Philippines—Update

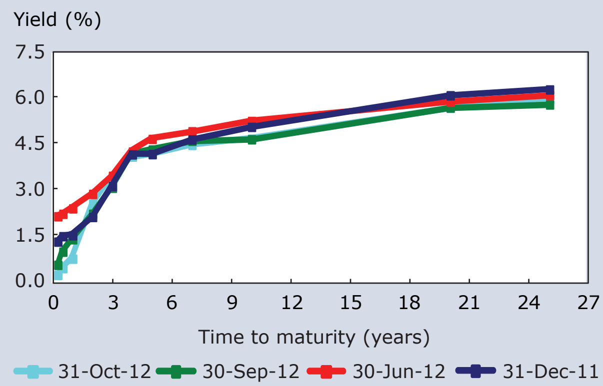
Yield Movements

Between end-December and end-October, the Philippine local currency (LCY) government bond yield curve arched slightly upward as yields on both ends fell, while those in the 2- to 3-year range rose **(Figure 1)**. Yields for tenors of 1 year and below plunged between 75 basis points (bps) and 108 bps as foreign investors sought these bills on the back of the strong peso. Government bonds with maturities of 4 years and above fell between 1 bp and 40 bps during the same period. Meanwhile, yields for tenors between 2 years and 3 years climbed 31 bps–43 bps.

Between end-June and end-October, the yield curve generally shifted downward with a steepening bias as the decline at the short-end outpaced that of the long-end. Movement in the yield curve reflected the monetary easing policies implemented by Bangko Sentral ng Pilipinas (BSP) and the country's credit upgrade from Standard and Poor's (S&P) in July and Moody's Investors Service (Moody's) in October. Government securities with maturities of 1 year and below dropped the most, with declines ranging between 163 bps and 190 bps. The yield spread between the 2- and 10-year tenors narrowed 31 bps between end-June and end-October—from 241 bps to 210 bps.

Inflation in the Philippines has been favorable in 2012, enabling the pursuit of expansionary fiscal and monetary policy goals. Consumer price inflation began slowing after peaking in August at 3.8% year-on-year (y-o-y); September and October inflation came in at 3.6% and 3.1%, respectively. Year-to-date headline inflation stood at 3.2% at end-October, while core inflation, which excludes selected food and energy items, was slightly higher at 3.8%. Both figures fell at the low-end of the government's 3%–5% annual target inflation range. Slower inflation in October was brought about by falling prices of food and oil imports, and an appreciating peso.

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



LCY = local currency.
Source: Bloomberg LP.

During the first half of 2012, the growth of the Philippine economy surpassed many analysts' forecasts as gross domestic product (GDP) grew 6.1% y-o-y. Growth trends in the second half of the year point to a slight easing due to disruptions caused by weather disturbances and a slowdown in exports and remittances, the combined effects of which may result in curtailed household consumption.

Merchandise exports recovered to grow 22.8% y-o-y in September from a 9.0% fall in August, bringing cumulative 9-month export growth to 7.2% y-o-y on US$40.1 billion in exports. Electronics products were a drag on export performance, dropping 7.24% y-o-y in January–September. Meanwhile, cumulative January–August personal remittances from overseas Filipinos grew 5.6% y-o-y, reaching US$15.3 billion. Total remittances for the month of August grew 7.9% y-o-y. Cash remittances expanded 7.6% y-o-y in August and 5.5% y-o-y in January–August. In June, BSP began recording personal remittances in line with the International Monetary Fund's (IMF) balance of payment calculation methodology.

