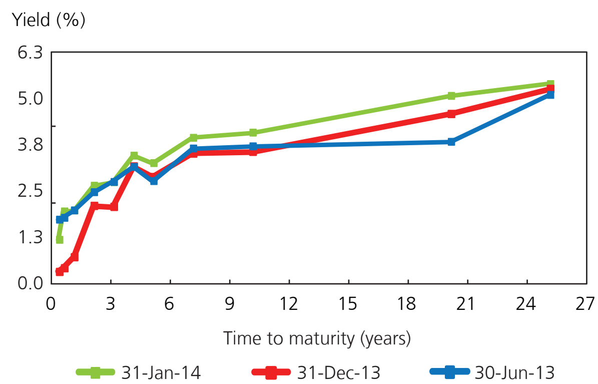
Philippines

Yield Movements

Between end-June and end-December 2013, yields fell for most Philippine local currency (LCY) bonds, particularly for those with tenors of 3 years and less **(Figure 1)**. Yields for tenors of 1 year and less plunged between 128 basis points (bps) and 143 bps, while yields for 2- and 3-year bonds fell 38 bps and 68 bps, respectively. The fall in the yields was a result of a correction after the market sell-off in May, due to speculation that the United States (US) Federal Reserve would begin tapering its quantitative easing (QE) program, and market buying on the short-end of the curve due to uncertainties over the Federal Reserve's tapering. Moreover, the continued benign inflation of the country and Moody's upgrade of the Philippines to investment grade on 3 October provided good news for the market. Meanwhile, yields on 20- and 25-year bonds rose 76 bps and 16 bps, respectively.

Figure 1: Philippines' Benchmark Yield Curve—LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

Between end-December and end-January, yields rose for all tenors. Yields for tenors of 1 year and less rose between 88 bps and 155 bps, while yields for bonds with tenors of between 2 and 20 years rose between 30 bps and 68 bps. The rise in yields was mainly due to market concerns as the US Federal Reserve continued to taper its QE program, reducing monthly bond-buying from US$85 billion to US$75 billion in January and announcing a further reduction to US$65 billion starting in February. Moreover, market players are pushing yields higher to maintain the interest rate differential with US Treasury yields as the latter have been rising. Auctions for Treasury bills and 3-year paper in January were met with relatively low demand. The Bureau of the Treasury (BTr) rejected bids for 6-month paper and accepted lower bids for the other tenors as market players posted higher yields. In addition, there are inflation concerns mostly due to the effects of Typhoon Haiyan and other upside risks.

Inflation for January increased to 4.2% year-on-year (y-o-y) from 4.1% in December 2013. Although the average inflation rate for full-year 2013 of 3.0% was still within the Bangko Sentral ng Pilipinas' (BSP) target range of 3%–5%, upside risks to inflation remain in 2014. These include (i) food inflation due to supply concerns as a result of weather-related production disruptions; (ii) higher electricity rates due to power supply concerns and the pending petition by electricity distributor Meralco for a rate hike; and (iii) continued peso depreciation, with the currency falling 8.3% in 2013 and 2.0% year-to-date as of end-January 2014, due to concerns generated by the US Federal Reserve's tapering of its QE program. Thus, speculation of possible monetary tightening by the BSP has also added to uncertainties in the market.

The Philippine economy grew 6.5% y-o-y in 4Q13, following revised 6.9% y-o-y growth in 3Q13. The decline in growth was primarily due to effects of Typhoon Haiyan. Despite this, growth continues to be supported by the strong performance of the services sector, which expanded 6.5% y-o-y in 4Q13. Meanwhile, growth in the manufacturing sector accelerated to 12.3%. For the full-year 2013, real GDP grew 7.2%.

Size and Composition

The Philippine LCY bond market grew at a robust annual rate of 10.2% in 2013, led by both Treasury bills and bonds **(Table 1)**. Total LCY bonds reached PHP4,481 billion (US$101 billion) at end-November, up 4.0% from end-September's level of PHP4,307 billion. Government securities accounted for the majority of bonds outstanding, totaling PHP3,889 billion, while corporate bonds summed to PHP591.5 billion.

