# Philippines—Update

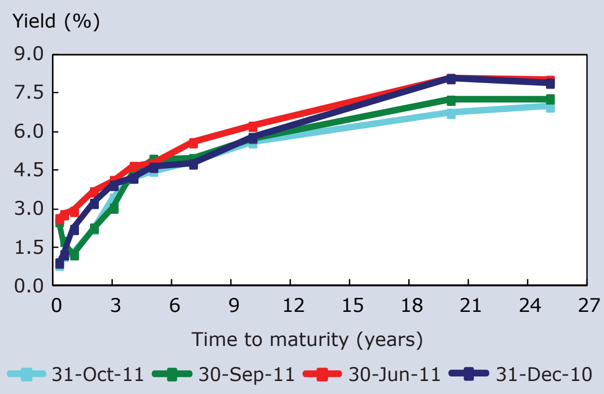
## Yield Movements

The Philippine government bond yield curve flattened from the belly through the end of the curve between the beginning of the year and end-October **(Figure 1)**. Yields for all tenors declined year-to-date, with the exception of the 4- and 7-year tenors, due to a lack of liquid benchmarks. Yields for tenors between 3 months and 5 years dropped between 5 basis points (bps) and 97 bps, while yields for 10-year through 25-year tenors decreased 19 bps–131 bps.

Between end-June and end-October, the yield curve shifted downward as domestic liquidity fanned buying momentum and concerns over inflation abated. Yields for tenors between 3 months and 2 years declined between 139 bps—173 bps as foreign investment flowed back into Philippine government securities on easing inflation expectations. The rest of the curve fell between 28 bps and 130 bps, with the recently issued 20-year jumbo bond posting the biggest drop. Spreads between 2- and 10-year yields widened to 323 bps in October from 245 bps in June after the yield on the 2-year tenor fell almost 140 bps.

Consumer price inflation quickened slightly to 5.2% year-on-year (y-o-y) in October from 4.8% in September, using the 2006-based consumer price index (CPI) series. The 2000-based CPI series produced a 5.3% y-o-y increase in October and a 4.6% rise in September. Year-to-date inflation averages through October using the 2006- and 2000-based series were 4.8% and 4.5%, respectively, which are both still within the government's target range of 3.0%–5.0% for 2011. October inflation was greatly affected by higher utility and food indices, including upward adjustments in electricity and water rates, and tight supply conditions due to typhoon-related production disruptions. Bangko Sentral ng Pilipinas (BSP) noted that the uptick in inflation would be temporary and forecast that future inflation would be well-anchored in its target range.

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




LCY = local currency.
Source: Bloomberg LP.

Gross domestic product (GDP) growth in the Philippines fell to 3.4% y-o-y in 2Q11 from 4.9% in 1Q11, based on 2000 price levels. Reduced government spending, sluggish export growth resulting from the global economic slowdown, and consumption weakened by escalating consumer prices all contributed to lower GDP growth in 2Q11. The government revised its 2011 GDP forecast to a range of 4.5%–5.5% from the original 7.0%–8.0%, and its 2012 GDP forecast to 5.0%–6.0% from 5.5%–6.5%. Growth targets for exports and imports were also lowered to 5% and 13%, respectively in 2011 from original estimates of 9%–10% for exports and 17%–18% for imports.

The Philippines' faltering growth rate has been the prime concern of the government, especially with inflation expectations well within the target range. As a result, BSP held its policy rates and reserve requirement ratios steady in its last two policy meetings in September and October. BSP's overnight reverse repurchase rate (borrowing facility) was left at 4.5% and its overnight repurchase rate (lending facility) was left at 6.5%. The reserve requirement ratio for banks was left at 21%.

