Philippines

Yield Movements

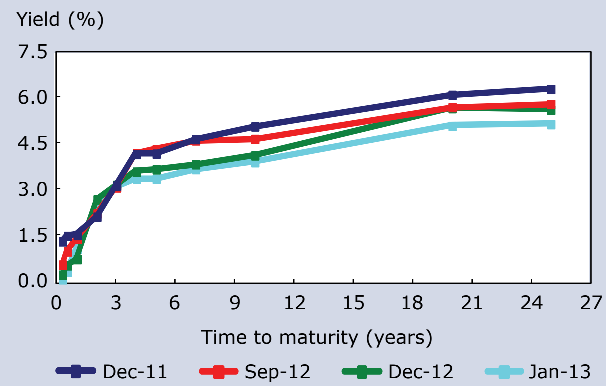
Between end-September and end-December, Philippine local currency (LCY) government bond yields fell for most tenors with the exception of the 2- and 3-year tenors **(Figure 1)**. Yields for tenors of 1 year and below plunged between 32 basis points (bps) and 65 bps on the back of foreign demand driven by the strong peso. Yields on tenors between 4 years and 10 years fell 53 bps–77 bps. Yields for the 20- and 25-year tenors fell 3 bps and 19 bps, respectively. In contrast to the rest of the curve, yields rose 45 bps and 8 bps, respectively, for the 2- and 3-year tenors. The fall in yields along most of the curve was also influenced by future supply factors as the Bureau of Treasury (BTr) announced a change in the auction schedule for 1Q13. In the past, auctions for government bonds were conducted every other week. In 1Q13, auctions for treasury bills and bonds will be held once a month.

Between end-December and end-January, the entire yield curve shifted downward again (except the 1-year maturity), particularly at the longer-end. Yields fell between 15 bps and 20 bps for tenors of less than 1-year. Yields fell 6 bps–30 bps between the 2- and 7-year maturities. Yields for longer tenors fell between 22 bps and 57 bps. Rates fell due to monetary policy changes implemented by Bangko Sentral ng Pilipinas (BSP) toward the end of January. While BSP elected to keep policy rates unchanged, it lowered the rate granted to special deposit accounts (SDAs). In contrast to the rest of the curve, the 1-year maturity rose 33 bps.

As a result of these movements, the yield spread between the 2- and 10-year tenors narrowed 21 bps between end-December and end-January: from 155 bps to 134 bps.

In addition to supply factors and monetary policy, yields have fallen in the Philippines due to positive economic data. Inflation in the Philippines was favorable in 2012, enabling the pursuit of expansionary fiscal and monetary policy goals. Consumer price inflation has generally been slow and steady in recent months at 2.8% year-on-year (y-o-y) in November, 2.9% in December, and 3.0% in January. Inflation for 2012 averaged 3.2%, near the lower-end of the government's 3%–5% target. For 2013, the government's inflation forecast was lowered to 3.1% from 3.9% last December 2012.

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



LCY = local currency.
Source: Bloomberg LP.

Gross domestic product (GDP) growth was also strong in the last 2 quarters of 2012. GDP expanded 6.8% y-o-y in 4Q12 and 7.2% in 3Q12. Growth in 4Q12 was driven by the services sector. For the full-year 2012, GDP grew 6.6% y-o-y. Exports were also robust toward the end of the year. Exports rose 5.5% y-o-y in November and 6.1% in October, but these increases were substantially lower than September's 22.8% growth.

The country's gross international reserves (GIR) reached US$85.8 billion at end-January. The increase in the GIR was due to the BSP's forex operations as well as income from investments abroad. The GIR balance at end-January was large enough to cover 12.3 months of imports and payments of services abroad, and was equal to 5.8 times the country's external short-term debt by residual maturity.