BSP has noted an increase in the level of liquidity in the financial system as the Philippine currency

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

	Amount (billion)								Growth Rate (%)						
	Jun-12		Jul-12		Aug-12		Sep-12		Jun-12		Jul-12	Aug-12	Sep-12		
	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	3,667	87	3,745	90	3,752	89	3,801	91	12.4	2.9	2.1	0.2	16.1	3.7	1.3
Government	3,172	75	3,239	78	3,237	77	3,286	79	11.5	1.7	2.1	(0.1)	14.7	3.6	1.5
Treasury Bills	255	6	259	6	257	6	262	6	(33.1)	(4.7)	1.4	(0.6)	(20.6)	2.7	1.8
Treasury Bonds	2,793	66	2,856	68	2,855	68	2,900	69	19.0	2.5	2.3	0.04	19.8	3.8	1.6
Others	124	3	124	3	124	3	124	3	6.4	(2.4)	0.0	0.3	8.6	0.3	0.0
Corporate	495	12	506	12	515	12	514	12	18.7	11.5	2.2	1.9	26.1	3.9	(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 bonds issued by government agencies, instrumentalities, and corporations with which repayment was guaranteed by the National Government. These include issues of Power Sector Assets and Liabilities Management (PSALM), National Food Authority, and others.
5. Peso Global Bonds (PHP-denominated bonds but payable in US$) and multi-currency Retail Treasury Bonds are not included. As of 30 September 2012, the Government of the Philippines and Petron Corporation had PHP98.9 billion and PHP20.0 billion of Peso Global Bonds outstanding, respectively. The government also had PHP20.8 billion of multi-currency Retail Treasury Bonds outstanding.

Source: Philippine Bureau of the Treasury and Bloomberg LP.

strengthens. To help insulate the country from "risks associated with weaker external demand by encouraging investment and consumption," BSP has stated that further monetary easing may be necessary. In its meeting on 25 October, BSP reduced the policy rates by another 25 bps each, bringing the overnight borrowing (reverse repurchase) and lending (repurchase) rates to 3.5% and 5.5%, respectively. BSP reported that it would continue easing monetary policy as needed to ward off the destabilizing effects of an overly strong peso.

Size and Composition

The Philippine LCY bond market grew at a robust rate of 16.1% y-o-y as of end-September, led by both treasury and corporate bond expansion **(Table 1)**. Improving macroeconomic fundamentals combined with transparency in political governance has improved business sentiment and encouraged investment. Total LCY bonds outstanding reached PHP3.8 trillion (US$91 billion) at end-September, up 3.7% from end-June's level of almost PHP3.7 trillion. Government securities still accounted for the majority of bonds outstanding, totaling PHP3.3 trillion, while corporate bonds summed to PHP514 billion.

Government Bond Market Development. Outstanding fixed-income instruments issued by the Philippine government and government-controlled companies rose 14.7% y-o-y and 3.6% quarter-on-quarter (q-o-q) to close at PHP3.3 trillion at end-September. Treasury bonds advanced at the most rapid pace—19.8% y-o-y and 3.8% q-o-q—to stand at PHP2.9 trillion at end-September. Meanwhile, only treasury bills registered a decline in 3Q12, contracting 20.6% y-o-y to PHP262 billion. However, September's balance of outstanding treasury bills was up 2.7% on a q-o-q basis. Total outstanding bonds of government agencies was almost unchanged at PHP124 billion in 3Q12, although this was 8.6% higher than in the same period last year.

In terms of issuance in 3Q12, PHP143 billion worth of treasury bills were sold compared with PHP63 billion of treasury bonds. Notable issues included the PHP30 billion worth of 182-day treasury bills sold in September and the PHP25 billion of 362-day treasury bills sold in August. Among treasury bonds, PHP9 billion worth of 5-year, PHP18 billion of 7-year, PHP18 billion of 10-year, PHP9 billion of 20-year, and PHP9 billion of 25-year bonds were sold during the quarter.

The National Home Mortgage Finance Corporation (NHMFC), the government's secondary mortgage institution, sold a total of PHP420 million of residential mortgage-backed securities known as Bahay Bonds II **(Table 2)**. NHMFC opted to list PHP300 million of the bonds with the Philippine Dealing and Exchange Corporation (PDEx), marking the first time that mortgage-backed securities were listed on the country's exchange.

The government has programmed LCY borrowing of PHP90 billion through its regular auction schedule in 4Q12. Half of the borrowing will consist of treasury bills with 91-, 182-, and 364-day tenors, and the other half will consist of treasury bonds with maturities of 5, 7, and 10 years.

