infrastructure upgrades, improve service levels, and extend service coverage. These subsidies

contribute to inefficiency, threaten service sustainability, and encourage overexploitation of water. Moreover, they frequently end up disproportionately benefiting upper-income groups. This leaves poorer families without the needed support.⁵³

Properly valuing and managing water is critical to achieving water security (Figure 34). It confronts the challenges of a resource going from public to private “good” through its access and delivery systems. Currently, this is a problem in how local utilities and WSPs operate. At its source, water is usually treated as a public good, an open-access resource, or a common-pool resource. It is available for public use without exclusion – at the risk of overuse, exploitation, and degradation. Costly investments in infrastructure like dams, pipes, and treatment systems are needed to benefit cities, farms and households. In the case of water supply and sanitation infrastructure, these are generally private goods (or services, i.e., the services are both excludable and rivalrous). Other services like flood protection provided by dams and levees, are public goods. And because these are public goods, no one can be excluded nor can user fees be easily collected. There is a need to rationalize institutional arrangements; get incentives right; and obtain the necessary financing to fund investments.



Photo by: MaryTraveller

⁵¹ This paragraph draws from Uncharted Waters (Damania et al., 2017), a description further refined in the 2021 World Water Development report on Valuing Water (UNESCO, 2021).

⁵² Damania, et al. (2023). Detox Development. World Bank.

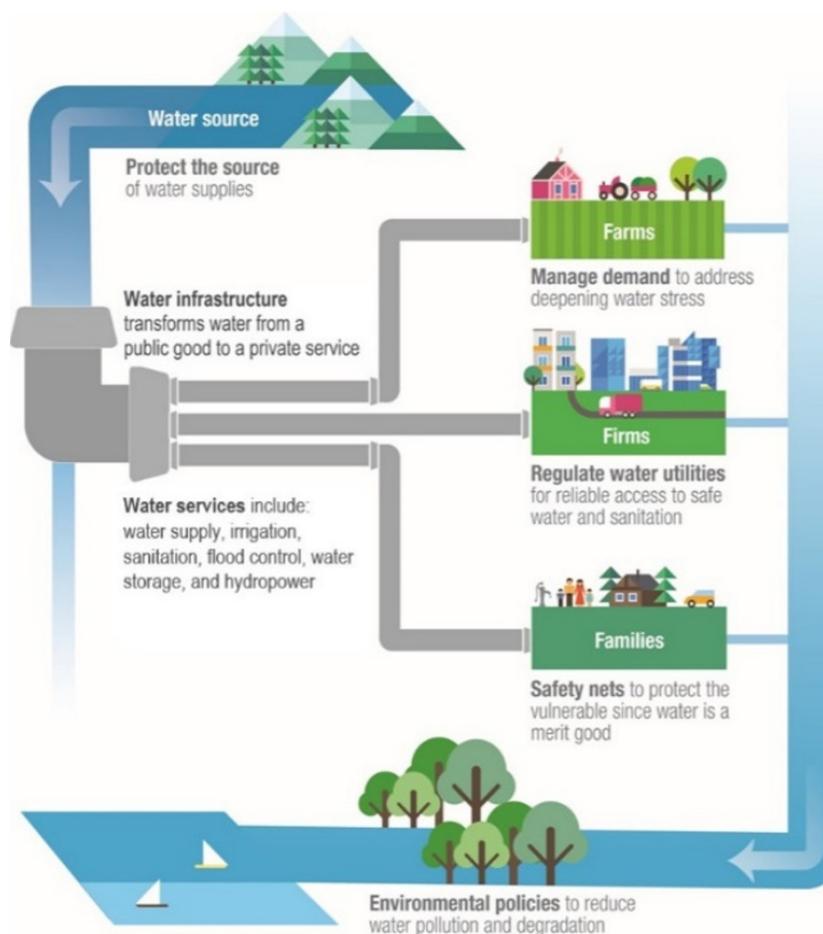
⁵³ Andres et al. (2019). Doing more with less: Smarter subsidies for water supply and sanitation. World Bank.