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

| | Amount (billion) | | | | | | | | Growth Rate (%) | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Jun-11 | | Jul-11 | | Aug-11 | | Sep-11 | | Jun-11 | | Jul-11 | Aug-11 | Sep-11 | | |
| | PHP | US$ | PHP | US$ | PHP | US$ | PHP | US$ | y-o-y | q-o-q | m-o-m | m-o-m | y-o-y | q-o-q | m-o-m |
| Total | 3,264 | 75 | 3,237 | 77 | 3,256 | 77 | 3,260 | 74.5 | 6.2 | 3.3 | (0.8) | 0.6 | 2.7 | -0.1 | 0.1 |
| Government | 2,847 | 66 | 2,822 | 67 | 2,848 | 67 | 2,851 | 65 | 5.6 | 3.2 | (0.9) | 0.9 | 1.9 | 0.2 | 0.1 |
| Treasury Bills | 381 | 9 | 345 | 8 | 341 | 8 | 333 | 7.613 | (32.8) | (4.6) | (9.4) | (1.2) | (42.4) | (12.6) | (2.3) |
| Treasury Bonds | 2,346 | 54 | 2,360 | 56 | 2,389 | 57 | 2,401 | 55 | 17.5 | 4.9 | 0.6 | 1.3 | 14.9 | 2.3 | 0.5 |
| Others | 119 | 3 | 117 | 3 | 117 | 3 | 117 | 3 | (9.7) | (2.7) | (1.7) | 0.0 | (11.2) | (1.7) | 0.0 |
| Corporate | 417 | 10 | 415 | 10 | 409 | 10 | 409 | 9.35 | 10.9 | 3.6 | (0.5) | (1.5) | 9.3 | (1.9) | 0.2 |

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 end-of-period LCY–US$ 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 National Power Corporation and Power Sector Assets and Liabilities Management.
Source: Philippine Bureau of the Treasury and Bloomberg LP.

## Size and Composition

The expansion of the local currency (LCY) bond market remained modest in 3Q11. Issuance of treasury and corporate bonds buoyed overall growth, compensating for the contraction in treasury bill and other government debt issuance.

Total LCY bonds outstanding grew to PHP3.3 trillion (US$74.5 billion) at end-September, up 2.7% y-o-y **(Table 1)**. This was lower than the 6.2% y-o-y growth rate at end-June as reduced expenditure by the national government reduced funding requirements. LCY bonds outstanding were relatively flat in 3Q11 as growth in treasury bonds was offset by declines in all other government and corporate securities. Government bonds (including treasury bills and government-controlled companies) rose 1.9% y-o-y to PHP2.9 trillion at end-September, while corporate bonds grew 9.3% y-o-y to PHP409 billion. However, the share of treasury bills in the government's total debt stock shrank to PHP333 billion for a decline of 12.6% quarter-on-quarter (q-o-q), while that of longer-term treasury bonds surged 14.9% y-o-y to PHP2.4 trillion.

In 3Q11 significant new government bond issuances included the 10.5- and 20-year treasury bonds from the July bond exchange. Significant corporate issues in 3Q11 included the notes of Filinvest Land Inc. (FLI) and SM Investments Corp (SMIC). FLI's 5-year corporate notes carried a coupon of 6.1962% and totaled PHP3 billion. SMIC's PHP5 billion issue consisted of 7-year bonds totaling PHP916 million with a 5.75% coupon and 10-year bonds totaling PHP4.1 billion with a 6.625% coupon.

## Corporate Bond Market Development

At end-September, total outstanding LCY corporate bonds stood at PHP409 billion. Less than 50 firms had corporate bonds outstanding, with the top 30 issuers accounting for almost 94% of the total.

Except for Manila North Tollways and Tanduay Distilleries, all 30 of the top corporate borrowers are listed on the Philippine Stock Exchange. San Miguel Brewery was the largest issuer with PHP38.8 billion of bonds outstanding. Banco de Oro Unibank was the second-largest with PHP36.5 billion and Ayala Corporation was next with PHP26.0 billion **(Table 2).**

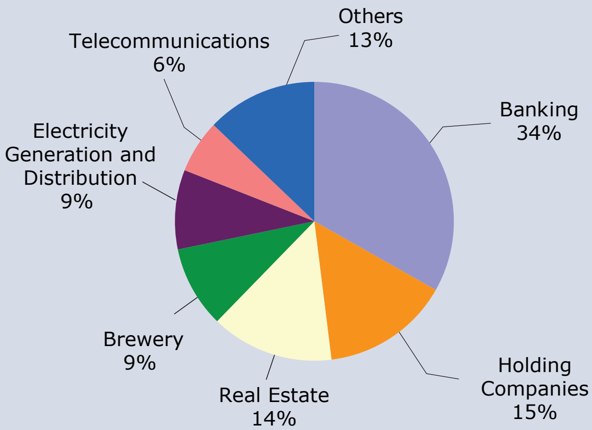
**Table 2: Top 30 Issuers of LCY Corporate Bonds in the Philippines** (as of September 2011)

