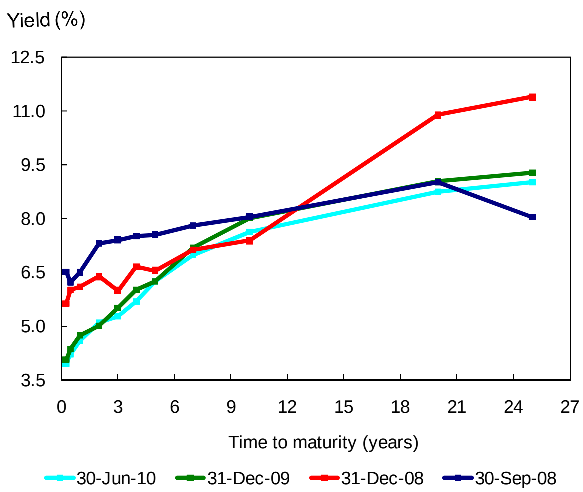
Philippines—Update

Yield Movements

Philippine government bond yields declined across all tenors between end-March and end-June, except for 2-year benchmark bonds, which rose by 10 basis points. The improved economic outlook and still-moderate consumer prices brought yields on most tenors to lower levels. The yield spread between 2- and 10-year government bonds widened to 252.5 basis points, the largest among all Association of Southeast Asian Nations (ASEAN) +3 countries **(Figure 1)**.

Figure 1: Philippines' Benchmark Yield Curve–Local Currency Government Bonds



Source: Bloomberg LP

Consumer price inflation eased to 4.3% year-on-year (y-o-y) in May from 4.4% in April due to slower price increases for fuel, light, and water. According to the Bangko Sentral ng Pilipinas (BSP), the May inflation rate justified BSP's decision to keep the policy rate steady at 4.0%. Meanwhile, BSP cut its 2010 inflation forecast to 4.7% from 5.1% as the risk of food and energy price hikes diminished.

The Department of Finance (DOF) reported on 22 June that the budget deficit in May reached PHP30.5 billion, which was a huge 168.2% y-o-y increase caused by expenditures exceeding revenue collections as some agencies fell short of their collection targets. This brought the January–May budget gap to PHP162.1 billion, which was well above the deficit ceiling of PHP145.2 billion for the first half of 2010. The government, therefore, raised its first half deficit target by 23% to PHP178.5 billion, but retained its 2010 deficit-to-gross domestic product (GDP) target of 3.6%.

Meanwhile, the Philippines' GDP growth rate accelerated to 7.3% y-o-y in 1Q10, the highest rate of growth since 2Q07. Both private and government spending surged in 1Q10, mainly due to heavy election-related spending. Exports of goods and services rebounded in 1Q10, growing 17.9% y-o-y compared with a 6.7% contraction in 4Q09, due largely to 28.1% y-o-y growth in merchandise exports. Imports of goods and services grew 20.3% y-o-y in 1Q10, exceeding 4Q09's 6.8% growth rate. With a positive outlook, the Development Budget Coordination Committee on 15 June raised its 2010 GDP forecast to 5.0%–6.0% from 2.6%–3.6%.

Size and Composition

As of 31 March 2010, total local currency (LCY) government bonds stood at PHP3.0 trillion for an 11.1% y-o-y increase. On a quarterly basis, the stock of government bonds grew 2.9% from end-2009 levels **(Table 1)**.

On 7 January, the Philippines successfully sold USD-denominated bonds worth USD1.5 billion, the first international global bond transaction out of Asia this year. The issuance, which was more than six times oversubscribed, comprised a USD650 million re-opening of the 2020 bonds at a yield of 5.67% and a USD850 million re-opening of the 2034 bonds at a yield of 6.66%. The proceeds of the sale will be used for infrastructure and reconstruction projects in response to damage caused by typhoons that hit the country in 2009.

The following month, the government sold JPY100 billion worth of 10-year samurai bonds via private placement and with a guarantee from the state-backed Japan Bank for International Cooperation (JBIC) for up to 95% of the bonds

Table 1: Size and Composition of Philippine LCY Bond Markets

	Amount (billion)								Growth Rate (%)						
	Dec-09		Jan-10		Feb-10		Mar-10		Dec-09		Jan-10	Feb-10	Mar-10		
	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	2,912	63	2,872	62	2,850	62	2,996	66	8.1	3.4	-1.4	-0.8	11.1	2.9	5.1
Government	2,560	56	2,550	55	2,506	54	2,639	58	3.1	2.3	-0.4	-1.7	7.3	3.1	5.3
Treasury Bills	622	13	518	11	534	12	579	13	-19.2	2.4	-16.7	2.9	-24.6	-6.9	8.5
Treasury Bonds	1,839	40	1,903	41	1,861	40	1,948	43	12.9	1.7	3.5	-2.2	21.0	6.0	4.7
Others	100	2	129	3	112	2	112	2	18.2	11.8	29.9	-13.7	35.2	12.0	0.0
Corporate	351	8	322	7	345	7	357	8	66.5	12.4	-8.4	7.1	51.0	1.5	3.5

m-om=month-on-month, 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/USD rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.
4. "Others" include government-guaranteed bonds such as Land Bank of the Philippines and National Power Corporation (Napocor).

Source: Bureau of Treasury and Bloomberg LP.

under its Japanese Market Access Support Facility. The bonds were priced at par and carried a coupon of 2.32%.

The Bureau of the Treasury (BTr) sold USD350 million worth of multicurrency retail bonds to overseas Filipino workers on 21 April. The proceeds, which were USD150 million short of the planned issue size, comprised USD298 million and EUR39 million worth of bonds.