In October, the government reached another milestone by completing a 25-year Retail Treasury Bond (RTB) offering worth PHP188 billion. The RTBs, which carry a coupon of 6.125% payable quarterly, are primarily intended to encourage participation by individual investors and promote savings. The 25-year RTBs have the longest maturity of any RTB issue.

Corporate Bond Market Development. As of end-September, total outstanding LCY corporate bonds stood at PHP514 billion (US$12.3 billion), equivalent to a growth rate of 26.1% y-o-y. Comparing 3Q12 with 2Q12, the size of the corporate bond market expanded modestly at 3.9% q-o-q. A total of PHP27.4 billion of LCY corporate bonds were sold in 3Q12. Major issuers for the quarter included (i) SM Investments Corporation (SMIC), (ii) First Metro Investment Corporation (FMIC), and (iii) Security Bank Corporation (SBC).

In October, BDO issued PHP5 billion of fixed-rate certificates of deposit (CDs). The CDs carry a coupon of 5.25% payable quarterly.

Only 47 companies are actively tapping the capital markets in the Philippines. Not surprisingly, the top 30 issuers accounted for 93.2% of the total amount of LCY corporate bonds outstanding (PHP514 billion) at end-September **(Table 3)**. Out of the top 30 bond issuers, only 5 companies were privately-held corporations and the rest were publicly listed with the Philippine Stock Exchange (PSE). San Miguel Brewery (SMB) remained the largest corporate borrower in the country with PHP45.2 billion of outstanding debt. Banco de Oro Unibank (BDO)

Table 2: Selected Issuance in 3Q12

	Issue Date	Amount		Coupon Rate (%)	Bond Type
		PHP (billion)	US$ (billion)		
July-September 2012					
SM Investments Corporation	16-Jul-12	15.00	0.36		Senior Unsecured
PHP6.34 billion 6.0% due 2019					
PHP8.66 billion 6.9442% due 2022					
First Metro Investment Corporation	10-Aug-12	7.00	0.17		Senior Secured
PHP4 billion 5.5% due 2017					
PHP3 billion 5.75% due 2019					
Security Bank Corporation	15-Aug-12	5.00	0.12	5.5	Certificate of Deposit
Bahay Bonds II Special Purpose Trust	17-Aug-12	0.42	0.01		Mortgage-Backed
PHP300 million 4.8% due 2017					
PHP120 million 6.00% due 2022					

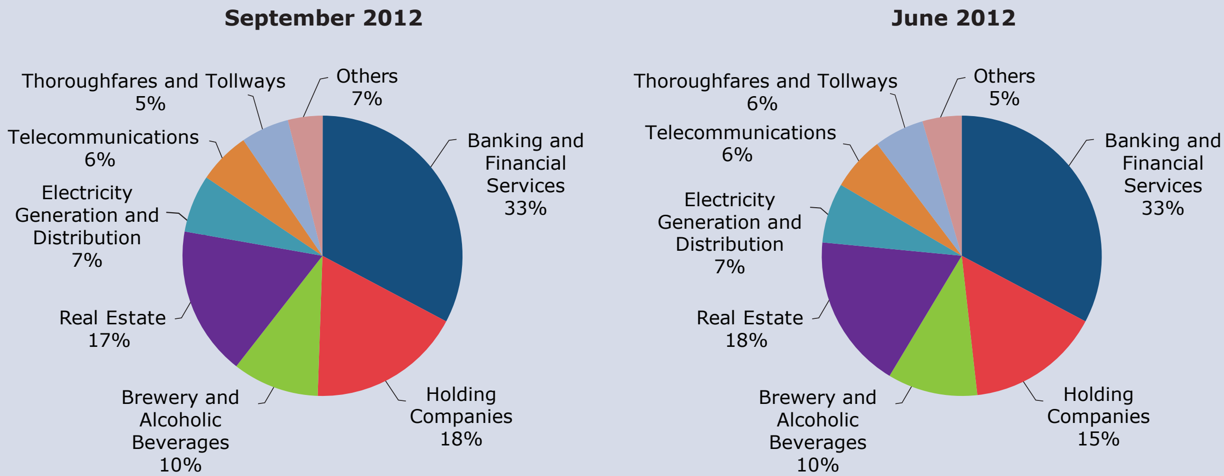
Note: *AsianBondsOnline* classifies Bahay Bonds II Special Purpose Trust as part of government bonds.
Source: Bloomberg LP.

