Philippines

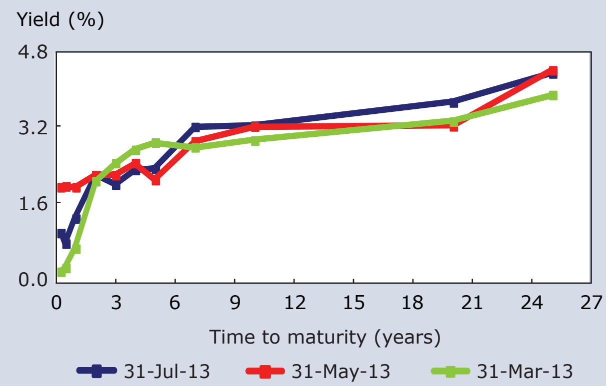
Yield Movements

Between end-March and end-May, Philippine local currency (LCY) government bond yields rose for most tenors **(Figure 1)**. The rise in yields was most evident for tenors of 1 year and below, with yields rising between 127 basis points (bps) and 175 bps. Yields for 10- and 25-year bonds increased 29 bps and 51 bps, respectively. The rise in yields was due to a sell-off at the end of May driven by speculation that the United States (US) Federal Reserve would soon start tapering its quantitative easing program. In contrast, yields for 3-, 5-, and 7-year bonds fell between 25 bps and 78 bps.

Between end-May and end-July, yields fell for most tenors. Yields for tenors of 1 year and below plunged between 65 bps and 119 bps, while yields for 3- and 4-year bonds fell 20 bps and 14 bps, respectively. The fall in yields was due to a correction in the market after the aforementioned sell-off in late May. Yields fell in the Philippines in July due to continued high liquidity in the market and as a result of the Bangko Sentral ng Pilipinas (BSP) lowering the Special Deposit Account (SDA) rate to 2.0% at its 25 April meeting of the Monetary Board and limiting the access of banks to the facility. Data from BSP showed that SDA deposits totaled PHP1.79 trillion during the week of 8–12 July, down 1.5% from PHP1.82 trillion at end-May and 3.5% from PHP1.86 trillion at end-April. Funds from these accounts may have shifted to government securities or time deposits as SDA investors typically have low risk appetites.

Economic data in the Philippines continues to be positive. Inflation remained benign, enabling the pursuit of expansionary fiscal and monetary policy goals. Consumer price inflation was 2.1% year-on-year (y-o-y) in August, bringing year-to-date inflation to the slow and steady rate to 2.8%, which is below BSP's 2013 target range of 3%–5%. This led BSP to hold its policy rates steady during its two most recent Monetary Board meetings on 13 June and 25 July.

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



LCY = local currency.
Source: Bloomberg LP.

In 2Q13, the Philippine economy grew 7.5% y-o-y, following a revised 7.7% growth in 1Q13. The growth was mainly due to strong business and consumer sentiment, as well as sustained government capital expenditure. This growth was also supported by the strong performance of the services sector, which offset the negative contribution of exports. Exports declined in 2Q13 due to continued weakness in the global economy. However, industry participants are hopeful that global demand will benefit from the gradual recovery of the US economy and efforts in Japan to revive its moribund economy.

Size and Composition

The Philippine LCY bond market grew at a robust rate of 12.1% y-o-y as of end-June, led by both treasury bills and bonds **(Table 1)**. Total LCY bonds reached PHP4.1 trillion (US$95 billion) at end-June, up 1.9% from PHP4 trillion at end-March. Government securities accounted for the majority of bonds outstanding, totaling PHP3.5 trillion, while corporate bonds summed to PHP540.8 billion.

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

	Outstanding Amount (billion)						**Growth Rate** (%)			
	2Q12		**1Q13**		**2Q13**		**2Q12**		**2Q13**	
	PHP	**US$**	**PHP**	**US$**	**PHP**	**US$**	**q-o-q**	**y-o-y**	**q-o-q**	**y-o-y**
Total	3,646	87	4,008	98	4,086	95	2.3	11.8	1.9	12.1
Government	3,151	75	3,476	85	3,545	82	1.0	10.8	2.0	12.5
Treasury Bills	255	6	290	7	295	7	(4.7)	(33.1)	1.9	15.7
Treasury Bonds	2,772	66	3,073	75	3,137	73	1.8	18.1	2.1	13.2
Others	124	3	113	3	113	3	(2.4)	6.4	0.0	(8.5)
Corporate	495	12	532	13	541	13	11.5	18.7	1.7	9.3

( ) = negative, LCY = local currency, 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. Data for government bonds as of end-May 2013.
5. "Others" comprises bonds issued by government agencies, instrumentalities, and corporations with which repayment was guaranteed by the central government. These include issues of Power Sector Assets and Liabilities Management (PSALM), National Food Authority, and others.
6. Peso Global Bonds (PHP-denominated bonds payable in US$) and multi-currency Retail Treasury Bonds (RTBs) are not included. As of end-June 2013, the Government of the Philippines and Petron Corporation had PHP129.7 billion and PHP20 billion of outstanding Peso Global Bonds, respectively. There was a total of PHP6 billion of outstanding multi-currency treasury bonds as of end-May 2013.