| Issuers | Outstanding Amount | | State-Owned | Privately-Owned | Listed Company | Type of Industry |
|---|---|---|---|---|---|---|
| | LCY Bonds (PHP billion) | LCY Bonds (US$ billion) | | | | |
| 1. San Miguel Brewery, Inc. | 38.80 | 0.89 | No | Yes | Yes | Brewery |
| 2. Banco De Oro Unibank, Inc. | 36.50 | 0.83 | No | Yes | Yes | Banking |
| 3. Ayala Corporation | 26.00 | 0.59 | No | Yes | Yes | Diversified Operations |
| 4. SM Investments Corporation | 21.40 | 0.49 | No | Yes | Yes | Diversified Operations |
| 5. Philippine National Bank | 21.25 | 0.49 | No | Yes | Yes | Banking |
| 6. Manila Electric Company | 18.82 | 0.43 | No | Yes | Yes | Electricity Distribution |
| 7. Metropolitan Bank & Trust Company | 18.50 | 0.42 | No | Yes | Yes | Banking |
| 8. Rizal Commercial Banking Corporation | 16.00 | 0.37 | No | Yes | Yes | Banking |
| 9. Ayala Land, Inc. | 15.51 | 0.35 | No | Yes | Yes | Real Estate |
| 10. Robinsons Land Corporation | 15.00 | 0.34 | No | Yes | Yes | Real Estate |
| 11. JG Summit Holdings, Inc. | 13.31 | 0.30 | No | Yes | Yes | Diversified Operations |
| 12. Globe Telecom, Inc. | 12.72 | 0.29 | No | Yes | Yes | Telecommunications |
| 13. Philippine Long Distance Telephone Co | 12.50 | 0.29 | No | Yes | Yes | Telecommunications |
| 14. Energy Development Corporation | 12.00 | 0.27 | No | Yes | Yes | Electricity Generation |
| 15. Bank of the Philippine Islands | 10.00 | 0.23 | No | Yes | Yes | Banking |
| 16. Petron Corporation | 10.00 | 0.23 | No | Yes | Yes | Oil Refining and Marketing |
| 17. SM Development Corporation | 10.00 | 0.23 | No | Yes | Yes | Real Estate |
| 18. First Philippine Holdings Corporation | 8.49 | 0.19 | No | Yes | Yes | Electricity Generation and Distribution |
| 19. Allied Banking Corporation | 8.00 | 0.18 | No | Yes | Yes | Banking |
| 20. Filinvest Land, Inc. | 8.00 | 0.18 | No | Yes | Yes | Real Estate |
| 21. Aboitiz Power Corporation | 6.88 | 0.16 | No | Yes | Yes | Electricity Generation |
| 22. Megaworld Corporation | 6.38 | 0.15 | No | Yes | Yes | Real Estate |
| 23. Metrobank Card Corporation | 6.30 | 0.14 | No | Yes | Yes | Diversified Financial Services |
| 24. Manila North Tollways Corporation | 5.28 | 0.12 | No | Yes | No | Public Thoroughfares |
| 25. China Banking Corporation | 5.00 | 0.11 | No | Yes | Yes | Banking |
| 26. Tanduay Distilleries, Inc. | 5.00 | 0.11 | No | Yes | No | Beverages |
| 27. United Coconut Planters Bank | 4.52 | 0.10 | No | Yes | Yes | Banking |
| 28. Manila Water Company, Inc. | 4.00 | 0.09 | No | Yes | Yes | Water Distribution |
| 29. SM Prime Holdings, Inc. | 3.99 | 0.09 | No | Yes | Yes | Real Estate Management Services |
| 30. Union Bank of the Philippines | 3.75 | 0.09 | No | Yes | Yes | Banking |
| **Total Top 30 LCY Corporate Issuers** | **383.91** | **8.77** | | | | |
| **Total LCY Corporate Bonds Outstanding** | **409.19** | **9.35** | | | | |
| **Top 30 as % of Total LCY Corporate Bonds Outstanding** | **93.8%** | **93.8%** | | | | |

LCY = local currency.
Source: Bloomberg LP.