The utilities play an important role in expanding access and improving service delivery; their performance, however, is uneven and largely unchecked. There are more than 618 out of 1,634 cities and municipalities outside of Metro Manila as of 2022 that are primarily served by LGU-run utilities⁵⁴; these have no clear service delivery or efficiency targets. Without targets, LGU-run WSPs are not pushed to improve services.

These LGUs do not need to report on the quality of their services to any regulator. The Local Water Utilities Administration (LWUA) has the oversight, regulatory, and financing responsibility over local Water Districts (WDs). It collects the performance data of more than 500 local WDs in the country. The WD performance data only becomes a factor during tariff determinations by the LWUA; they are not used for benchmarking purposes.

Figure 34. Water Management towards Achieving Water Security



Source: Damania, R. et al. (2017)

⁵⁴ Data from the Department of the Interior and Local Government (DILG)



3.2.3 Investments: Need for Better-Leveraged Financing and Funding, Targeting Priority Areas

Projected resources for the sector are considerably lower than the target investment to reach universal access. Given current estimates, known resources flowing into the sector stand at only 15 percent of the target set in the WSS Masterplan in 2022.⁵⁵ At this current level of investment, the country will not be able to meet its 2030 target of universal WSS coverage. Some of the most urgent and capital-intensive investments include dams for storage to ensure water source for supply, bulk water supply systems, treatment facilities, transmission and distribution systems, and safely managed sanitation facilities.

The lack of policy clarity on the funding of the water supply and sanitation sector at the national level is hindering its performance

The policy issue is whether the national government will continue to financially support the sector given that WSS is a devolved service. A 2022 World Bank study⁵⁶ showed that the sector needs continued fiscal support from the national government to enable it to achieve universal WSS coverage (Box 6). While LGUs are responsible for providing WSS services under the LGC, they will struggle to fund all the activities devolved to them. The case studies show that the LGUs need assistance to deliver WSS services.

The current ad hoc approach to the sector's funding does not create self-sustaining and creditworthy utilities capable of improving coverage and services; it also undermines the efficiency of public resource allocation.

The lack of policy clarity on NG sector funding for WSS has resulted in a lack of programs and projects initiated by national government agencies (NGAs) for WSS. In the last few years, the LGUs have resorted to the legislative budget process to get the funding they need.

But this legislative-initiated ad hoc investment programming for WSS is not a strategic and efficient use of the country's resources for the following reasons: (i) there is no prioritization process, so it is uncertain whether the funding goes to the most in need; (ii) there are no guidelines for the funding allocation, hence, the its objective of gradually implementing its devolution policy is potentially being undermined; (iii) the available budget is not being used to catalyze finance, hence, the opportunity to multiply available resources is lost; (iv) the available budget is not being used to incentivize reforms at the LGU and utility level; and (iv) there is no provision for the sustainability of services, so there is a risk that the same beneficiaries will again require the government's financial support in the future.

There is a need to increase water storage to increase the resilience of water supply services. Increasing water storage will be a huge step in securing water sources for sustainable water supply services, and other purposes such as flood management. Per capita storage capacity in the Philippines was only 68 m³ as of 2017. It was well behind that of neighboring countries such as Vietnam (473 m³), Malaysia (722 m³), and Thailand (1,145 m³). An analysis of water deficits and storage needs in water-stressed Central Luzon estimated that about 4,868 million cubic meters (MCM) will be needed by 2050. This requires an investment of about USD1.8 billion or 0.015 percent of GDP over the period; this is a small amount given the magnitude of potential benefits. While a full assessment of storage needs is required, the need for additional storage is already evident in many areas.

⁵⁵ Excluding WSS investments in Metro Manila

⁵⁶ World Bank. (2022). Advisory Services and Analytics – Strengthening PH Water Supply and Services.



