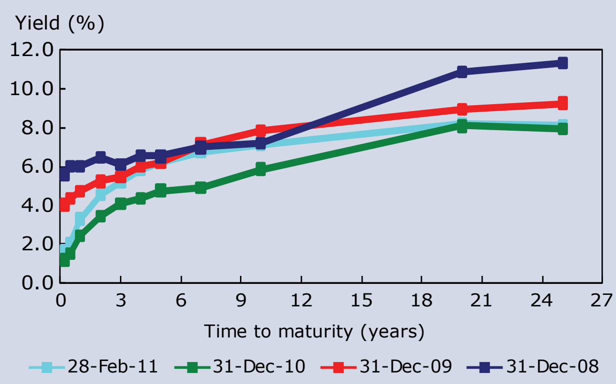
Philippines—Update

Yield Movements

The entire Philippine yield curve shifted downward between the end of 2009 and the end of 2010. Philippine government bond yields, however, have since risen for all maturities as a rise in commodity prices and transportation costs has increased concerns about future inflation **(Figure 1)**. The yields at the short-end of the curve rose between 45 and 85 basis points, while yields in the belly to the long-end of the curve climbed between 15 and 185 basis points. Yield spreads between 2- and 10-year tenors widened to 255 basis points on 28 February from 246 basis points at end-December.

The Philippines' gross domestic product (GDP) rose by 7.1% year-on-year (y-o-y) in 4Q10, following a revised 6.3% expansion in 3Q10, as business and consumer spending grew. Full-year 2010 GDP growth surged to 7.3% y-o-y, the Philippine economy's largest expansion in 34 years. Record growth rates of foreign trade and election-related stimulus spending helped the government to surpass its target of 5.0%–6.0% for 2010. The industrial and services sectors, which expanded 12.1% and 7.1% y-o-y, respectively, also fueled economic growth in 2010.

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



LCY = local currency.
Source: Bloomberg LP.

The Philippines' fiscal deficit for 2010 widened to PHP314.4 billion, equivalent to 3.7% of GDP. This was lower than the budgeted amount of PHP325 billion or 3.9% of GDP. The government aims to achieve a deficit-to-GDP ratio of 2% by 2013.

Consumer price inflation for the month of February rose to 4.3% y-o-y, higher than the previous month's 3.6%. The year-to-date average of 3.9% remained within the government's target range of 3.0%–5.0% for 2011. Rising inflation in February was traced mainly to higher prices of food items caused by adverse weather conditions and a continued rise in petroleum products due to political tensions in the Middle East.

The Monetary Board of Bangko Sentral ng Pilipinas (BSP) kept its key policy interest rates steady at 4.0% for the overnight borrowing (reverse repurchase [RRP]) facility and 6.0% for the overnight lending (repurchase [RP]) facility in February. The interest rates on term RRPs, RPs, and special deposit accounts were also left unchanged. The policy rates have been held steady since July 2009 to support economic activity. BSP noted the sustained increase in inflation, and reported that it is closely monitoring all risks to future inflation and is prepared to take the appropriate monetary policy actions to safeguard price stability. The next policy meeting will be held on 24 March.

Size and Composition

The size of the Philippines' local currency (LCY) bond market rose 9.4% year-on-year (y-o-y), with total volume reaching PHP3.2 trillion (USD72.8 billion) as of end-December, buoyed primarily by government borrowing **(Table 1)**. Compared with 3Q10, total LCY bonds outstanding in 4Q10 were relatively unchanged and registered only 0.2% quarter-on-quarter (q-o-q) growth, as a lack of issuance in the corporate sector offset the increase in government LCY bonds.

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

	Amount (billion)								Growth Rate (%)						
	Sep-10		Oct-10		Nov-10		Dec-10		Sep-10		Oct-10	Nov-10	Dec-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	2,817	59.5	2,912	63.1	3,182	72.6	3,187	72.8	13.0	3.6	0.3	0.2	9.4	0.2	(0.3)
Government	2,504	52.9	2,560	55.5	2,799	63.8	2,818	64.3	11.8	3.8	(0.0)	0.7	10.1	0.7	0.0
Treasury Bills	607	12.8	622	13.5	578	13.2	527	12.0	(4.8)	1.9	(4.3)	(1.7)	(15.2)	(8.8)	(3.0)
Treasury Bonds	1,807	38.2	1,839	39.8	2,089	47.6	2,160	49.3	15.6	4.6	1.2	1.4	17.5	3.4	0.8
Others	89	1.9	100	2.2	132	3.0	131	3.0	47.9	—	—	—	31.5	(0.6)	(0.6)
Corporate	313	6.6	351	7.6	383	8.7	368	8.4	22.4	1.7	2.6	(3.3)	4.8	(3.7)	(2.9)

— = not applicable, 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.