Among LCY corporate bonds outstanding, banks were the dominant issuers of subordinated debt (34%) as they continued to improve their capitalization and ensure compliance with Basel III requirements **(Figure 2)**. Holding companies ranked second (15%) and real estate developers and operators were third (14%). Electric generation and distribution companies and a brewery shared the fourth spot with 9% of the total each. Telecommunications firms comprised 6% of the total and other companies from various industries accounted for the remaining 13%.

**Figure 2: LCY Corporate Bond Issuers by Industry**
(as of September 2011)




LCY = local currency.
Source: Bloomberg LP.

## Benchmark Government Securities Bid–Ask Spreads

In 2011 the most traded government securities with the most frequent bid–ask (two-way) quotes were monitored to identify liquidity trends in the LCY government bond market **(Tables 3 and 4)**. Government securities with the highest level of activity were products of the government's series of bond swaps. The data used to capture the bid–ask spreads for these securities were obtained from the Bloomberg pages of the money brokers operating in the Philippines.

Bid–ask spreads for benchmark government securities tightened from 7 January through 28 October **(Figure 3)**, narrowing from almost 13 bps during the first half of the year to less

**Table 3: Benchmark Government Securities Monitored from January to October 2011**

| Series | ISIN | Outstanding Amount (as of August 2011) | | Coupon (%) | Maturity Date | Years to Maturity |
|---|---|---|---|---|---|---|
| | | PHP billion | US$ billion | | | |
| FXTN 5-67 | PIBD0514A673 | 107.93 | 2.55 | 6.250 | 27-Jan-14 | 2.42 |
| FXTN 7-48 | PIBD0716A488 | 136.77 | 3.24 | 7.000 | 27-Jan-16 | 4.42 |
| FXTN 10-42 | PIBD1016I420 | 66.87 | 1.58 | 9.125 | 4-Sep-16 | 5.03 |
| FXTN 25-8 | PIBD2535L086 | 166.01 | 3.93 | 8.125 | 16-Dec-35 | 24.38 |

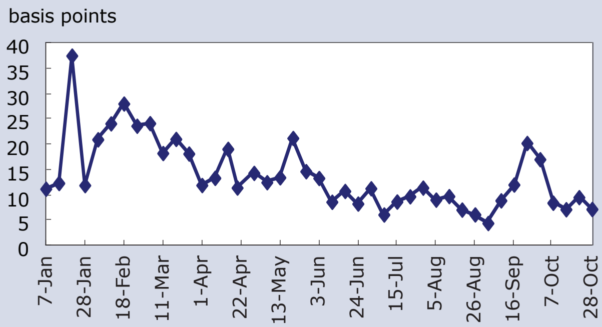
ISIN = International Securities Identification Number.
Source: Philippine Bureau of the Treasury.

**Table 4: Additional Benchmark Government Securities Monitored from July to October 2011**

| Series | ISIN | Outstanding Amount (as of August 2011) | | Coupon (%) | Maturity Date | Years to Maturity |
|---|---|---|---|---|---|---|
| | | PHP billion | US$ billion | | | |
| RTB 10-2 | PIID1021C027 | 63.68 | 1.51 | 7.375 | 3-Mar-21 | 9.54 |
| FXTN 10-53 | PIBD1021D531 | 32.46 | 0.77 | 6.500 | 28-Apr-21 | 9.69 |
| FXTN 10-54 | PIBD1022G545 | 67.62 | 1.60 | 6.375 | 19-Jan-22 | 10.42 |
| FXTN 20-17 | PIBD2031G171 | 255.84 | 6.06 | 8.000 | 19-Jul-31 | 19.95 |

ISIN = International Securities Identification Number.
Source: Philippine Bureau of the Treasury.

**Figure 3: Benchmark Government Securities Bid-Ask Spreads, 7 January–28 October 2011**




Note: 1 basis point = 0.01 percentage point.
Source: *AsianBondsOnline*.

than 10 bps in 3Q11 on improving liquidity. However, there were some notable spikes within this overall trend. Spreads widened to 37 bps during the week of 17–21 January following the partial issuance of 20-year bonds by the Bureau of the Treasury (BTR) despite lack of demand. This fueled more selling pressures causing loss-limit stops to be triggered. Inflation concerns also heightened that same week as transportation costs and oil prices rose. During the week of 16–20 May, average spreads rose 21 bps as Philippine inflation forecasts were raised and the Greek debt problem worsened. More recently, average spreads widened 20 bps during the week of 19–23 September after European finance ministers ruled out further economic stimulus measures and Italy's debt rating was downgraded by Standard & Poor's (S&P).