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

	Outstanding Amount (billion)								Growth Rate (%)						
	Sep-12		Oct-12		Nov-12		Dec-12		Sep-12		Oct-12	Nov-12	Dec-12		
	PHP	US$	PHP	US$	PHP	US$	PHP	US$	q-o-q	y-o-y	m-o-m	m-o-m	m-o-m	q-o-q	y-o-y
Total	3,801	91	3,805	92	3,837	94	4,085	100	3.7	16.1	0.1	0.8	6.5	7.5	20.5
Government	3,286	79	3,290	80	3,314	81	3,559	87	3.6	14.7	0.1	0.7	7.4	8.3	20.5
Treasury Bills	262	6	263	6	272	7	275	7	2.7	(20.6)	0.4	3.7	0.9	5.0	(6.8)
Treasury Bonds	2,900	69	2,903	71	2,928	72	3,171	77	3.8	19.8	0.1	0.9	8.3	9.3	24.5
Others	124	3	124	3	113	3	113	3	0.3	8.6	0.0	-8.8	0.0	-8.8	(1.0)
Corporate	514	12	515	13	524	13	526	13	3.9	26.1	0.1	1.7	0.5	2.3	20.7

( ) = negative, 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 31 December 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.

The Philippines' strong economic performance has led to positive actions from several ratings agencies. In October, Moody's Investors Service (Moody's) raised the Philippines' sovereign debt rating to Ba1, one notch below investment grade. In December, Standard & Poor's (S&P) kept its Philippine debt rating unchanged at BB+, but raised its outlook to positive from stable, making it likely that the Philippines will be upgraded in 2013.

Size and Composition

The Philippine LCY bond market was growing at a robust rate of 20.5% y-o-y as of end-December, led mostly by treasury bonds **(Table 1)**. Total LCY bonds reached PHP4.1 trillion (US$100 billion) at end-December, up 7.5% from end-September's level of almost PHP3.8 trillion. Government securities accounted for the majority of bonds outstanding, totaling PHP3.6 trillion (87% of total), while corporate bonds summed to PHP526 billion.

Government Bond Market Development. Outstanding fixed income instruments issued by the Philippine government and government-controlled companies rose 20.5% y-o-y and 8.3% quarter-on-quarter (q-o-q) to close at PHP3.6 trillion at end-December. Among such instruments, treasury bonds advanced at the most rapid pace—24.5% y-o-y and 9.3% q-o-q—to stand at PHP3.2 trillion at end-December. Meanwhile, only treasury bills registered a decline in 4Q12, contracting 6.8% y-o-y to PHP275 billion. However, December's balance of outstanding treasury bills was up 5.0% on a q-o-q basis.

In terms of issuance in 4Q12, PHP52 billion worth of treasury bills were sold compared with PHP89 billion of treasury bonds.

The government has programmed LCY borrowing of PHP120 billion through its regular auction schedule in 1Q13. This will consist of PHP45 billion of treasury bills with 91-, 182-, and 364-day tenors, and the remainder in the form of treasury bonds with maturities of 7, 10, and 25 years. Also, the government has changed the frequency of its auctions in 1Q13. Auctions for treasury bills and bonds will each be held once a month for a total of six auctions. In contrast, there were 11 auctions scheduled in 4Q12.

Corporate Bond Market Development. As of end-December, total outstanding LCY corporate bonds stood at PHP526 billion (US$13 billion), driven by a growth rate of 20.7% y-o-y. Comparing 4Q12 with 3Q12, the amount of corporate bonds outstanding rose 2.3%. A total of PHP16 billion of LCY corporate bonds were sold in 4Q12. Major issuers for the quarter included (i) Ayala Corp., (ii) Ayala Land, and (iii) Banco de Oro Unibank (BDO) **(Table 2)**.

Only 47 companies are actively tapping the capital markets in the Philippines. Not surprisingly, the top 30 issuers accounted for 93.5% of the total amount of LCY corporate bonds outstanding (PHP526 billion) at end-December **(Table 3)**. Out of the top 30 bond issuers, only four companies were privately held corporations and the rest were publicly listed on the Philippine Stock Exchange (PSE). San Miguel Brewery (SMB) remained the largest corporate borrower in the country with PHP45.2 billion of outstanding debt. BDO followed SMB as the next largest borrower with PHP43 billion. Ayala Corp. was in the third spot with PHP40 billion of outstanding bonds.