Government Bonds. Outstanding fixed-income instruments issued by the Philippine government and government-controlled companies rose 3.4% quarter-on-

Table 1: Size and Composition of the LCY Bond Market in the Philippines

	Outstanding Amount (billion)						Growth Rate (%)			
	4Q12		3Q13		4Q13		4Q12		4Q13	
	PHP	US$	PHP	US$	PHP	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	**4,064**	**99**	**4,307**	**99**	**4,481**	**101**	**6.9**	**19.9**	**4.0**	**10.2**
Government	3,538	86	3,763	87	3,889	88	7.7	19.8	3.4	9.9
Treasury Bills	275	7	310	7	333	7	5.0	(6.8)	7.3	21.0
Treasury Bonds	3,150	77	3,339	77	3,440	77	8.6	23.7	3.0	9.2
Others	113	3	113	3	116	3	(8.8)	2.3	2.6	2.6
Corporate	526	13	544	13	592	13	2.3	20.7	8.7	12.4

( ) = negative, LCY = local currency, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg end-of-period LCY–US$ rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.
4. Data for government bonds as of end-November 2013.
5. "Others" comprise bonds issued by government agencies, entities, and corporations for which repayment is guaranteed by the Government of the Philippines. This includes bonds issued by Power Sector Assets and Liabilities Management (PSALM) and the National Food Authority, among others.
6. Peso Global Bonds (PHP-denominated bonds payable in US dollars) and multi-currency Retail Treasury Bonds (RTBs) are not included. As of end-November 2013, the Government of the Philippines and Petron had PHP129.7 billion and PHP20.0 billion of outstanding Peso Global Bonds, respectively. There was a total of PHP9.0 billion of outstanding multi-currency Treasury bonds at end-November 2013.

Sources: Bureau of the Treasury and Bloomberg LP.

quarter (q-o-q) and 9.9% y-o-y to close at PHP3,889 billion at end-November. Treasury bills expanded 7.3% q-o-q and 21.0% y-o-y to stand at PHP332.6 billion at end-November, as demand for shorter tenors was high due to uncertainties in the market. Treasury bonds increased 3.0% q-o-q and 9.2% y-o-y to PHP3,440 billion. Meanwhile, fixed-income instruments issued by government-controlled companies registered an increase of 2.6% y-o-y to PHP116.5 billion at the end of 4Q13.

In terms of issuance, 4Q13 saw less volume, PHP127.9 billion compared with PHP340.0 billion in 3Q13, due to the government's comfortable cash position after the issuance of PHP150 billion worth of 10-year Retail Treasury Bonds (RTBs) in August.

The government has programmed LCY borrowing of PHP135 billion through its regular auction schedule in 1Q14: PHP60 billion of Treasury bills with 91-, 182-, and 364-day tenors; and PHP75 billion of Treasury bonds with 3-, 5-, and 7-years tenors.

Corporate Bonds. As of end-December, total outstanding LCY corporate bonds grew 8.7% q-o-q and 12.4% y-o-y to reach PHP591.5 billion. The market saw a lot of corporate bond issuances in 4Q13, a total of PHP77.4 billion compared to PHP19.5 billion, PHP14.0 billion, and PHP32.0 billion in the first 3 quarters of the year, respectively. Local firms took advantage of relatively low interest rates before the end of the year, in anticipation of higher rates in 2014 as a result of the Federal Reserve tapering its QE program and rising inflation concerns.

Twelve companies issued bonds, long-term negotiable certificates of deposits (LTNCDs) , and Tier 2 notes in 4Q13. Meralco was the largest issuer in 4Q13 raising PHP18.5 billion worth of bonds **(Table 2)**, Development Bank of the Philippines was second with PHP10.0 billion of Tier 2 notes, and Aboitiz Equitiz Ventures was third with PHP8.0 billion of corporate bonds.

Only 52 companies are actively tapping the bond market in the Philippines. The top 33 issuers accounted for 93.4% of the total amount of LCY corporate bonds outstanding at end-December **(Table 3)**. Out of the top 33 bond issuers, only seven companies were privately held corporations and the rest were publicly listed with the Philippine Stock Exchange (PSE). Ayala Land was the largest corporate issuer in the country with PHP49.9 billion of outstanding debt at end-December. San Miguel Brewery was the next largest borrower with PHP45.2 billion outstanding. Ayala Corporation was in the third spot with PHP40 billion of outstanding bonds.