The Home Development Mutual Fund (HDMF)—also known as the Pag-IBIG Fund—issued PHP12 billion worth of 5-year bonds on 10 March. Investors responded very positively to the offer as tenders reached PHP31 billion. Proceeds from the sale will be used to refinance debt maturing in May and expand the agency's funding.

Meanwhile, the Power Sector Assets and Liabilities Management Corporation (PSALM) sold PHP30 billion (USD672 million) of 5- and 7-year fixed-rate retail bonds on 13 April, its maiden domestic bond sale. The PHP20 billion (USD448 million) of bonds were divided equally between 5- and 7-year tranches, while the remaining PHP10 billion (USD224 million) were sold through public offering. The bonds were priced at yields of 6.875% for the 5-year tranche and 7.750% for the 7-year tranche. Proceeds from the bonds will be used by PSALM to augment working capital and support its liability management program.

By the end of 1Q10, total corporate bonds outstanding stood at PHP357 billion, up 51% from the previous year. Of the total amount, PHP129.3 billion, or 36%, came from local and foreign commercial banks, while the remaining 67% were from non-financials.

Tanduay Distillers Inc. sold PHP5 billion worth of fixed-rate bonds on 12 February, which it will use to fund operations and refinance debt. At the end of April, Ayala Corporation issued a 7-year bond (with a put at year 5) worth PHP10 billion, the first time a PHP-denominated bond had been issued featuring a put option. This added feature will allow Ayala Corporation to extend the tenor of the note to 7 years while achieving 5-year pricing. The retail bond pays a 7.2% coupon per annum for a spread of 91.5 basis points over the 5-year benchmark PDST-R2.

In the international bond market, Rizal Commercial Banking Corporation (RCBC) sold USD250 million of 5-year senior unsecured notes with a 6.25% coupon in early February. This was the first international bond issue by RCBC since 2006. In mid-March, port operator International Container Terminal Services (ICTS) raised USD250 million from a 10-year bond issue. The bonds carried a fixed coupon of 7.375% and were priced at par. Proceeds from the bond issue will be used to fund the company's investments in existing and new terminals as well as to refinance existing obligations.

San Miguel Brewery remained the largest corporate issuer, with outstanding bonds totaling PHP38.8 billion, followed by Banco de Oro Universal Bank with PHP33 billion, and the Manila Electric Company (Meralco) with PHP20.2 billion. The amount of bonds outstanding among the top 20 corporate issuers comprised 81% of the total corporate bond market **(Table 2)**.

Table 2: Top 20 LCY Corporate Bonds Outstanding by Issuers (as of 31 March)

Rank	Issuer	Amount Outstanding (PHP billion)
1	San Miguel Brewery Inc.	38.80
2	Banco de Oro Unibank Inc.	33.00
3	Manila Electric Company	20.22
4	Metropolitan Bank & Trust	18.50
5	Philippine National Bank	17.75
6	Petron Corporation	16.30
7	Rizal Commercial Banking Corporation	16.00
8	Globe Telecom	15.80
9	Robinsons Land Corporation	15.00
10	JG Summit Holdings Inc.	13.31
11	Energy Development Corporation	12.00
12	SM Prime Holdings Inc.	11.50
13	Bank of Philippine Islands	10.00
14	SM Investments Corporation	9.40
15	Allied Banking Corporation	8.00
16	Ayala Land Inc.	7.00
17	Aboitiz Power Corporation	6.89
18	Megaworld Corporation	6.40
19	Ayala Corporation	6.00
20	Security Bank Corporation	6.00
	Top 20 Total	**287.87**
	Total Corporate Bonds Outstanding	**356.57**
	Top 20/Total Corporate Bonds Outstanding	**81%**

Source: Bloomberg LP.

Policy, Institutional and Regulatory Developments

2010 National Budget Totals PHP1.54 trillion

The Philippine Government approved the PHP1.54 trillion national budget on 8 February. The fiscal deficit level was set at 3.6% of GDP.

BSP Withdraws Crisis-Relief Measures

BSP's Monetary Board decided to reduce the peso rediscounting budget from PHP60 billion to PHP40 billion effective 15 March 2010. In April, BSP further reduced the peso rediscounting budget from PHP40 billion to the pre-crisis level of PHP20 billion effective 3 May 2010. BSP also decided to restore the pre-crisis guidelines relating to access to the rediscounting facility, such as restoring the loan value of all eligible rediscounting papers to 80% from 90% and reverting to the pre-crisis non-performing loan (NPL) ratio requirement for access to the facility of 2 percentage points, instead of 10, above the industry average.

SEC Approves IRR for new REIT Law

The Philippine Securities and Exchange Commission (SEC) en banc committee approved on 13 May the Implementing Rules and Regulations (IRR) of Republic Act (RA) 9856 or The Real Estate Investment Trust (REIT) Act of 2009. RA 9856 seeks to promote the development of capital markets, broaden the participation of Filipinos in the ownership of real estate companies in the Philippines, use the capital market as an instrument to help finance and develop infrastructure projects, and protect the investing public. Prior to the approval, the SEC released a draft IRR of RA 9856 for a 1-week comments period. According to SEC Secretary Gerard Lukban, the only substantial change made to the draft was raising the minimum capitalization for fund managers tasked to handle the REITs to PHP100 million from the PHP10 million contained in the draft.

Meanwhile, the Philippine Stock Exchange (PSE) is finalizing the proposed listing rules for REITs.