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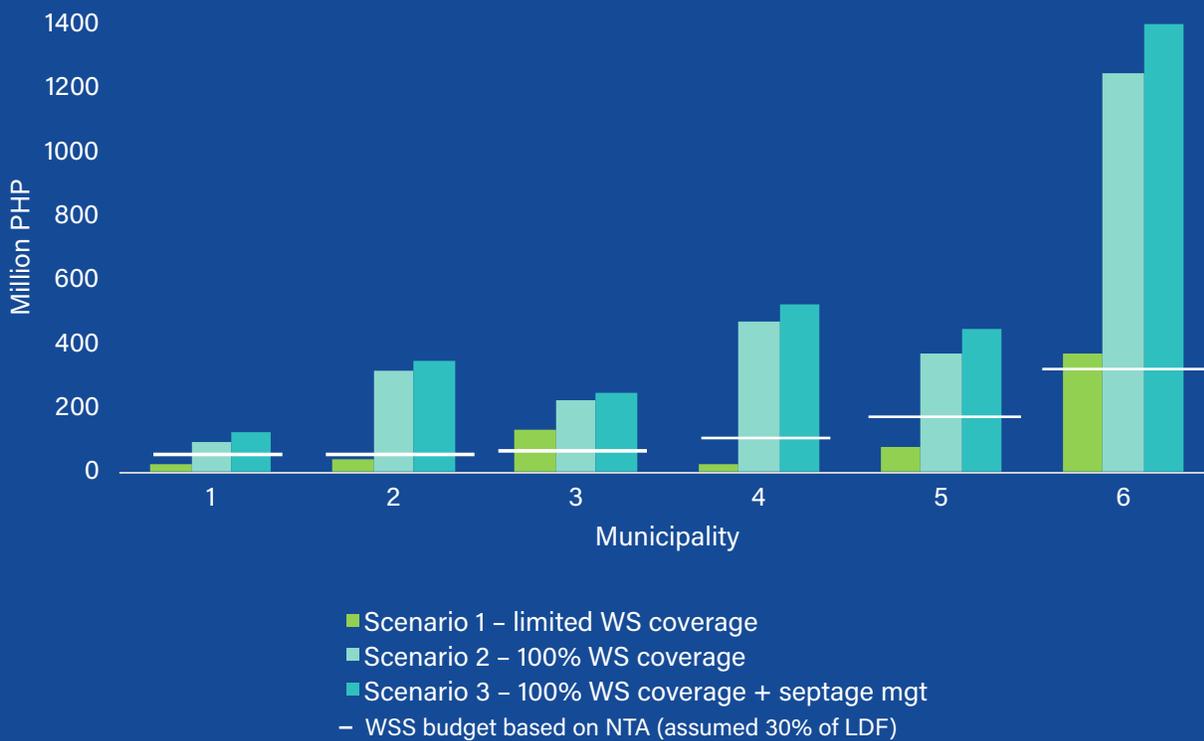
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Box 6. LGU Investment Simulation to Meet Universal Access to WSS

In a 2022 World Bank study, six study areas were selected to demonstrate possible outcome scenarios given varying levels of required investments at specified targets (Figure 35). The target areas were a mix of one LGU-run WSP, two non-operational water districts (NOWD), and three functional WDs. For each study area, three scenarios with different service targets were used as the basis for estimating investment cost requirements. Scenario one provides for 60 percent coverage

of Level III or safely managed water services; scenario two assumes that 100 percent will be provided with Level III services; and scenario three includes both 100 percent Level III and 100 percent safely managed sanitation. The simulation demonstrates that the LGUs cannot undertake the levels of investment requirement on their own. Even with increased allocation from their NTAs because of the Mandanas Ruling, the LGUs cannot provide the required investments.

Figure 35. Simulation of LGU Investments to Achieve Universal Access to WSS services



Source: World Bank. (2022). Advisory Services and Analytics – Strengthening PH Water Supply and Services.

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3.3 The way forward: Scaling Up and Speeding Up Efforts on Institutions, Incentives, and Investments for Universal Access to WSS.

The Philippines has taken the first critical step by prioritizing reaching universal water and sanitation access by 2030.