The diversity of LCY corporate bond issuers in 4Q13 was comparable with that in 3Q13 **(Figure 2)**. Banks and financial services, including investment houses, remained the leading issuer of debt in 4Q13 with 25.5% of the total as BSP moved toward more stringent liquidity and capital requirements. The market share of most industries

Table 2: Notable LCY Corporate Bond Issuance in 4Q13

Corporate Issuers	Coupon Rate (%)	Issued Amount (PHP billion)
Meralco		
7-year bond	4.38	11.50
12-year bond	4.88	7.00
Development Bank of the Philippines		
10-year Tier 2 Notes	4.88	10.00
Aboitiz Equity Ventures		
7-year bond	4.41	6.20
10-year bond	4.62	1.80
Filinvest Land		
7-year bond	4.86	4.30
10-year bond	5.43	2.70
Ayala Land		
7-year bond	4.63	4.00
20-year bond	6.00	2.00
BDO Unibank		
5.5-year LTNCD	3.13	5.00
Land Bank of the Philippines		
5.5-year LTNCD	3.13	5.00
RCBC		
5.5-year LTNCD	3.25	2.86
5.5-year LTNCD	0.00	2.14
Philippine National Bank		
5.5-year LTNCD	3.25	4.00
Asia United Bank		
5.25-year LTNCD	3.50	0.90

LCY = local currency, LTNCD = long-term negotiable certificate of deposit.
Source: Bloomberg LP.

remained unchanged, except for real estate, which increased to 19.5% from 17.9%. Firms from industries as diverse as electricity generation and distribution, telecommunications, and thoroughfares and tollways continued to have shares of total corporate bonds outstanding in the single-digit levels.

As the sole fixed-income exchange in the country, PDEx captures the secondary trading of listed fixed-income issues. The volume of secondary trading of government securities surged between 2005 and 2013 **(Figure 3)**. From an annual trading volume of PHP437.7 billion in 2005, trading volume increased to PHP5,692.0 billion in 2013.

Total trading volume in 2013 increased 12.9% y-o-y to PHP5,692 billion from PHP5,042 billion in 2012. Between 2005 and 2013, treasury bonds accounted for the highest share in the total trading volume. However, its share also declined from 81.6% in 2005 to 59.8% in 2013. Meanwhile, the share of RTBs increased from 5.5% in 2005 to 37.2% in 2013. This reflects the market's interest in longer-tenored government securities, particularly the 20- and 25-year maturities, which are mostly RTBs.

Foreign Currency Denominated Bonds. In January, the Philippines raised US$1.5 billion from the sale of 10-year US$-denominated global bonds. The bonds carry a coupon of 4.2%. The bond issuance occurred concurrently with a 1-day tender offer for 11 series of US$-denominated bonds maturing between 2015 and 2025. This was its first dollar bond issuance since January 2012, and is the first to achieve an international investment-grade rating—Baa3 from Moody's, BBB– from Standard & Poor's, and BBB– from Fitch Ratings.

Investor Profile

The largest grouping of investors in government securities in 4Q13 comprised banks and financial institutions with 31.6% of the total **(Figure 4)**. This was up slightly from a share of 30.9% in 4Q12. Contractual savings institutions—including the Social Security System (SSS), Government Service Insurance System (GSIS), Pag-ibig, and life insurance companies—and tax-exempt institutions—such as trusts and other tax-exempt entities—accounted for 24.4% of the total in 4Q13, down from 25.4% in 4Q12. The share of funds being managed by BTr, which includes the Bond Sinking Fund, also fell to 18.9% in 4Q13 from 20.8% in 4Q12. The participation of custodians slightly decreased to 13.2% from 13.4% in the same period in 2012. The share of other government entities and other investors, which include individuals and private corporations, increased to 11.8% in 4Q13 from 9.5% in 4Q12.

Policy, Institutional, and Regulatory Developments

BSP Issues Circular on Amendments to Regulations on FX Transactions

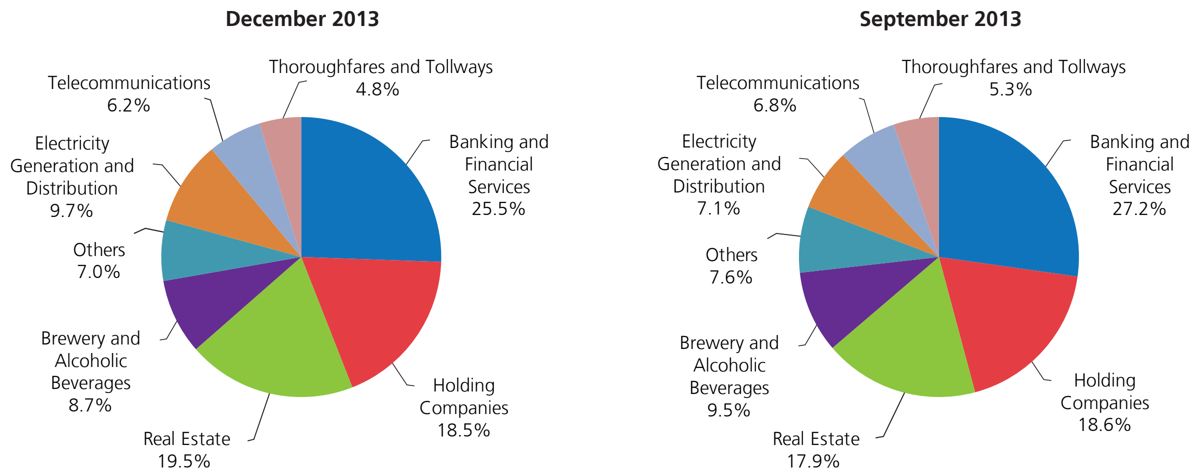
On 7 November, the BSP released the implementing circular on the amendments to the manual regulations on foreign exchange (FX) transactions. This included (i) allowing prepayment of BSP-registered short-term loans subject to required documents, (ii) waiver of the submission of documents to support reports on importations under documents against acceptance and open account arrangements, and (iii) clarification of the prescriptive