Table 3: Top 30 Issuers of LCY Corporate Bonds in the Philippines (as of end-September 2012)

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.	45.21	1.08	No	Yes	Yes	Brewery
2. BDO Unibank Inc.	38.00	0.91	No	Yes	Yes	Banking
3. SM Investments Corporation	36.09	0.86	No	Yes	Yes	Diversified Operations
4. Ayala Corporation	36.00	0.86	No	Yes	Yes	Diversified Operations
5. Ayala Land Inc.	30.51	0.73	No	Yes	Yes	Real Estate
6. Philippine National Bank	21.85	0.52	No	Yes	Yes	Banking
7. Rizal Commercial Banking Corporation	21.00	0.50	No	Yes	Yes	Banking
8. Manila Electric Company	19.38	0.46	No	Yes	Yes	Electricity Distribution
9. Metropolitan Bank & Trust Co.	18.50	0.44	No	Yes	Yes	Banking
10. Philippine Long Distance Telephone Co.	17.50	0.42	No	Yes	Yes	Telecommunications
11. SM Development Corporation	16.31	0.39	No	Yes	Yes	Real Estate
12. Filinvest Land, Inc	15.00	0.36	No	Yes	Yes	Real Estate
13. Petron Corporation	13.60	0.33	No	Yes	Yes	Oil Refining and Marketing
14. JG Summit Holdings, Inc.	13.31	0.32	No	Yes	Yes	Diversified Operations
15. Security Bank Corporation	13.00	0.31	No	Yes	Yes	Banking
16. Energy Development Corporation	12.00	0.29	No	Yes	Yes	Electricity Generation
17. First Metro Investment Corporation	12.00	0.29	No	Yes	Yes	Investment Banking
18. Robinsons Land Corporation	12.00	0.29	No	Yes	Yes	Real Estate
19. MTD Manila Expressway Corporation	11.50	0.28	No	Yes	No	Transport Services
20. South Luzon Tollway Corporation	11.00	0.26	No	Yes	No	Transport Services
21. Globe Telecom Inc.	10.92	0.26	No	Yes	Yes	Telecommunications
22. United Coconut Planters Bank	9.52	0.23	No	Yes	Yes	Banking
23. Allied Banking Corporation	8.00	0.19	No	Yes	Yes	Banking
24. Megaworld Corporation	6.38	0.15	No	Yes	Yes	Real Estate
25. Manila North Tollways Corporation	6.15	0.15	No	Yes	No	Public Thoroughfares
26. Bank of the Philippine Islands	5.00	0.12	No	Yes	Yes	Banking
27. China Banking Corporation	5.00	0.12	No	Yes	Yes	Banking
28. SM Prime Holdings Inc.	5.00	0.12	No	Yes	Yes	Real Estate Management Services
29. Tanduay Distilleries Inc.	5.00	0.12	No	Yes	No	Alcoholic Beverages
30. Philippine Phosphate Fertilizer Corporation	4.50	0.11	No	Yes	No	Agricultural Chemicals
Total Top 30 LCY Corporate Issuers	**479.23**	**11.48**				
Total LCY Corporate Bonds	**514.43**	**12.32**				
Top 30 as % of Total LCY Corporate Bonds	**93.2%**	**93.2%**				

LCY = local currency.
Note: Petron Corporation has PHP20 billion of peso global bonds outstanding that are not included in this statistics.
Source: Bloomberg LP.

Figure 2: LCY Corporate Bond Issuers by Industry



LCY = local currency.
Source: Bloomberg LP.

followed SMB as the next largest borrower with PHP38.0 billion. SMIC was in the third spot with PHP36.1 billion of outstanding bonds.