This is a crucial move toward water security with far-reaching cross-sectoral socio-economic impacts, especially for the poorest households whose access to both water and sanitation has not substantially improved over the last ten years. Less than a decade away from the 2030 goalpost, the

country will need to scale up and speed up its ongoing efforts. This way, WSS access can be expanded and services can be improved, while working on the long-term reforms in the sector. This section discusses how securing the basics on Institutions, Incentives and Investments can help in the country's run to reach its 2030 goals.

3.3.1 Institutions: Strengthening Policies and Governance

Given the current operating environment, policies, institutions, and regulations for both WRM and WSS need to be reviewed in order to improve sector coordination. The enabling environment is very critical to facilitate the implementation of sustainable long-term programs.

Water Resources Management

WWRM would allow a more efficient management and allocation of water across various stakeholders and uses. Doing a river-basin approach which considers all aspects of water resources within a river basin facilitates IWRM implementation; it also ensures resilience from climate risks. It will also help manage conflicting water source requirements that includes WSS and irrigation. This will help de-risk water projects, thus enabling greater investor interest. The current River Basin Development and Management Plans provide very good baseline information on the individual river basins. But they lack important items that are useful for decision-making. There is a need to operationalize the goals by translating the plans into specific targets, indicators, and performance criteria, among others. The IWRM guidelines on a river basin approach exists and

can be useful for decision-making on the water uses.

WSS Services

A clear funding policy for the sector is necessary and will allow the Philippines to prioritize programs while gradually implementing WSS devolution. It will also enable the country to catalyze finance and use the available resources to incentivize WSPs. A draft national government-LGU funding policy has been prepared by the DBM and is currently under review. The country may also consider the formal adoption of a Unified Resource Allocation Framework (URAF) as a guide to prioritize support in WSS support. The URAF was designed to ensure equity of investments and the use of scarce budget resources to catalyze finance, and attain universal WSS access.

Beyond coordination at the national level, achieving water security at the local level requires working with local governments and the private sector, with clear regulations. There is a need to strengthen vertical coordination in planning, financing, and regulation. There is also a need to improve horizontal coordination among sector agencies



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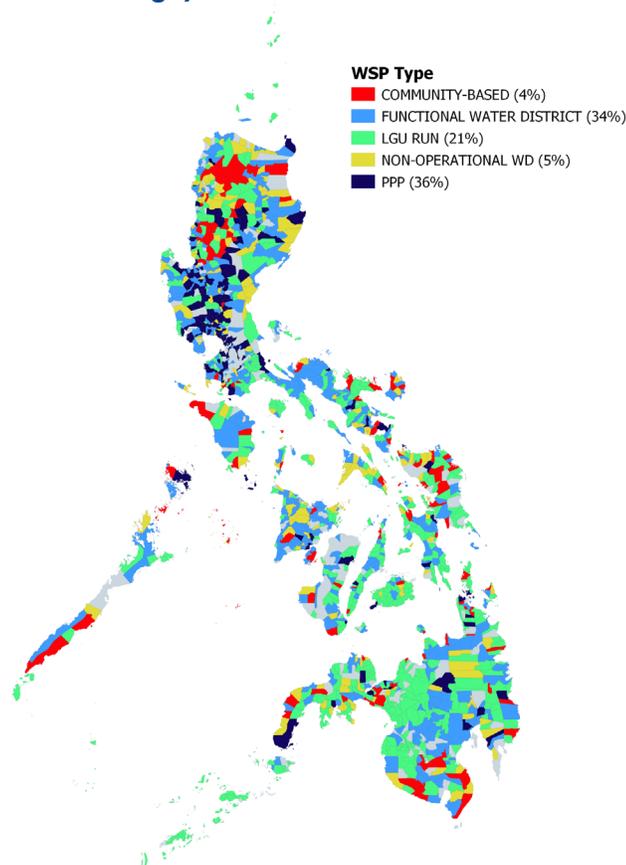
and the Department of Finance (DOF). The LGC clearly states that the LGUs are primarily responsible for the provision of water supply and sanitation. Funding, financing, and regulation of WSS, however, involve stakeholders at all government levels. There are various arrangements for WSS service delivery in LGUs. These include government-owned and controlled corporations (water districts), LGU-run utilities, community-based water groups, and private water companies. The regulation of these various water service providers is not consistent. There are differences in standards and procedures for service level requirements and tariff setting. Additionally, over a third of the country's population is now served by the private sector for water supply⁵⁷ through partnerships with local WDs or LGUs. Joint Ventures (JVs) are the most prominent mode of private sector participation for WDs. Figure 36 shows water service providers by management type per municipality. Proper regulation of all

these service providers is needed to ensure affordable and sustainable WSS services.