Table 3: Top 33 Issuers of LCY Corporate Bonds in the Philippines

Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
	LCY Bonds (PHP billion)	LCY Bonds (US$ billion)			
1. Ayala Land	49.9	1.1	No	Yes	Real Estate
2. San Miguel Brewery	45.2	1.0	No	Yes	Brewery
3. Ayala Corporation	40.0	0.9	No	Yes	Diversified Operations
4. Meralco	37.9	0.9	No	Yes	Electricity Distribution
5. SM Investments	36.1	0.8	No	Yes	Diversified Operations
6. Philippine National Bank	30.9	0.7	No	Yes	Banking
7. BDO Unibank	23.0	0.5	No	Yes	Banking
8. Filinvest Land	21.5	0.5	No	Yes	Real Estate
9. Energy Development Corporation	19.0	0.4	No	Yes	Electricity Generation
10. RCBC	19.0	0.4	No	Yes	Banking
11. Philippine Long Distance Telephone	17.2	0.4	No	Yes	Telecommunications
12. Globe Telecom	17.0	0.4	No	Yes	Telecommunications
13. Maynilad Water Services	16.6	0.4	No	No	Water
14. SM Development	14.3	0.3	No	Yes	Real Estate
15. Petron	13.6	0.3	No	Yes	Oil Refining and Marketing
16. Security Bank	13.0	0.3	No	Yes	Banking
17. First Metro Investment	12.0	0.3	No	No	Investment Banking
18. MTD Manila Expressway	11.5	0.3	No	No	Transport Services
19. South Luzon Tollway	11.0	0.2	No	No	Transport Services
20. GT Capital Holdings	10.0	0.2	No	Yes	Investment Companies
21. Robinsons Land	10.0	0.2	No	Yes	Real Estate
22. Metrobank	10.0	0.2	No	Yes	Banking
23. United Coconut Planters Bank	9.5	0.2	No	No	Banking
24. JG Summit Holdings	9.0	0.2	No	Yes	Diversified Operations
25. Allied Banking	8.0	0.2	No	Yes	Banking
26. Aboitiz Equity Ventures	8.0	0.2	No	Yes	Diversified Operations
27. Union Bank of the Philippines	6.8	0.2	No	Yes	Banking
28. Megaworld	6.4	0.1	No	Yes	Real Estate
29. Manila North Tollways	6.1	0.1	No	No	Transport Services
30. Tanduay Distilleries	5.0	0.1	No	No	Alcoholic Beverages
31. SM Prime Holdings	5.0	0.1	No	Yes	Real Estate
32. Rockwell Land	5.0	0.1	No	Yes	Real Estate
33. Bank of the Philippine Islands	5.0	0.1	No	Yes	Banking
Total Top 33 LCY Corporate Issuers	**552.4**	**12.4**			
Total LCY Corporate Bonds	**591.5**	**13.3**			
Top 33 as % of Total LCY Corporate Bonds	**93.4%**	**93.4%**			

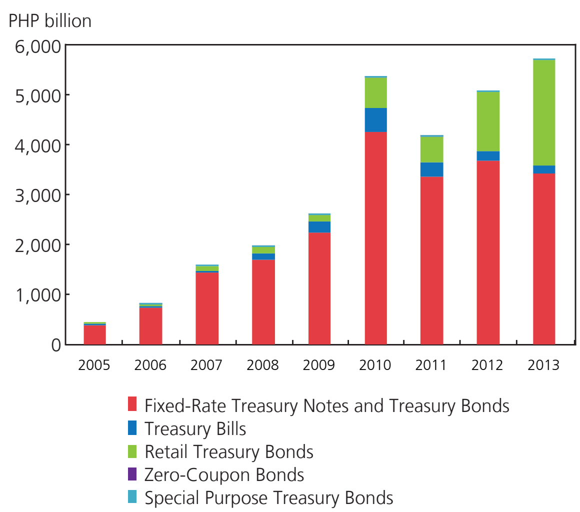
LCY = local currency.
Notes:
1. Data as of end-December 2013.
2. Petron has PHP20 billion of Global Peso Bonds outstanding that are not included in this table.
3. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Bloomberg data.