Sources: Bureau of the Treasury and Bloomberg LP.

Government Bond Market Development. Outstanding fixed-income instruments issued by the Philippine government and government-controlled companies rose 12.5% y-o-y and 2.0% quarter-on-quarter (q-o-q) to close at PHP3.5 trillion at end-May. Treasury bills advanced at the fastest pace—15.7% y-o-y and 1.9% q-o-q—to stand at PHP295.1 billion at end-May. Treasury bonds expanded 13.2% y-o-y and 2.1% q-o-q to PHP3.1 trillion. Meanwhile, fixed-income instruments issued by government-controlled companies registered a decline of 8.5% y-o-y to PHP113.5 billion at the end of 2Q13.

In terms of issuance in 2Q13, PHP90.9 billion worth of treasury bills were sold compared with PHP30 billion of treasury bonds. The government has programmed LCY borrowing of PHP150 billion through its regular auction schedule in 3Q13: PHP60 billion of treasury bills with 91-, 182-, and 364-day tenors; PHP60 billion of treasury bonds with 3- and 5-years tenors; and PHP30 billion of 10-year Retail Treasury Bonds (RTBs). As of end-July, PHP20 billion and PHP30 billion had been raised through treasury bills and bonds, respectively.

Corporate Bond Market Development. As of end-June, total outstanding LCY corporate bonds grew 9.3% y-o-y and 1.7% q-o-q to reach PHP540.8 billion (US$13 billion). The sole issuer of corporate bonds in 2Q13 was the Energy Development Corporation, which raised PHP14 billion worth of 7- and 10-year bonds **(Table 2)**.

Only 51 companies are actively tapping the capital market in the Philippines. The top 31 issuers accounted for 92.2% of the total amount of LCY corporate bonds outstanding (PHP540.8 billion) at end-June **(Table 3)**. Out of the top 31 bond issuers, only five companies are privately-held corporations and the rest are publicly listed with the Philippine Stock Exchange (PSE). San Miguel Brewery (SMB) remained the largest corporate issuer in the country with PHP45.2 billion of outstanding debt. Ayala Corporation followed SMB as the next largest borrower with PHP40 billion. Banco de Oro Unibank was in the third spot with PHP38 billion of outstanding bonds.

Table 2: Notable LCY Corporate Bond Issuance in 2Q13

Corporate Issuer	**Coupon Rate** (%)	**Issued Amount** (PHP billion)
Energy Development Corp.		
7-year bond	4.16	7.00
10-year bond	4.73	7.00

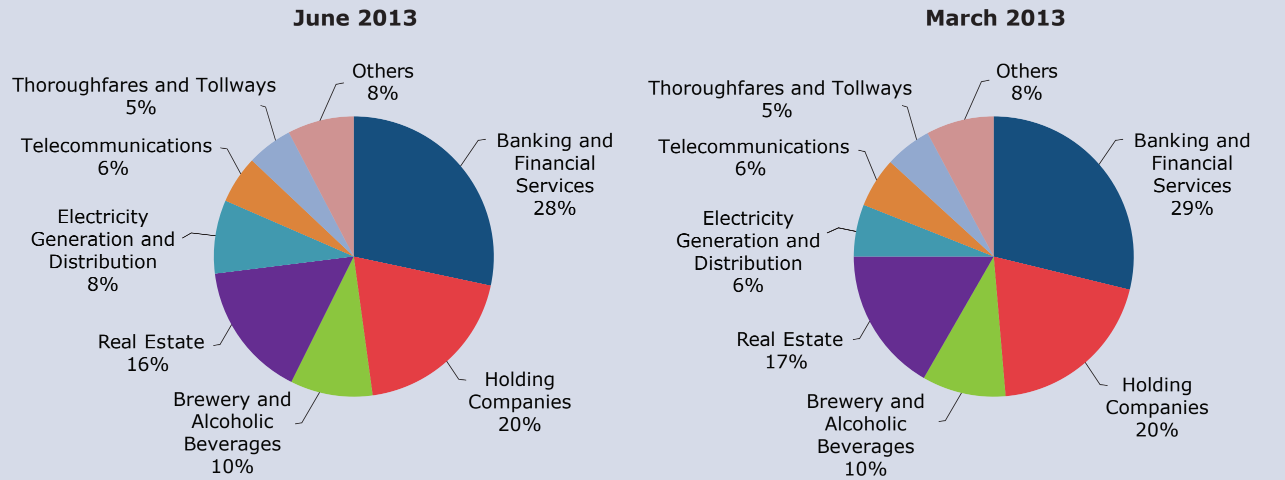
Source: Bloomberg LP.