The Philippines could consider a holistic, targeted, and well-coordinated approach to address the institutional fragmentation.

The WRMO has a key role to play in leading the efforts to integrate the NGAs involved in WSS. National government agencies need to have clear roles in WSS which they should perform in a coordinated manner. This will ensure the implementation of aligned projects and the achievement of sector targets. The WRMO also needs to support and enable the LGUs to improve WSS provision. As mentioned previously, sustainable reforms take time and long-term planning. Utilities and LGUs could implement programs using an iterative process – one where they tweak and improve based on lessons learned from both successes and failures.

Figure 36. Water Service Providers by Management Type per Municipality (percent based on population coverage)



Source: World Bank (2022).

⁵⁷ A 2022 World Bank study estimated that about 36% of the country's population is now served by the private sector.

3.3.2 Incentives: Focus on Service Providers

The tools of the box: tariffs, taxes, and transfers. Tariffs, taxes, and transfers are the three major means for funding water investments. Tariffs are user-paid fees and typically increase with the amount of service used. Cost-recovery tariffs may be estimated to cover the total costs of service provision (i.e., including the depreciation and the profitability of the total capital employed), or some selected portions of these. Any costs not recovered through tariffs must be covered through a combination of taxes and transfers, with important differences across countries.⁵⁸ Balancing the three “Ts” is crucial for governments to achieve water security sustainably and inclusively, and provide universal access to WSS.

To price water right, there is a need for a national regulatory body that will clarify service level requirements; set tariff setting mechanisms; and monitor WSP performance. The LWUA and the National Water Resources Board have different service level obligations imposed on WSPs. JVs are regulated by their contracts which have different obligations. LGUs have no clear performance standards. All these differences lead to variable pricing assumptions and methodologies. Ideally, the pricing of water should take into consideration the following: capital recovery, reasonable rate of return, depreciation reserve fund of water utilities, automatic adjustment mechanism, operating expenses, and other factors relevant to the development, construction, installation, commissioning, operation and maintenance, and

integration of waterworks systems and infrastructure for safe water use. A national regulatory body will ensure that service standards and tariff setting mechanisms are properly defined and aligned across the country. Beyond pricing, the national regulatory body must ensure that utilities adhere to quality of service, transparency, benchmarking and citizen engagement.

Governance and regulation issues of LGUs/ WSPs may be further improved by making government support conditional on meeting certain governance and performance requirements. The government could incentivize the performance of service providers. It can make the size and type of fiscal transfers dependent on their progress in improving access to WSS and service efficiency. Key is setting clear standards and monitoring compliance of service levels for WSPs such as water service coverage, water quality, availability, pressure, non-revenue water, customer service, and operating efficiency standards, among others.

Aside from water pricing as discussed above, the LGUs need to support WSPs on the road to creditworthiness. This can be done by: (i) ringfencing their cashflows from the overall LGU accounts and ensure tariffs can recover costs; (ii) undertaking technical capacity building program so utilities can sustainably manage and operate water systems; and (iii) providing viability gap funding to keep services affordable. WSPs need to work on becoming efficient to provide sustainable services (Box 7).

⁵⁸ Andres et al., (2019).



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Box 7. Financial Viability from Efficiency Gains

Efficiency gains can enable a utility to become financially viable and help it achieve creditworthiness. A World Bank study (Goksu et al., 2017) found that operational efficiency gains could make 65 percent of 690 utilities included in the study financially viable – even prior to implementing tariff reforms. Financial viability was defined in the study as the recovery of 120 percent of operating costs.

