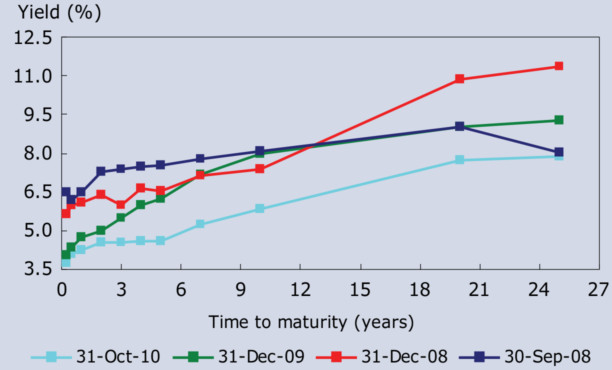
Philippines—Update

Yield Movements

Philippine government bond yields fell for all maturities between end-December 2009 and end-October 2010 on expectations of sustained economic growth **(Figure 1)**. The decline at the shorter-end of the curve ranged between 25 and 95 basis points, while the drop at the belly to the longer-end of the curve was more significant, ranging from 140 to 215 basis points. Yield spreads between 2- and 10-year tenors narrowed to 133 basis points in end-October 2010, from 300 basis points at end-December 2009, as the yield curve flattened.

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



LCY = local currency.
Source: Bloomberg LP.

The Philippines' gross domestic product (GDP) posted 7.9% year-on-year (y-o-y) growth in 2Q10, following revised 7.8% growth in 1Q10, brought about by the improved performance of domestic investment as well as sustained moderate growth in personal consumption and government spending.

In November, the Monetary Board of the Bangko Sentral ng Pilipinas (BSP), based on its benign outlook for inflation, decided to keep its overnight borrowing (reverse repurchase) rate at 4.0% and the overnight lending (repurchase) rate at 6.0%. Consumer price inflation eased to 2.8% y-o-y in October—its lowest level in 11 months—from 3.2% in September. The inflation rate in January–October stood at 4.0%, well within the central bank's target of 3.5%–5.5% for 2010.

Meanwhile, the Philippine government posted a PHP259.8 billion fiscal deficit in the first 9 months of 2010, which was less than the budgeted amount of PHP273.7 billion due to lower-than-expected spending. Revenue collections in the first 9 months of the year for both the Bureau of Internal Revenue and the Bureau of Customs fell below their respective targets. On the other hand, total expenditure was lower at PHP1.15 trillion, compared with a PHP1.21 trillion target, as a result of savings in interest payments brought about by lower borrowing costs. The government has set its budget deficit ceiling for 2010 at PHP325 billion, or approximately 3.9% of GDP. The government also plans to cut the deficit to 3.2% of GDP in 2011 and 2.6% in 2012.

Size and Composition

The Philippines' total local currency (LCY) bonds outstanding increased 13.0% y-o-y to PHP3.18 trillion as of end-September **(Table 1)**. On a quarter-on-quarter (q-o-q) basis, total LCY bonds outstanding grew 3.6%, driven by an increase in outstanding government bonds.

Outstanding government LCY bonds rose 11.8% y-o-y to PHP2.80 trillion as of end-September, mainly due to the 15.6% y-o-y increase in outstanding government treasury bonds. Other bonds, which include government-guaranteed bonds and bonds owned by government-owned-and-controlled corporations (GOCCs), increased 47.9% y-o-y to reach PHP132 million. Meanwhile, the outstanding amount of treasury bills fell 4.8% y-o-y to PHP578 billion.

In 3Q10, the government issued a total of PHP113.3 billion in government bonds, including PHP97.5 billion worth of 5-, 7-, and 10-year retail treasury bonds. The government also issued PHP62.5 billion in treasury bills.

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

	Amount (billion)								**Growth Rate** (%)						
	Jun-10		**Jul-10**		**Aug-10**		**Sep-10**		**Jun-10**		**Jul-10**	**Aug-10**	**Sep-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	3,072	66.2	3,110	68.3	3,206	70.7	3,182	72.5	11.6	2.5	1.2	3.1	13.0	3.6	(0.8)
Government	2,696	58.1	2,727	59.9	2,824	62.3	2,799	63.7	9.8	2.1	1.2	3.5	11.8	3.8	(0.9)
Treasury Bills	567	12.2	581	12.8	613	13.5	578	13.2	(16.5)	(2.0)	2.3	5.5	(4.8)	1.9	(5.6)
Treasury Bonds	1,996	43.0	2,015	44.3	2,079	45.9	2,089	47.6	18.3	2.5	0.9	3.2	15.6	4.6	0.5
Others	132	2.8	132	2.9	132	2.9	132	3.0	47.9	18.1	0.0	0.0	47.9	-	-
Corporate	376	8.1	382	8.4	382	8.4	383	8.7	26.8	5.5	1.7	0.0	22.4	1.7	0.0

LCY = local currency, m-o-m = 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 LP end-of-period LCY—USD rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.
4. "Others" includes government-guaranteed bonds such as Land Bank of the Philippines and National Power Corporation (Napocor).
Source: Philippine Bureau of the Treasury and Bloomberg LP.