The diversity of LCY corporate bond issuers in 4Q12 was comparable with that in 3Q12 **(Figure 2)**. Banks and financial services, including investment houses, remained the leading issuers of debt in 4Q12, with 33% of the total, as BSP moved toward more stringent liquidity and capital requirements. The market share of most industries remained unchanged, except for thoroughfares and tollways, which fell to 5% in 1Q12 from 6% in 3Q12, and electricity generation and distribution, which rose to 7% from 6%. Of note, firms from industries as diverse as (i) electricity generation and distribution, (ii) telecommunications, and (iii) thoroughfares and tollways continued to hold single-digit shares of total corporate bonds outstanding.

PDEx Trade Volume Trends—Government Securities. As the sole fixed income exchange in the country, the Philippine Dealing and Exchange Corporation (PDEx) captures the secondary trading of listed fixed income issues. The volume of secondary trading of government securities surged between 2005 and 2012 **(Figure 3)**. From an annual trading volume of PHP437.7 billion in 2005, trading volume increased to PHP5.04 trillion in 2012. The largest annual volume was recorded in 2010, when secondary trading reached PHP5.35 trillion. In 2005–2012, treasury bonds accounted for almost 73% 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 4Q12 comprised banks and financial

Table 2: Selected Issuance in 4Q12

	Issue Date	Issued Amount		Bond Type
		PHP (billion)	US$ (billion)	
Ayala Corporation	23-Nov-12	10	0.24	Senior Unsecured
PHP10 billion 5.45% due 2019				
Ayala Land	31-Oct-12	1	0.02	Senior Secured
PHP1 billion 5% due 2015				
BDO Universal Bank	15-Oct-12	5	0.12	Certificate of Deposit
PHP5 billion 5.25% due 2019				

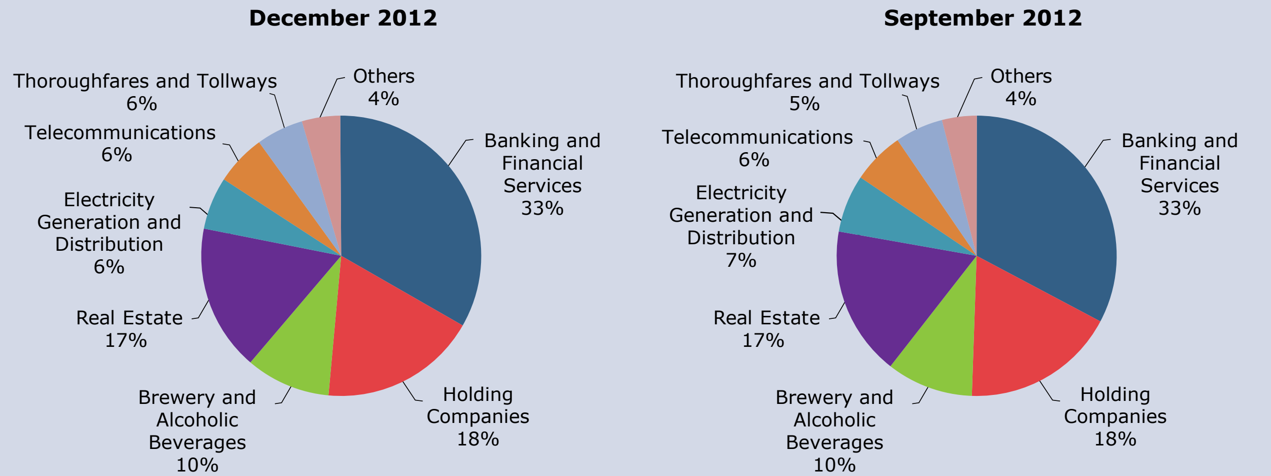
Source: Bloomberg LP.