With a 10 percent increase in revenue, the proportion of financially viable utilities increased to 77 percent. The efficiency gains were achieved through measures to cut costs and increase revenue: collection rate increased to 100 percent; non-labor cost was reduced by 15 percent; NRW was reduced to 25 percent; and revenue increased by 10 percent.

3.3.3 Investments: Focus on priority areas; Tap the private sector; and Implement a programmed approach.

There is a need to focus on cities where almost 50 percent of the population lives, as well as in poor and lagging areas. Urban areas face water stress as populations and activities grow. The growth of the NCR and CALABARZON⁵⁹ is shown in Figure 37 below as an example. These regions account for over 45 percent of the country's GDP. In addition to addressing increasing demand, utilities with high NRW must bring this down with much less water to go around in urban areas. The costs of improved service delivery are much lower when undertaken through NRW reduction rather than through capital investment projects to augment supply (Frauendorfer and Liemberger, 2010).

In addition to cities, WSS investment support needs to be focused on municipal LGUs that are poor, vulnerable to climate change impacts, and are lagging in WSS service coverage. A 2023 World Bank study identified

114 municipal LGUs that have poverty incidence above 20 percent and with WSS service coverage of less than 50 percent. These are mostly rural areas that are poor and lagging in services, are badly impacted by disasters, and would need to be prioritized.

There is room from the national to the local level to use their scarce budget resources more strategically to mobilize concessional output-based aid (ODA) financing and private finance. Full public funding should be the last resort in areas or projects where the country cannot mobilize financing. The situation in the Philippines is common. Moreover, is a growing awareness by governments and their partners of the need for a more systematic and integrated approach to the public and private financing of the sector (Figure 38).

⁵⁹ CALABARZON is an administrative region in the Philippines, designated as Region IV-A. The region comprises five provinces: Batangas, Cavite, Laguna, Quezon and Rizal; and one highly urbanized city, Lucena.



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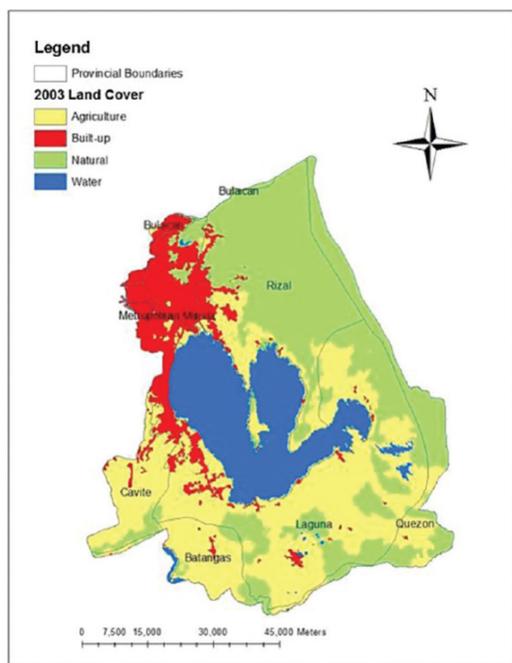
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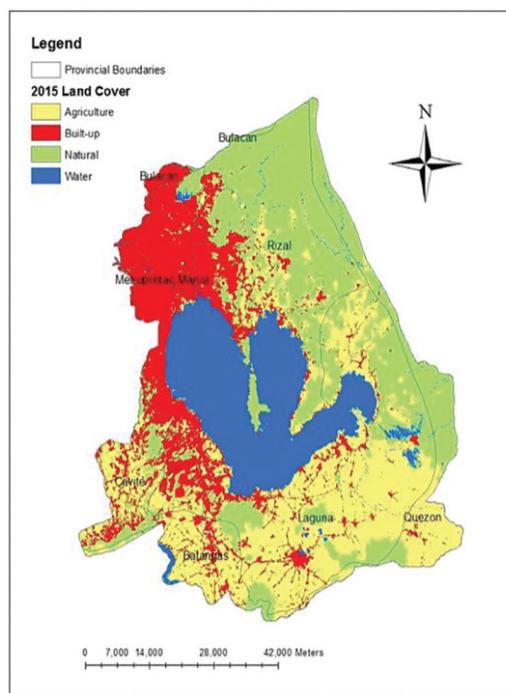
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Figure 37. Rate of Urbanization in NCR and CALABARZON.