Figure 2: LCY Corporate Bond Issuers by Industry



LCY = local currency.
Source: Bloomberg LP.

Figure 3: PDEx Trade Volume Trends—Government Securities



Note: PDEx reports one side of the trade only.
Source: Philippine Dealing and Exchange Corporation (PDEx).

period for filing requests for BSP registration of foreign direct investment and rules on currency swaps.

BSP Liberalizes Rules on the Issuance of LTNCTDs

On 23 December, the Monetary Board of BSP issued new guidelines liberalizing the issuance of Long-Term Negotiable Certificates of Time Deposits (LTNCTDs). This included lifting the PHP5 billion issue size cap for LTNCTD offerings by banks. With this are also refinements of the rules to promote issuer accountability. These include raising the reserve requirement from 3% to 6% of outstanding LTNCTDs, and listing the instruments on an accredited exchange platform.

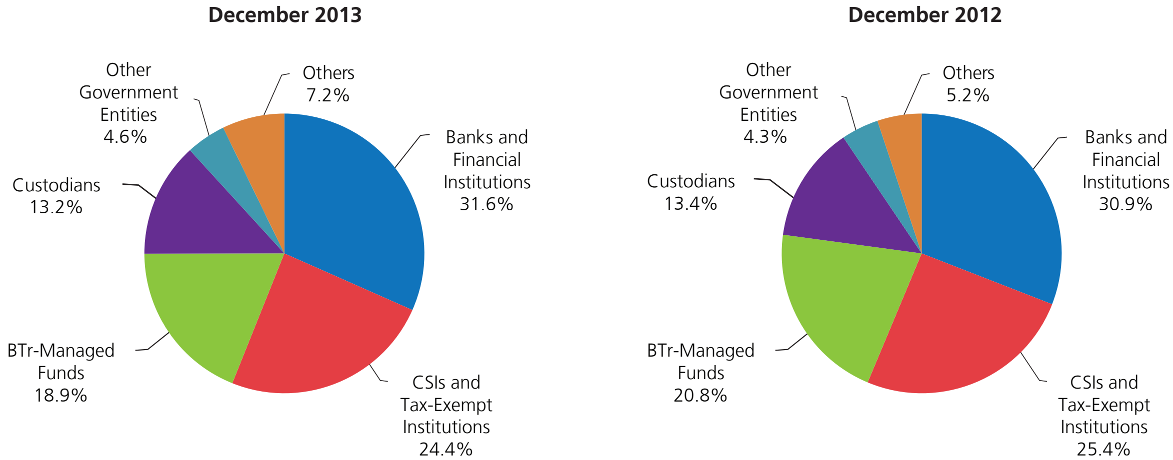
BSP, DOF, IC, PDIC, and SEC Create Financial Stability Coordination Council

On 29 January, BSP, the Department of Finance (DOF), Insurance Commission (IC), Philippine Deposit Insurance Corporation (PDIC), and Securities and Exchange Commission (SEC) signed a memorandum of agreement to formally create the Financial Stability Coordination Council. Its key roles will include identifying, managing, and mitigating the build-up of systemic risks, with the objective of securing financial stability in the Philippines.

BSP Maintains Policy Rates

On 6 February, the Monetary Board of BSP decided to keep its key policy rates—the overnight borrowing and lending rates—steady at 3.50% and 5.50%, respectively. The reserve requirement ratios and the interest rate for BSP's Special Deposit Account facility were also kept steady. Despite the slight increase in inflation due to an increase in food prices as a result of weather-related production

Figure 4: LCY Government Bonds Investor Profile



BTr = Bureau of the Treasury, CSIs = contractual savings institutions, LCY = local currency.
Source: Bloomberg LP.

disruptions, BSP cited that the future inflation path continues to be broadly in line with BSP's target ranges of 3.0%–5.0% for 2014 and 2.0%–4.0% for 2015. The Monetary Board noted certain upside risks to inflation, including the pending petitions for adjustments of utility rates and a possible uptick in food prices. BSP also noted that while global economic conditions have become more challenging due to recent US monetary policy adjustments and concerns over growth sustainability in emerging markets, expectations for domestic activity remain firm.