Philippines—Update

Yield Movements

The short-end of the government yield curve was at its lowest level since June 2008. Meanwhile, 7- and 10-year bond yields climbed from end-2008 levels and almost reached the levels prevailing at end-September 2008. The long-end of the curve has risen less than the belly and short-end, mainly due to the fact that long-dated bonds are a small segment of the total government bond market and are thinly traded **(Figure 1)**.

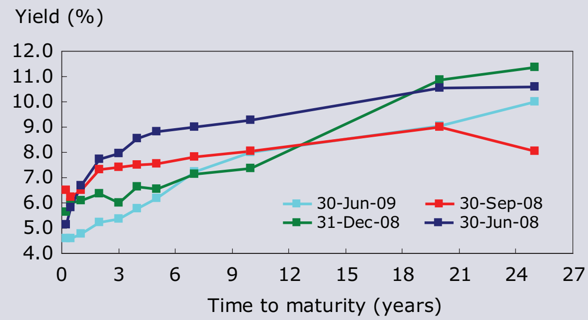
Bangko Sentral ng Pilipinas (BSP) has said that its current monetary stance remains appropriate for now, given that liquidity in the system is sufficient to help boost growth and inflation is expected to stay within manageable levels. BSP's Monetary Board has slashed a total of 200 basis points from the policy rate since December 2008, bringing the current rate to a historic low of 4.0% in an effort to help reverse the economic downturn.

The inflation rate in July slowed further to 0.2% year-on-year (y-o-y), bringing the year-to-date inflation average down to 4.3%, which is within the target range for 2009. BSP has attributed the downward trajectory of inflation primarily to the base effect of high prices for commodities last year and it assured the public that the economy is not facing the threat of deflation. BSP has said it will continue to monitor monetary conditions to ensure that settings are appropriately calibrated to its inflation outlook and the requirements of the Philippine economy.

Size and Composition

The amount of outstanding government bonds as of June 2009 fell by 0.2% quarter-on-quarter (q-o-q) to PHP2.456 trillion from PHP2.460 trillion in March. The value of government-guaranteed bonds (bonds issued by public sector corporations with government guarantees) rose by 7.9% and treasury bonds by 4.8%, while treasury bills fell 11.5%. On a month-on-month (m-o-m) basis, the total amount of government bonds fell by 0.6% from end-May levels of PHP2.483 trillion **(Table 1)**.

Figure 1: Benchmark Yield Curve–Local Currency Government Bonds



Source: Bloomberg LP.

In March, the national government issued the first residential mortgage-backed securities in the Philippines—valued at PHP2.2 billion—through the National Home Mortgage and Finance Corporation (NHMFC). NHMFC plans to offer more of these securities in the future. In terms of foreign currency (FCY) bonds, the Philippines successfully issued another USD-denominated bond on 14 July totaling USD750 million and due in January 2020. The earlier issuance of USD1.5 billion in January had been expected to be the government's only dealing in the international debt market this year, but the need to finance a larger-than-forecast budget deficit forced a second bond issue.

National Treasurer Roberto Tan said this would be the last global bond offering for the year and that the rest of the government's financing needs would be covered either locally or through the issuance of JPY-denominated bonds. The Development Budget Coordination Council (DBCC) revised this year's deficit ceiling from PHP199.2 billion to PHP250 billion, or equivalent to 3.2% of gross domestic product (GDP). The national government reported in August that the budget deficit for the first 7 months of the year had reached PHP188 billion.

Table 1: Size and Composition of Philippine LCY Bond Markets

	Amount (billion)								Growth Rate (%)						
	Mar-09		Apr-09		May-09		Jun-09		Mar-09		Apr-09	May-09	Jun-09		
	PHP	USD	PHP	USD	PHP	USD	PHP	USD	y-o-y	q-o-q	m-o-m	m-o-m	y-o-y	q-o-q	m-o-m
Total	2,696	56	2,752	57	2,769	57	2,753	57	7.8	0.1	2.1	0.6	8.2	2.1	(0.6)
Government	2,460	51	2,475	51	2,483	51	2,456	51	5.1	(0.9)	0.6	0.3	4.0	(0.2)	(1.1)
Treasury Bills	768	16	752	16	726	15	680	14	9.4	(0.3)	(2.1)	(3.4)	(8.3)	(11.5)	(6.4)
Treasury Bonds	1,610	33	1,641	34	1,668	35	1,687	35	3.0	(1.1)	1.9	1.7	9.6	4.8	1.2
Central Bank Bonds	0	0	0	0	0	0	0	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Others	83	2	82	2	89	2	89	2	6.5	(2.0)	(0.5)	8.4	11.3	7.9	0.0
Corporate	236	5	278	6	286	6	297	6	49.2	11.9	17.6	3.1	62.4	25.6	3.6

y-o-y = year-on-year, q-o-q =quarter-on-quarter, m-o-m = month-on-month.
Note:
1. Calculated using data from national sources.
2. Bloomberg end-of-period LCY–USD rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.
4. Others inclue government-guaranteed bonds such as Land Bank of the Philippines and National Power Corporation (Napocor).

Source: Bureau of the Treasury and Bloomberg LP.

The Philippine government is likely to proceed with the issuance of USD1.5 billion worth of *samurai* bonds in the 4Q09. The DOF and JBIC signed a memorandum of understanding in June for the proposed *samurai* bond issuance to take place within 2 years. JBIC will guarantee 95% of the present value of all principal and interest payments. Aside from the issuance of *samurai* bonds, the government is also considering other fundraising options, including the issuance of retail treasury bonds to finance a rising budget deficit.