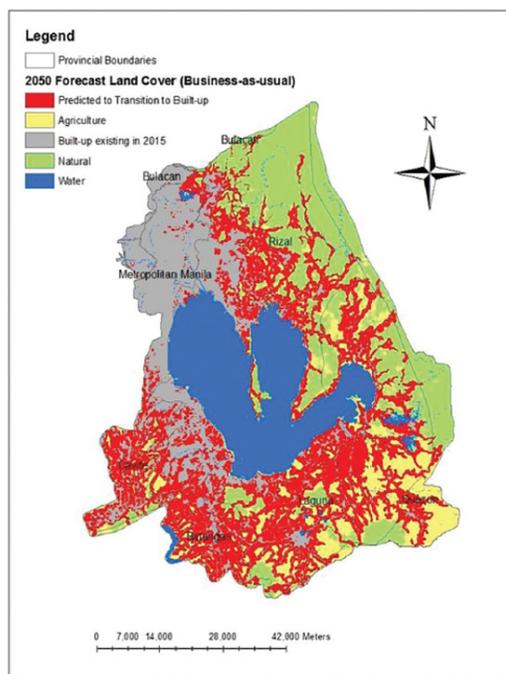


2003 harmonized land cover map [raw (unprocessed) land cover map obtained from NAMRIA; boundaries map from LLDA].



2015 harmonized land cover map [raw (unprocessed) land cover map obtained from NAMRIA; boundaries map from LLDA].

Mobilizing private capital to scale up WSS investments would involve ensuring the projects' financial viability. The 2021 Philippine Water Supply and Sanitation Masterplan (PWSSMP) estimates that about half of the required investments to meet universal coverage will come from the private sector. The government, both national and local, could look at providing viability gap funding, credit enhancement, and blended finance. Another entry point in rural WSS is microfinancing. This refers to the use of small loans to help households and small businesses afford the cost of water and sanitation services. Microfinancing has been successful in sanitation projects that provide small loans to households for constructing or improving toilets.⁶⁰ Additionally, some ways to unlock private capital entail getting incentives right. This is usually through reforms in policy and regulation. For example, a tariff policy that allows increases for improved services will provide a financing support mechanism to cover operational shortfall during the early years of implementation.⁶¹



2050 forecast for conversion to built-up land assuming "business-as-usual" conditions.

Source: Tanganco, et al. (2019)

⁶⁰ An example of this is Water.org's WaterCredit Initiative® loan program. The program operates in the following way: (i) Water.org partners with selected institutions (microfinance partners); (ii) The microfinance partners establish WSS loans in their portfolio of offerings, while Water.org provides technical assistance, connections, and resources to get them started; (iii) People in need access these small, affordable loans to put a tap or toilet in their homes and access local resources to do the work; (iv) Every repaid loan is re-lent to another family in need of WSS. Source: Water.org. <https://water.org/solutions/watercredit/>.

⁶¹ IFC (2019).