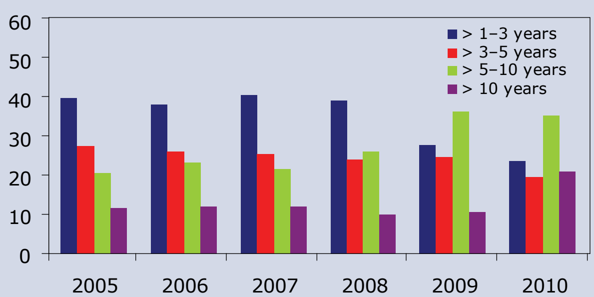
Total LCY government bonds outstanding rose 10.1% y-o-y to PHP2.8 trillion (USD64.3 billion) as of end-December, driven by a surge in treasury bonds of 17.5% y-o-y in 4Q10, as the government lengthened its debt maturity profile with a debt exchange program. Corporate sector bonds outstanding grew by 4.8% y-o-y. Meanwhile, treasury bills outstanding declined by 15.2% y-o-y to close the year at PHP527 billion (USD12 billion).

In 4Q10, the government borrowed a total of PHP304 billion (USD6.9 billion) through LCY debt issuance: PHP223.1 billion (USD5.1 billion) in treasury bonds and PHP81.3 billion (USD 1.9 billion) in treasury bills. Included among the treasury bonds were PHP199 billion (USD4.5 billion) worth of new 10- and 25-year bonds issued under the debt exchange program mentioned above. Bonds totaling PHP173 billion (USD3.9 billion) were made eligible to either be swapped for new 10- and 25-year bonds, or tendered for cash to be sourced from new subscriptions of 25-year bonds. The coupon rates of the 10- and 25-year bonds were set at 5.875% and 8.125%, respectively. The bond swap effectively extended the average maturity of the accepted bonds from 6.7 years to 22.5 years. The average coupon of the accepted bonds decreased by 0.47%, thereby reducing the government's overall funding costs.

The maturity profile of LCY government securities has changed significantly from the time the government introduced its debt exchange program in February 2006. Government borrowing in the form of 1- to 3-year tenors averaged between 38% and 41% of total LCY outstanding debt in 2005–08. This share dropped to 28% at end-2009, and 23% at end-2010. Meanwhile, the portion of bonds maturing within 5–10 years as a percentage of total LCY government debt rose from 21% in 2005 to 36% in 2010. In addition, bonds having maturities of more than 10 years comprised only 12% of total LCY government debt in 2005 before jumping to 21% by 2010. These trends reflect the government's progress in fiscal consolidation over this period **(Figure 2)**.

LCY corporate bonds rose to PHP368 billion (USD8.4 billion) as of end-December with the top 30 corporate issuers accounting for 93.6% of the total LCY corporate bond market. San Miguel Brewery remained the leader in terms of bonds outstanding with PHP38.8 billion (USD886 million) followed by Banco de Oro Unibank with PHP28.0 billion (USD639 million), and Rizal Commercial Banking Corporation with PHP21.0 billion (USD479 million) **(Table 2)**. Among LCY corporate bonds outstanding, 33.4% were issued by commercial banks, 12.7% by real estate developers, and 11.3% by a brewery company. Also, 27 out of the top 30 corporate issuers at end-December were listed companies.

Figure 2: LCY Government Securities Maturity Profile (individual maturities as % of total)



LCY = local currency.
Source: Philippine Bureau of the Treasury.

Foreign Currency Bonds

In line with the government's liability management program, the Philippines completed a USD3.1 billion bond exchange in October 2010 in which outstanding USD-denominated bonds were exchanged for new USD-denominated global bonds. The government issued USD2.2 billion in new bonds due January 2021 and USD949 million of re-opened bonds due October 2034, after inviting offshore bondholders to tender their existing holdings in exchange for longer-maturity debt. The new 2021 bonds were priced to yield 4.091%, while the re-opened 2034 bonds were priced to yield 5.276%. Bonds maturing between February 2011 and January 2017 can be exchanged for either of these bonds. Bonds maturing between January 2019 and January 2031 can be exchanged only for the reopened bonds due October 2034. The government was able to raise USD200 million from the 2021 bonds, with the rest issued in exchange for old bonds.

The corporate sector also took advantage of positive market sentiment in 4Q10 to issue USD-denominated bonds. Banco de Oro Universal Bank sold USD300 million of bonds due April 2016 with a coupon of 3.875%, while SM Investments Corporation sold USD400 million of bonds due October 2017 with a coupon of 5.5%.

In January, SMC Global Power Holdings Corp, a wholly-owned subsidiary of San Miguel Corporation, and Energy Development Corporation (EDC) tapped the global market and each raised USD300 million in USD-denominated bonds. SMC Global issued 5-year bonds with a coupon of 7.0%, while EDC issued 10-year bonds with a coupon of 6.5%.