Table 3: Top 30 Issuers of LCY Corporate Bonds in the Philippines

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.	45.2	1.08	No	Yes	Yes	Brewery
2. BDO Unibank Inc.	43.0	1.03	No	Yes	Yes	Banking
3. Ayala Corporation	40.0	0.96	No	Yes	Yes	Diversified Operations
4. SM Investments Corporation	36.1	0.86	No	Yes	Yes	Diversified Operations
5. Ayala Land Inc.	31.2	0.75	No	Yes	Yes	Real Estate
6. Philippine National Bank	21.9	0.52	No	Yes	Yes	Banking
7. Rizal Commercial Banking Corporation	21.0	0.50	No	Yes	Yes	Banking
8. Manila Electric Company	19.4	0.46	No	Yes	Yes	Electricity Distribution
9. Philippine Long Distance Telephone Co.	17.3	0.42	No	Yes	Yes	Telecommunications
10. Maynilad Water Services	16.6	0.40	No	Yes	Yes	Water
11. SM Development Corporation	16.3	0.39	No	Yes	Yes	Real Estate
12. Filinvest Land Inc.	14.5	0.35	No	Yes	Yes	Real Estate
13. Petron Corporation	13.6	0.33	No	Yes	Yes	Oil Refining and Marketing
14. JG Summit Holdings Inc.	13.3	0.32	No	Yes	Yes	Diversified Operations
15. Security Bank Corporation	13.0	0.31	No	Yes	Yes	Banking
16. Energy Development Corporation	12.0	0.29	No	Yes	Yes	Electricity Generation
17. First Metro Investment Corporation	12.0	0.29	No	Yes	Yes	Investment Banking
18. Robinsons Land Corporation	12.0	0.29	No	Yes	Yes	Real Estate
19. MTD Manila Expressway Corporation	11.5	0.28	No	Yes	No	Transport Services
20. South Luzon Tollway Corporation	11.0	0.26	No	Yes	No	Transport Services
21. Globe Telecom Inc.	10.9	0.26	No	Yes	Yes	Telecommunications
22. Metropolitan Bank & Trust Co.	10.0	0.24	No	Yes	Yes	Banking
23. United Coconut Planters Bank	9.5	0.23	No	Yes	Yes	Banking
24. Allied Banking Corporation	8.0	0.19	No	Yes	No	Banking
25. Megaworld Corporation	6.4	0.15	No	Yes	Yes	Real Estate
26. Manila North Tollways Corporation	6.1	0.15	No	Yes	No	Public Thoroughfares
27. Bank of the Philippine Islands	5.0	0.12	No	Yes	Yes	Banking
28. China Banking Corporation	5.0	0.12	No	Yes	Yes	Banking
29. SM Prime Holdings, Inc.	5.0	0.12	No	Yes	Yes	Real Estate
30. Tanduay Distilleries Inc.	5.0	0.12	No	Yes	Yes	Alcoholic Beverages
Total Top 30 LCY Corporate Issuers	**491.9**	**11.78**				
Total LCY Corporate Bonds	**526.1**	**12.60**				
Top 30 as % of Total LCY Corporate Bonds	**93.5%**	**93.5%**				

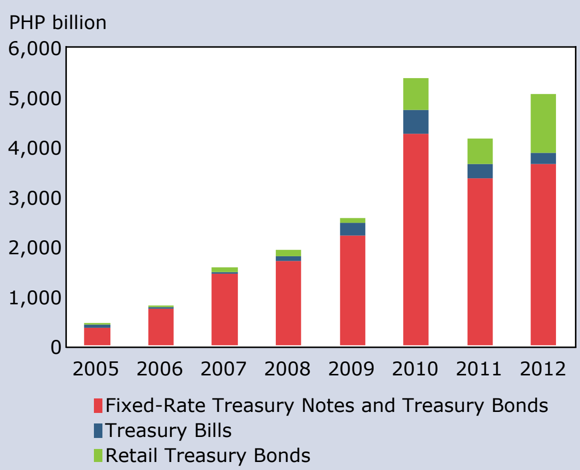
LCY = local currency.
Notes:
1. Data as of 31 December 2012.
2. Petron Corporation has PHP20 billion of global peso bonds outstanding that are not included.
3. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Bloomberg data.

Figure 2: LCY Corporate Bond Issuers by Industry



LCY = local currency.
Source: Bloomberg LP.