In 3Q11 the series with the tightest bid–ask spreads were FXTN 20-17 and FXTN 25-08 with averages of 2 bps and 7 bps, respectively. The 3Q11 averages of the following series were also in the single digits: FXTN 10-42 (8 bps), RTB 10-2 (8 bps), FXTN 10-53 (9 bps), and FXTN 10-54 (9 bps). Bid–ask spreads for FXTN 5-67 widened in 3Q11 and became less frequent. The average bid–ask spread for FXTN 5-67 widened from 10 bps in 1H11 to 24 bps in 3Q11. Meanwhile, two-way quotes for FXTN 7-48 also became less frequent.

## Foreign Currency Bonds

### Philippines Buys Back FCY Debt

In October the government bought back a total of US$1.3 billion of outstanding EUR- and US$-denominated bonds. The government aims to convert its foreign currency (FCY) obligations to LCY bonds as part of its debt liability management efforts. The equivalent of US$17.5 billion of outstanding FCY-denominated bonds is eligible for repurchase. In line with the buyback exercise, the government raised US$50 million through a reopening of its bond maturing on 23 October 2034 with a coupon of 6.375% per annum. The bond was sold at a price of 117.5 to yield 5.077%. The proceeds from the sale will be used to partially fund the repurchase of eligible bonds under the buyback program.

## Policy, Institutional, and Regulatory Developments

### PSE Readies for Interconnectivity with ASEAN Exchanges

The Philippine Stock Exchange (PSE) extended its trading hours starting in October in preparation for increased connectivity with Bursa Malaysia, the Singapore Exchange, and the Stock Exchange of Thailand under the Association of Southeast Asian Nations (ASEAN) Exchange Collaboration project. The project is the first step in a plan to develop a single market data and order routing network for Southeast Asian capital markets. PSE lengthened its trading hours of 9:30 a.m. to 12 noon by 1 hour to close at 1 p.m. In January 2012 the bourse will further extend its hours to include an afternoon trading session. The ASEAN Exchange Collaboration project named SunGard Financial Systems as the technology provider for the cross-border trading platform in June. The trading link is programmed to start in March 2012, with Indonesia and Viet Nam expected to join in the latter part of 2012.

### BTr Sells Retail Treasury Bonds

The Bureau of the Treasury (BTr) issued PHP110 billion of 10- and 15-year Retail Treasury Bonds (RTBs) in October. Of the total amount, PHP54.97 billion of 10-year RTBs was issued and PHP55.12 billion of 15-year RTB was sold. BTr's bond sinking fund purchased PHP53 billion of the total to secure the government's maturing obligations. The 10-year and 15-year RTBs carry coupons of 5.75% and 6.25%, respectively. RTBs have the same features as treasury bonds with the exception of coupons that are paid quarterly and individual investments as low as PHP5,000.

In March BTr issued a total of PHP104 billion of 5- and 10-year RTBs, with coupons of 6.0% and 7.375%, respectively.

### BIR Issues Tax Rules on PERA Act

The Personal Equity and Retirement Account (PERA) Act will be implemented after the Bureau of Internal Revenue (BIR) has issued the relevant tax regulations covering investments in and transactions involving PERA accounts. The PERA investment scheme aims to encourage people to save for retirement by granting tax exemptions. PERA products have been described as an alternative to the Social Security System and the Government Service Insurance System. PERA contributions will be exempted from (i) final withholding tax on interest, (ii) capital gains tax on the sale of bonds and shares, (iii) 10% tax on cash and property dividends, and (iv) regular income tax. The tax rules will become effective on 1 January 2012.

### BSP Tightens Rules on Hedging Instruments

BSP imposed stricter rules on hedging instruments, particularly non-deliverable forward (NDF) contracts, to reduce speculation in the foreign exchange market. An NDF is a contract between two parties to buy or sell an asset such as foreign exchange at an agreed price and settlement date in the future. Counterparties settle the difference between the contracted NDF price and the spot price upon maturity. BSP raised the market risk weighting of NDF contracts to reflect the potential systemic risk they generate as a result of increased volatility in the foreign exchange market. The market risk capital charge to be used in the capital adequacy ratio (CAR) computation for banks for the net open position of NDF contracts will be raised from 10% to 15% effective 1 January 2012.