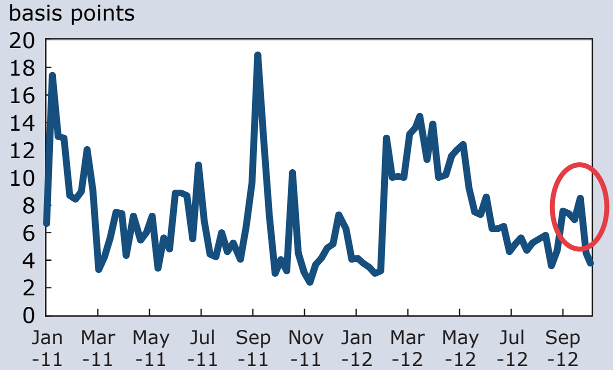
The diversity of LCY corporate bond issuers in 3Q12 was comparable with that in 2Q12 **(Figure 2)**. Banks and financial services, including investment houses, remained the leading issuers of debt in 3Q12 with 33% of the total as BSP moved toward more stringent liquidity and capital requirements. The share of holding companies rose to 18% in 3Q12 from 15% in 2Q12. Real estate companies, meanwhile, accounted for 17% of total LCY corporate bonds outstanding in 3Q12, slightly lower than the 18% share recorded in the previous quarter. The share of breweries and alcoholic beverage companies was 10% of the total, similar to their share at end-June. Firms from industries as diverse as (i) electricity generation and distribution, (ii) telecommunications, and (iii) thoroughfares and tollways continued to hold shares of total corporate bonds outstanding in the single-digit levels.

Benchmark Government Securities Bid–Ask Spreads. Liquidity in the secondary trading market for government securities is an indication of market sentiment and investor confidence. Bid–ask spreads and trading volume trends are common indicators of liquidity in the secondary market. *AsianBondsOnline* monitored the most traded treasury bonds with the most frequent bid–ask (two-way) quotes from 7 January 2011 to 25 October 2012. The data used to capture the bid–ask spreads for these securities were obtained from the Bloomberg pages of money brokers operating in the Philippines.

Bid–ask spreads for benchmark government securities continued to tighten in 2012, reflecting a trend discussed in previous editions of the Asia Bond Monitor **(Figure 3)**. Year-to-date through 25 October, bid–ask spreads averaged 7.7 bps. The average bid–ask spread stood at 7.6 bps in 1Q12 before increasing to 10.4 bps in 2Q12 on the back of rising risk aversion resulting from the possibility of a Greek exit from the eurozone and an economic slowdown in the People's Republic of China (PRC). From 1 July to 25 October, bid–ask spreads narrowed to 5.7 bps on renewed risk appetite resulting from the Philippines' credit upgrades from S&P and Moody's, and continuous monetary easing policies from BSP in response to the rapid appreciation of the Philippine peso.

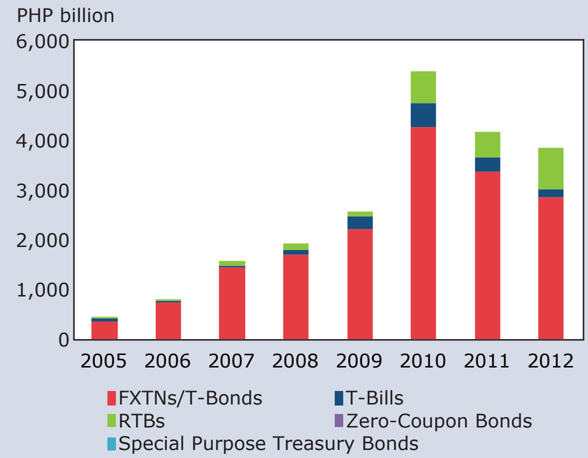
From 1 July to 25 October, the series with the tightest bid–ask spreads were FXTN 20-17 and RTB 20-1, with an average of 1.3 bps and 2.7 bps,

Figure 3: Weekly Average Bid–Ask Spreads of the Philippines' Most Active Government Securities, 7 January 2011–25 October 2012



Note: The following were included among the monitored government securities: (i) FXTN 7-51, (ii) FXTN 7-53, (iii) RTB 10-2, (iv) FXTN 10-53, (v) RTB 10-3, (vi) FXTN 10-54, (vii) FXTN 10-55, (viii) RTB15-1, (ix) RTB15-2, (x) FXTN 20-17, (xi) RTB 20-1, and (xii) FXTN 25-8.
Source: *AsianBondsOnline*.