Corporate bonds as of end-June 2009 stood at PHP297 billion, growing 25.6% q-o-q and 3.6% m-o-m. Contributing to the increase was a series of corporate issuances led by San Miguel Brewery, Banco de Oro Unibank, and Metropolitan Bank and Trust Company **(Table 2)**. In April, San Miguel Brewery issued PHP38.8 billion worth of bonds to pay for tangible and intangible assets that it will buy from its parent firm, the San Miguel Corporation. Lower Tier II notes were issued by Banco de Oro Unibank during 1Q09 and by other banks in the following quarter. Meanwhile, the Power Sector Assets and Liabilities Management Corporation (PSALM) successfully raised USD1 billion in global bonds in May. PSALM, a government-owned and -controlled corporation, was created by the Electric Power Industry Reform Act of 2001 for the principal purpose of managing the orderly sale, disposition, and privatization of the National Power Corporation's (Napocor) generation, real estate, and other disposable assets. The size of Napocor bonds as of 30 June stood at PHP34.86 billion. SM Investment Corporation (SMIC) raised PHP10 billion from 5-year and 7-year papers, while Petron managed to generate PHP10 billion from 5-year and 7-year bonds. Globe's bond issuance raised PHP5 billion, while LandBank's Tier 2 notes generated PHP6.9 billion.

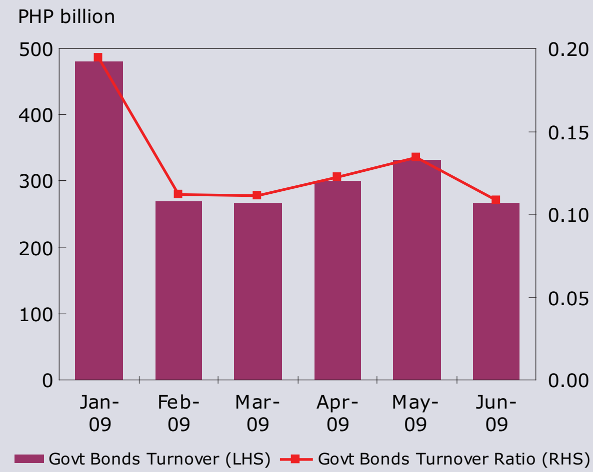
The new San Miguel Brewery issue of PHP38 billion has not only increased the size of the Philippine corporate market, but also provides a significant high-yield element to the LCY corporate bond market.

Table 2: Top 20 Corporate Issuers (PHP billion)

Issuer	Amount Outstanding
1. San Miguel Brewery	38.80
2. Banco De Oro Unibank	33.00
3. Metropolitan Bank & Tust Company	18.50
4. Philippine National Bank	17.75
5. Manila Electric Company	17.00
6. Petron Corporation	16.30
7. Rizal Commercial Banking	16.00
8. Globe Telecom	15.80
9. SM Prime Holdings	11.50
10. Bank Of The Philippine Islands	10.00
11. Ayala Land	7.00
12. Aboitiz Power Corporation	6.89
13. Ayala Corporation	6.00
14. Security Bank Corporation	6.00
15. International Container Terminal Services	5.71
16. Manila North Tollways Corporation	5.50
17. China Banking Corporation	5.00
18. First Gen Corporation	5.00
19. First Philippine Holdings	5.00
20. Philippine Long Distance Telephone Company	5.00

Source: Bloomberg LP.

Figure 2: Government Bond Trading Volume and Turnover Ratio



Source: Bureau of the Treasury.

	Moody's	S&P	Fitch
FCY LT Ratings	Ba3	BB-	BB
Outlook	Stable	Stable	Stable

Turnover

Government bond turnover in 2Q09 fell by 19% to 0.11 from the previous quarter. Philippine government bonds have become less liquid as most investors have become more risk averse due to the uncertain economic environment **(Figure 2)**.

Data for corporate bond turnover is not available.

Rating Changes

On 6 May, Fitch Ratings affirmed all of its credit ratings as well as its stable outlook for the Philippines, despite expectations that the country's deficit would exceed this year's ceiling.

On 3 July, Standard and Poor's (S&P) affirmed the Philippines' FCY and LCY ratings, while maintaining a stable outlook due to the resilience of the Philippines' external position and the strength of its banking sector.

On the other hand, Moody's Investors Service upgraded the Philippines' FCY and LCY government ratings on 23 July to Ba3 from B1, the country ceiling for FCY bank deposits to Ba3 from B1, and FCY bonds to Ba1 from Ba3. Meanwhile, the ratings outlook was changed from positive to stable.

Policy, Institutional, and Regulatory Developments

Philippines Considers Islamic Stock Index

The Philippines Stock Exchange (PSE) is considering setting up an index of *shari'a*-compliant stocks to compete with countries such as Malaysia in capturing a slice of the Islamic investment market. According to PSE, about 30 listed companies are *shari'a*-compliant.

Bangko Sentral ng Pilipinas Agrees to Extend Suspension of Mark-to-Market Rule on Foreign Currency Deposit Units

BSP agreed to extend the suspension of the mark-to-market rule on the asset cover for foreign currency deposit units (FCDUs) for another 6 months until September 2009. Total FCDU asset cover includes liquid assets (e.g., assets due from BSP–FCDUs, local banks, and foreign banks; interbank loans maturing within 1 year; un-matured export bills purchased; readily marketable FCDU debt instruments; FCY notes and coins on hand; FCY checks and other cash items; and short-term loans to exporters) and other eligible FCDU asset cover. The initial suspension was intended to be a one-time, temporary suspension of the mark-to-market rule that would be applicable only when determining the value of asset cover used for FCDU loans. However, BSP decided to extend the suspension to give FCDUs more flexibility in securing asset cover for loans.