Meanwhile, outstanding corporate LCY bonds stood at PHP383 billion as of end-September, posting growth of 22.4% y-o-y, but only 1.7% on a q-o-q basis. During July–September, three Philippine corporates issued a total of PHP5.1 billion worth of LCY bonds: (i) Philippine Long Distance Telephone Company (PHP2.5 billion), (ii) its wholly-owned subsidiary Smart Corporation (PHP2.5 billion), and (iii) Ayala Land Inc. (PHP84 million).

As of end-September, the top 20 corporate LCY issuers accounted for 80.3% of total corporate LCY bonds outstanding **(Table 2)**. San Miguel Brewery remained the top issuer with PHP38.8 billion of bonds outstanding, followed by commercial banks Banco de Oro Unibank (PHP33.1 billion) and Rizal Commercial Banking Corporation (PHP21.0 billion).

Table 2: Top 20 Corporate Bonds Outstanding by Issuers, September 2010

Rank	**Issuer**	**Amount Outstanding** (PHP billion)
1	San Miguel Brewery	38.80
2	Banco de Oro Unibank	33.09
3	Rizal Commercial Banking Corporation	21.00
4	Manila Electric Company	20.22
5	Metropolitan Bank & Trust Company	18.50
6	Philippine National Bank	17.75
7	Globe Telecom	16.80
8	Petron Corporation	16.30
9	Ayala Corporation	16.00
10	Robinson's Land Corporation	15.00
11	JG Summit Holdings	13.31
12	Energy Development Corporation	12.00
13	First Philippine Holdings	11.40
14	Bank of the Philippine Islands	10.00
15	SM Investments Corporation	9.40
16	Allied Banking Corporation	8.00
17	SM Prime Holdings	8.00
18	Philippine Long Distance Telephone Co	7.50
19	Ayala Land Inc.	7.34
20	Aboitiz Power Corporation	6.89
Top 20 Total		**307.29**
Total Corporate Bonds Outstanding		**382.52**
Top 20 as % of Total Corporate Bonds Outstanding		**80.30%**

LCY = local currency.
Source: Bloomberg LP.

Rating Changes

In August, Fitch Ratings affirmed the sovereign credit ratings of the Philippines at BB for its foreign currency (FCY) long-term issuer default rating, BB+ for its LCY long-term issuer default rating and country ceiling, and B for its short-term issuer default rating **(Table 3)**. Fitch Ratings also affirmed its stable outlook for the Philippines.

In November, Standard & Poor's (S&P) upgraded its long-term foreign currency (FCY) debt rating for the Philippines to BB from BB-, citing improvements in the country's external liquidity profile and external accounts. The rating upgrade also reflects the progress in the country's debt reduction and fiscal consolidation efforts. S&P has also affirmed its stable outlook for the country.

Table 3: Selected Sovereign Ratings and Outlook for the Philippines

	Moody's	S&P	Fitch
Sovereign FCY LT Rating	Ba3	BB	BB
Outlook	stable	stable	stable

FCY = foreign currency, LT = long term.
Source: Rating agencies.

Policy, Institutional, and Regulatory Developments

Government and Petron Issue Peso Global Bonds

In September, the government sold PHP44.1 billion (USD1.0 billion) of 10-year bonds in the first offshore LCY bond issuance from an Asian country. These bonds are exempt from the Philippines' 20% tax on interest income. The Philippine government noted that the peso global bond offer will enhance its debt investor profile by attracting more offshore investors to the country's capital markets, and that it will support its external liability management, especially in mitigating exposure to foreign exchange risk. The Bureau of Treasury does not count this bond as part of the government's PHP-denominated bond stock because the bonds are mainly held by foreigners and will be settled in United States (US) dollars upon maturity.

About 1 month after the successful issue of the government's USD1.0 billion peso global bond, energy company Petron Corporation raised PHP20.0 billion from the issuance of a 7-year peso global bond. The Petron global peso bond pays a coupon of 7.0% per year and is subject to a 20% withholding tax.

BSP Issues Moratorium on Approval of Banks' Hybrid Tier 1 and 2 Capital Instruments

BSP issued a memorandum in October to temporarily halt the approval of hybrid Tier 1, Tier 2, and other redeemable capital instruments. According to BSP, the moratorium was put in place to avoid uncertainty with the upcoming adoption of the Basel 3 reform package, as some debt instruments that are compliant with existing regulatory capital rules may be considered non-compliant under Basel 3. Banks and other financial institutions with approved but unissued hybrid Tier 1 and Tier 2 capital instruments were also advised to defer issuance to ensure conformity with the forthcoming capital guidelines. The moratorium will be in effect until 31 December 2010. The new Basel 3 capital rules, subject to approval of the leaders of the Group of 20 countries, are targeted to be implemented beginning 1 January 2013.