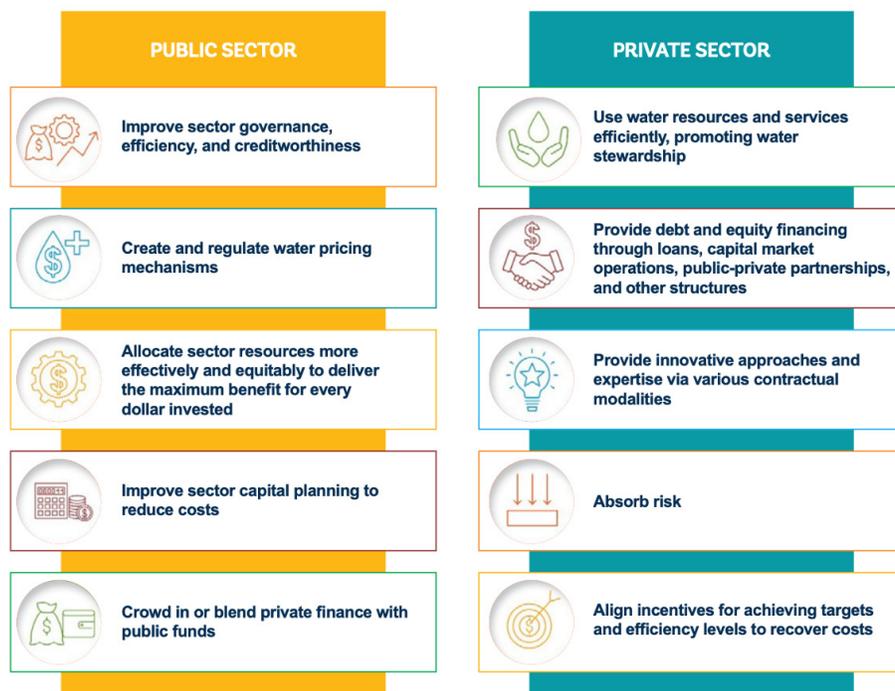


The Philippines could consider a programmed approach to roll out the required WSS investments. Such an approach would consist of horizontal integration or an institutional mechanism for coordination across the NGAs. It would also have vertical integration with LGUs for funding and capacity development assistance for preparing and implementing projects and sustaining utility operations. This approach recognizes the multi-level governance context of providing WSS services. A programmed approach is one where public spending follows a prioritization scheme with clear financing and funding arrangements by the national and local governments (blended financing, viability gap financing, output-based aid). The programmed approach can also be designed to attract private sector participation for WSS projects. Moreover, it can provide a vehicle to consolidate support from donors and development partners. This programmed approach should enable faster rollout of investments for WSS and sustainable service provision by WSPs. It would also allow project prioritization and ensure that government

support is given to those that are most in need. Sustainable reforms will require time and long-term planning. As such, implementation of the different initiatives may entail a series of forward movements. It will take time before the lessons learned from successful and unsuccessful experiences are incorporated.

Investing on water storage will help ensure water source for sustainable water supply services by increasing resilience to climate risks. During drought conditions, stored water augments the supply from the natural flow. During extreme rain events, dams and reservoirs can dampen flood heights downstream. This strategy could include maximizing current storage infrastructure by dredging to increase storage capacity, reoperating, rehabilitating, or retrofitting existing storage. It could also include developing new storage to include natural, built, and hybrid storage types. Water sources must be sustained to enable long-term water supply that is climate resilient.

Figure 38. Scaling up Finance for Water: The Roles of the Public and Private Sector



Source: Scaling up finance for water (Khemkha et al., 2023).



The above recommendations are summarized below:

Table 4. Three Key Priority Areas to Reach Universal Access to WSS.

	Main challenges	Key recommendations
Institutions	The country needs to continue its reforms in terms of policy, institutions, governance, and regulation, including better integration.	<ul style="list-style-type: none"> Clear policies and institutional arrangements with effective coordination, planning and management across sectors and levels of government, development, and enforcement of regulation. These policies include adoption of IWRM and a clear funding policy for the sector, among others.
Incentives	The authorities should work toward aligning stakeholders' incentives to address climate risks sustainably. Climate risks undermine resource availability in both quantity and availability. They also, threaten infrastructures not adequately built to sustain shocks.	<ul style="list-style-type: none"> Prices have to accurately reflect the true costs of service provision, O&M, and capital costs, as well as the environmental costs and subsidies that protect the poor Set clear standards and monitor compliance of service levels for WSPs. NG and LGUs need to support WSPs on the road to creditworthiness.
Investments	The country has a large outstanding and projected infrastructure and sector funding and financing needs.	<ul style="list-style-type: none"> Focus on priority areas – cities and poor and lagging areas. The country needs to use scarce public funds more efficiently. Tap the private sector. Adopt a programmed approach to investment rollout. Increase water storage capacity for water source management.



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