Rating Changes

In January, Moody's Investors Service changed the outlook on the government of the Philippines' Ba3 foreign currency (FCY) and LCY bond ratings to positive from stable on the back of the Philippines' (i) strengthening trend in its external payments position, (ii) successful conduct of monetary policy, and (iii) improved prospects for economic reform policies.

Also in January, Fitch Ratings affirmed the sovereign credit ratings of the Philippines at BB for its FCY long-term issuer default rating and BB+ for its long-term LCY issuer default rating and country ceiling. Fitch Ratings also affirmed its stable outlook for the Philippines **(Table 3)**.

Table 2: Top 30 LCY Corporate Issuers in the Philippines (as of 31 December 2010)

Issuer	Amount Outstanding (PHP billion)	State-Owned	Privately-Owned	Listed Company	Type of Industry
1. San Miguel Brewery, Inc	38.80	No	Yes	Yes	Brewery
2. Banco De Oro Unibank, Inc	28.00	No	Yes	Yes	Commer Banks Non-US
3. Rizal Commercial Banking Corporation	21.00	No	Yes	Yes	Commer Banks Non-US
4. Metropolitan Bank & Trust Company	18.50	No	Yes	Yes	Commer Banks Non-US
5. Philippine National Bank	17.75	No	Yes	Yes	Commer Banks Non-US
6. Globe Telecom, Inc	16.80	No	Yes	Yes	Telecom Services
7. Petron Corporation	16.30	No	Yes	Yes	Oil Refining & Marketing
8. Ayala Corporation	16.00	No	Yes	Yes	Diversified Operations
9. Robinsons Land Corporation	15.00	No	Yes	Yes	Real Estate Oper/Develop
10. JG Summit Holdings, Inc	13.31	No	Yes	Yes	Food-Misc/Diversified
11. Manila Electric Company	12.50	No	Yes	Yes	Electric-Distribution
12. Energy Development Corporation	12.00	No	Yes	Yes	Electric-Generation
13. Bank of the Philippine Islands	10.00	No	Yes	Yes	Commer Banks Non-US
14. SM Development Corporation	10.00	No	Yes	Yes	Real Estate Oper/Develop
15. SM Investments Corporation	9.40	No	Yes	Yes	Retail-Misc/Diversified
16. First Philippine Holdings Corporation	8.99	No	Yes	Yes	Electric-Integrated
17. Allied Banking Corporation	8.00	No	Yes	Yes	Commer Banks Non-US
18. Philippine Long Distance Telephone Co.	7.50	No	Yes	Yes	Telephone-Integrated
19. Ayala Land, Inc	7.34	No	Yes	Yes	Real Estate Oper/Develop
20. SM Prime Holdings, Inc	7.00	No	Yes	Yes	Real Estate Mgmnt/Serv.
21. Aboitiz Power Corporation	6.88	No	Yes	Yes	Electric-Generation
22. Megaworld Corporation	6.38	No	Yes	Yes	Real Estate Oper/Develop
23. Metrobank Card Corporation	6.30	No	Yes	No	Diversified Finan Serv.
24. Manila North Tollways Corporation	5.34	No	Yes	No	Public Thoroughfares
25. China Banking Corporation	5.00	No	Yes	Yes	Commer Banks Non-US
26. Filinvest Land, Inc	5.00	No	Yes	Yes	Real Estate Oper/Develop
27. Tanduay Distillers, Inc	5.00	No	Yes	No	Beverages-Wine/Spirits
28. Manila Water Company, Inc	4.00	No	Yes	Yes	Water
29. Union Bank of the Philippines, Inc	3.75	No	Yes	Yes	Commer Banks Non-US
30. Security Bank Corporation	3.00	No	Yes	Yes	Commer Banks Non-US
Total Top 30 Corporate Issuers	**344.83**				
Total Corporate Bonds Outstanding	**368.33**				
Top 30 as % of Total Corporate Bonds Outstanding	**93.62%**				

LCY = local currency.
Source: Bloomberg LP.

Table 3: Selected Sovereign Ratings and Outlook for the Philippines

	Moody's	S&P	Fitch
FCY Long-Term Rating	Ba3	BB	BB
Outlook	positive	stable	stable

FCY = foreign currency.
Source: Rating agencies.

Policy, Institutional, and Regulatory Developments

Government Issues Peso Global Bonds Anew

In January, the Philippine government took advantage of favorable market conditions and a low interest rate environment to sell USD1.25 billion (PHP54.77 billion) of 25-year peso global bonds. This issuance allowed the government to lengthen its debt maturity profile and reduce its exposure to foreign exchange risk. The bonds are PHP-denominated but will be settled offshore and payable in dollars. The conversion rate for the bonds at pricing was PHP43.777 to USD1.0. The government first sold a global peso bond in September 2010—USD1.0 billion (PHP44.1 billion) of 10-year bonds—which was the first offshore LCY bond issuance by an Asian country. The global bonds are not included in the government's official statistics for LCY bonds.