Figure 3: PDEx Trade Volume Trends—Government Securities



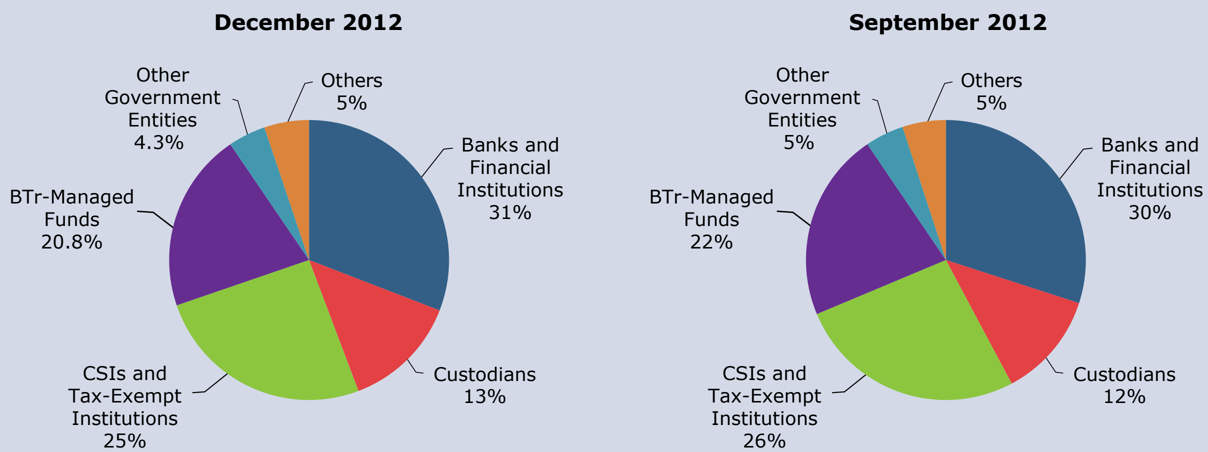
Note: PDEx reports one side of the trade only.
Source: Philippine Dealing and Exchange Corporation (PDEx).

institutions with 30.9% of the total **(Figure 4)**. This was slightly higher than its share of 30% in 3Q12. Contractual savings institutions—including the Social Security System (SSS), the Government Service Insurance System (GSIS), Pag-ibig, and life insurance companies—and tax-exempt institutions—such as trusts and other tax-exempt entities—accounted for 25.4% in 3Q12, down from 26.4% in 3Q12. Meanwhile, the share of funds being managed by the Bureau of the Treasury (BTr), which includes the Bond Sinking Fund, fell to 20.8% at end-December from 21.9% at end-June. The participation of custodians increased to 13.4% from 12.3% in the same period. Other government entities and other investors, which include individuals and private corporations, were almost unchanged between end-September and end-December at around 5.0% and 5.2%, respectively.

Rating Changes

Following Moody's upgrade on 29 October, S&P raised its outlook to positive. The rating agency announced that it may upgrade the Philippines this year and affirmed the country's BB+ rating. It said that the positive outlook was granted based on an improving political environment and the capacity of the government to pursue its reform agenda. S&P said that it may raise its rating if the country improves its revenue structure, reduces its reliance on foreign debt borrowing, and reduces its debt servicing.

Figure 4: 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 treasury bonds totaling almost PHP21 billion as of end-December 2012.
Source: Philippine Bureau of the Treasury.

Policy, Institutional, and Regulatory Developments

BSP Adopts Disclosure Rules for Capital Instruments

On 1 February, BSP added disclosure requirements, which are Basel III compliant, for debt instruments issued by banks. BSP has added a client suitability measure to determine whether the investor understands the risks involved in an investment. A risk disclosure statement must also be included that outlines the risks as well as the processes that would follow once thresholds are breached.

AMLA Amendments Approved

On 7 February, Congress ratified amendments to the Anti-Money Laundering Act (AMLA). The amendments include expanding the list of covered institutions required to report transactions in excess of PHP500,000 and the list of unlawful activities covered by the AMLA. The covered institutions were expanded to include companies such as forex dealers, pawnshops, remittance agents, and pre-need firms. Unlawful activities include terrorism, financing of terrorism, fraud, and bribery.