Figure 4: PDEx Trade Volume Trends—Government Securities, 2005–October 2012



FXTNs = fixed-rate treasury notes, RTBs = Retail Treasury Bonds.
Note: PDEx reports one side of the trade only.
Source: Philippine Dealing and Exchange Corporation (PDEx).

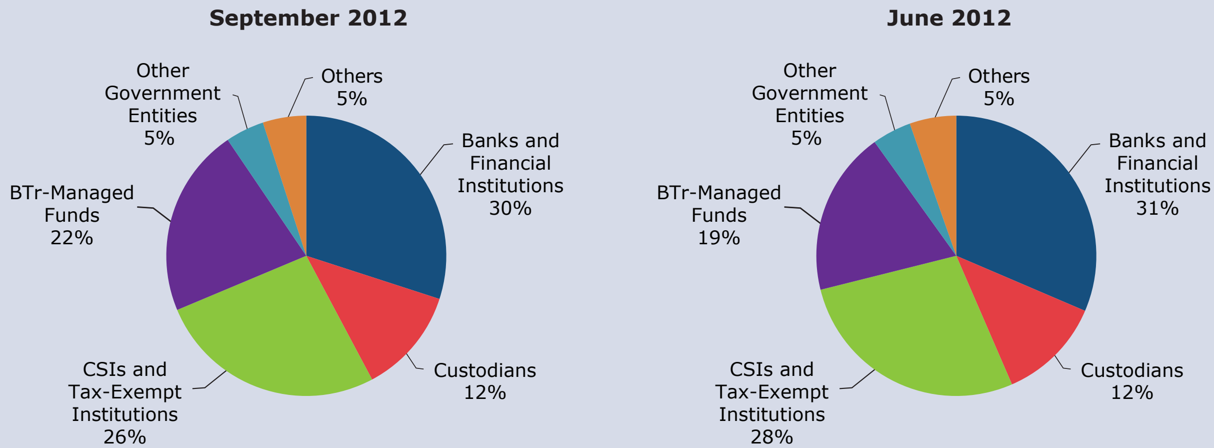
respectively. The other series considered the most liquid were (i) FXTN 7-51 with a bid–ask spread of 5.0 bps, (ii) FXTN 10-54 with 5.4 bps, (iii) FXTN 10-55 with 6.0 bps, and (iv) FXTN 10-53 and RTB 10-3 with 6.2 bps each. FXTN 25-08 and RTB 10-2 had bid–ask spreads of 7.2 bps and 7.7 bps, respectively. On-the-run 15-year RTBs enjoyed bid–ask spreads of 7.8 bps and 8.5 bps, respectively. Two-way quotes for FXTN 7-53 became less frequent and widened to 11.7 bps during the period. Meanwhile, two-way quotes for FXTN 5-67 (1.23 years), FXTN 7-48 (3.23 years), and FXTN 10-42 (3.83 years) were dropped from the analysis since it has been observed that they have lost their liquidity. Interestingly, these government securities have remaining maturities of less than 5 years.

PDEx Trade Volume Trends—Government Securities. As the sole fixed-income exchange in the country, PDEx captures the secondary trading of listed fixed-income issues. The volume of secondary trading of government securities has surged tremendously between 2005 and end-October 2012 **(Figure 4)**. From annual trading of PHP437.7 billion in full-year 2005, trade volume increased to PHP3.83 trillion in the first 10 months of 2012. The largest annual volume was recorded in 2010, when secondary trading reached PHP5.35 trillion. Between January 2005 and October 2012, treasury bonds accounted for almost 82% of all trades in the secondary market as investors sought greater capital gains and interest income from these securities.