BSP Further Liberalizes Rules on Foreign Exchange Transactions

In November, BSP issued Circular 698 which further liberalized the rules governing foreign exchange (FX) transactions. The circular comprised the following measures:

(i) increase the present ceiling of over-the-counter FX purchases made by residents from authorized agent banks (AABs) and AAB foreign exchange corporations without documentation for non-trade current account;

(ii) increase the present ceiling on the amount of pesos that departing non-resident tourists and Filipinos residing abroad may reconvert at airports or other ports of exit without need for proof-of-sale of FX;

(iii) increase the present ceiling on residents' purchase of FX from AABs and AAB foreign exchange corporations—from USD100,000 to USD1 million—to cover advance payment requirements for import transactions with prior BSP approval, subject to standard documentary requirements;

(iv) allow prepayment of private sector, BSP-registered foreign and FCY loans to be funded with FX from AABs and AAB foreign exchange corporations without prior BSP approval, subject to presentation of supporting documents;

(v) allow registering banks to act on requests by foreign investors for conversion into FX and outward remittances of peso funds, not to exceed the FX brought into the country less the amount used for investments actually made in the country, subject to conditions and documentary requirements; and

(vi) increase the present ceiling per investor per year—from USD30 million to USD60 million—of the amount that residents may purchase from AABs for outward investments and/or investments in Philippine bonds and other Philippine debt papers issued offshore, including PHP-denominated instruments to be settled in FX, provided the total FX purchases for any or all of these purposes by any investor in 1 year does not exceed the prescribed limit. This increase will be complemented by the following additional measures:

    (a) lift the registration requirement for outward investments in excess of the USD 60 million limit and replace this with reporting to BSP; and

    (b) extend the period of inward remittance and conversion to pesos, or reinvestment of proceeds and related earnings on outward investment of residents, from 2 and 7 banking days, respectively, to 30 banking days from receipt of funds abroad.

BSP Issues Circular for Early Adoption of IFRS/PFRS 9

On 10 January, BSP issued circular 708 to provide guidelines on the adoption of International/Philippine Financial Reporting Standards 9 (IFRS/PFRS 9). The new accounting standards aim to revise IAS 39, which has been criticized as being too difficult to apply and whose limitations were particularly underscored during the 2008/09 global financial crisis. The highlights of IFRS/PFRS 9 include (i) basing asset classification on the financial institution's business model versus the current practice of basing it on management's intention; (ii) reducing the number of asset categories to two, depending on asset features and the institution's business model, including (a) fair value and (b) amortized cost; and (iii) measuring at fair value through profit or loss investments in hybrid securities, overlying securitization structures, and other structured products. Upon adoption of PFRS 9 by financial institutions, the tainting rule for held-to-maturity (HTM) securities shall no longer apply. The tainting provision prohibits a financial institution from using the HTM category and requires the reclassification of the entire HTM portfolio to available-for-sale during the reporting period and for the next 2 years if the financial institution reclassified or sold a significant amount of HTM investments before maturity other than allowed conditions.

BSP Approves Regulations for the Establishment of Trust Corporations

BSP approved the rules and regulations governing the establishment of trust corporations through Circular 710. A trust corporation can be created and duly authorized by the Monetary Board to engage in a trust, other fiduciary business, and investment management activities. The trust corporation will have a required minimum capitalization of PHP300 million, which can increase as assets under management exceed PHP20 billion. Banks with established trust departments may spin them off into a trust corporation. A key feature of the trust corporation is the treatment of the single borrower's limit (SBL). The new rules stipulate that for a trust corporation owned by a bank or quasi-bank the assets under management of the trust corporation do not form part of the SBL calculations for the parent bank. This is in recognition that the arrangement between trustor and trustee is not a debtor–creditor relationship against which the SBL provisions apply.

PDEx Revises Rules on Listing and Settlement of Trades

In March, the Philippine Dealing and Exchange Corporation (PDEx), the sole fixed-income trading platform in the Philippines, amended its rules for the fixed-income securities market, particularly Rules 7 and 8. Rule 7, which covers enrollment of issuers and listing of securities, was revised to include the following requirements:

(i) the issuer's certificate of good standing from the Securities and Exchange Commission shall be submitted to PDEx within 3 months from the issue date of issuer's securities; and

(ii) the securities for listing should have no restrictions on transferability to investors of different tax categories.

Meanwhile, Rule 8, which discusses the settlement of trades, was revised to include the requirement that settlement participants shall access the liquidity measures available in the market (e.g., PDEx Repurchase Agreement Program, PDEx Securities Lending Transaction Program) to ensure the settlement of all trades on the settlement date.