Investor Profile

The largest grouping of investors of government securities in 3Q12 comprised banks and financial institutions with 30.0% of the total **(Figure 5)**. This was slightly down from their share of 31.5% in 2Q12. Contractual savings institutions—the Social Security System (SSS), the Government Service Insurance System (GSIS), Pag-ibig, and life insurance companies—and tax-exempt institutions—trusts and other tax-exempt entities—accounted for 26.4% in 3Q12, down from 27.6% in 2Q12. Meanwhile, the share of funds being managed by the Bureau of the Treasury (BTr), which includes the Bond Sinking Fund, rose to 21.9% at end-September from 19.0% at end-June. The participation of custodians remained steady in 3Q12 at around 12% of the total. Other government entities and other investor, which include individuals and private corporations, were almost unchanged between end-June and end-September at around 5%.

Figure 5: LCY Government Bonds Investor Profile



BTr = Bureau of Treasury, CSIs = contractual savings institutions, LCY = local currency.
Note: For the purpose of this investor profile only, LCY government bonds are defined as domestic bonds, which include multi-currency (US$ and EUR) retail tresury bonds totaling to almost PHP21 billion as of end-September 2012.
Source: Philippine Bureau of the Treasury.

Rating Changes

The Philippines received an upgrade from Moody's on 29 October, leaving its credit rating one notch away from investment grade **(Table 4)**. Moody's raised the foreign currency (FCY) and LCY long-term bond ratings of the Government of the Philippines to Ba1 from Ba2. The ratings outlook was stable for both. Moody's rationale for the upgrade took into account the Philippines' (i) improved economic performance and strong fiscal position in the face of deteriorating global demand, (ii) enhanced prospects for growth over the medium-term, and (iii) sound financial system that poses limited contingent risks and provides a stable source of government financing. Moody's also upgraded the issue ratings for the BSP-rated liabilities to Ba1 from Ba2, with a stable outlook.

Table 4: Selected Sovereign Ratings and Outlooks for the Philippines

	Moody's	S&P	Fitch
Sovereign FCY LT Rating	Ba1	BB+	BB+
Outlook	Stable	Stable	Stable

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

Policy, Institutional, and Regulatory Developments

BSP Requires Loss Absorbency Clause for Hybrid Instruments

BSP issued Circular 768 on 21 September, requiring instruments eligible as capital under Basel III rules to have loss absorbency features. The circular requires hybrid Tier 1 capital and lower Tier 2 capital to either be written off or converted into common equity upon the occurrence of a trigger event as determined by BSP. In addition, the circular states that "the issuance of any new shares as a result of the trigger event must occur prior to any public sector injection of capital so that the capital provided by the public sector is not diluted."

Philippines Sells PHP30.8 Billion (US$750 Million) of Global Peso Notes, Offers Bond Buy-Back

The Philippines sold PHP30.8 billion (US$750 million) of 10-year global peso notes priced at 3.9% during the second week of November. The foreign exchange rate at pricing was PHP41.07 to US$1. The proceeds will be used to partially fund the repurchase of the 15 most expensive US$- and euro-denominated government bonds. The government has offered to repurchase US$1.5 billion of such foreign bonds, with the offer set to expire on 15 November. Should the repurchase require additional US dollars, the government will source the needed funding from the reserves of the BSP. The global peso notes are registered with the US Securities and Exchange Commission (SEC) as they are PHP-denominated but settled in US dollars. The issuance and tender offer are part of the government's external liability management efforts to minimize the foreign exchange risk inherent in the Philippines' outstanding debt portfolio.

With the sale, the Philippines has completed three global peso notes offerings. The two previous issues were a PHP44.1 billion (US$1.0 billion) 10-year bond offering in September 2010 and a PHP54.8 billion (US$1.25 billion) 25-year bond offering in January 2011. *AsianBondsOnline* does not include global peso notes in its statistics of LCY and FCY government bonds.