Table 3: Top 31 Issuers of LCY Corporate Bonds in the Philippines

Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
	LCY Bonds (PHP billion)	LCY Bonds (US$ billion)			
1. San Miguel Brewery	45.2	1.0	No	Yes	Brewery
2. Ayala Corporation	40.0	0.9	No	Yes	Diversified Operations
3. BDO Unibank	38.0	0.9	No	Yes	Banking
4. SM Investments	36.1	0.8	No	Yes	Diversified Operations
5. Ayala Land	31.2	0.7	No	Yes	Real Estate
6. Energy Development	26.0	0.6	No	Yes	Electricity Generation
7. Philippine National Bank	21.9	0.5	No	Yes	Banking
8. Manila Electric	19.4	0.4	No	Yes	Electricity Distribution
9. Philippine Long Distance Telephone	17.3	0.4	No	Yes	Telecommunications
10. Maynilad Water Services	16.6	0.4	No	Yes	Water
11. Filinvest Land	14.5	0.3	No	Yes	Real Estate
12. SM Development	14.3	0.3	No	Yes	Real Estate
13. Rizal Commercial Banking	14.0	0.3	No	Yes	Banking
14. Petron	13.6	0.3	No	Yes	Oil Refining and Marketing
15. JG Summit Holdings	13.3	0.3	No	Yes	Diversified Operations
16. Security Bank	13.0	0.3	No	Yes	Banking
17. First Metro Investment	12.0	0.3	No	No	Investment Banking
18. MTD Manila Expressway	11.5	0.3	No	No	Transport Services
19. South Luzon Tollway	11.0	0.3	No	No	Transport Services
20. Globe Telecom	10.0	0.2	No	Yes	Telecommunications
21. GT Capital Holdings	10.0	0.2	No	Yes	Investment Companies
22. Metropolitan Bank & Trust	10.0	0.2	No	Yes	Banking
23. Robinsons Land	10.0	0.2	No	Yes	Real Estate
24. United Coconut Planters Bank	9.5	0.2	No	No	Banking
25. Allied Banking	8.0	0.2	No	Yes	Banking
26. Megaworld	6.4	0.1	No	Yes	Real Estate
27. Manila North Tollways	6.1	0.1	No	No	Public Thoroughfares
28. Bank of the Philippine Islands	5.0	0.1	No	Yes	Banking
29. China Banking	5.0	0.1	No	Yes	Banking
30. SM Prime Holdings	5.0	0.1	No	Yes	Real Estate
31. Tanduay Distilleries	5.0	0.1	No	Yes	Alcoholic Beverages
Total Top 31 LCY Corporate Issuers	**498.8**	**11.6**			
Total LCY Corporate Bonds	**540.8**	**12.5**			
Top 31 as % of Total LCY Corporate Bonds	**92.2%**	**92.2%**			

LCY = local currency.
Notes:
1. Data as of end-June 2013.
2. Petron Corporation has PHP20 billion of Global Peso Bonds outstanding that are not included in this table.
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



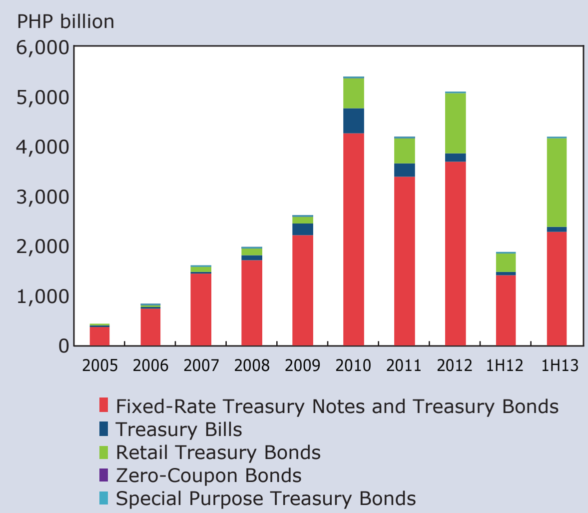
LCY = local currency.
Source: Bloomberg LP.

The diversity of LCY corporate bond issuers in 2Q13 was comparable with that in 1Q13 **(Figure 2)**. Banks and financial service companies, including investment houses, remained the leading issuers of debt in 2Q13 with 28.3% of the total as BSP moved toward more stringent liquidity and capital requirements. The market share of most industries remained unchanged, except for electricity generation and distribution, which rose to 8.5% in 2Q13 from 6.0% in 1Q13, and real estate, which fell to 15.7% from 16.7%. Firms from industries as diverse as (i) electricity generation and distribution, (ii) telecommunications, and (iii) thoroughfares and tollways continued to have shares of total corporate bonds outstanding in the single-digit levels.

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 end-2012 **(Figure 3)**. From an annual trading volume of PHP437.7 billion in 2005, trading volume increased to PHP5 trillion in 2012. The largest annual volume was recorded in 2010, when secondary trading reached PHP5.4 trillion.

Total trading volume for the first half of 2013 increased 125.0% y-o-y to PHP4.2 trillion, from PHP1.9 trillion in the same period in the previous year, equivalent to 82.4% of the total trade volume in 2012. Between January 2005 and June 2013, treasury bonds accounted for almost 76.9% of all trades in the secondary market as investors sought greater capital gains and interest income from these securities.

Figure 3: PDEx Trade Volume Trends—Government Securities

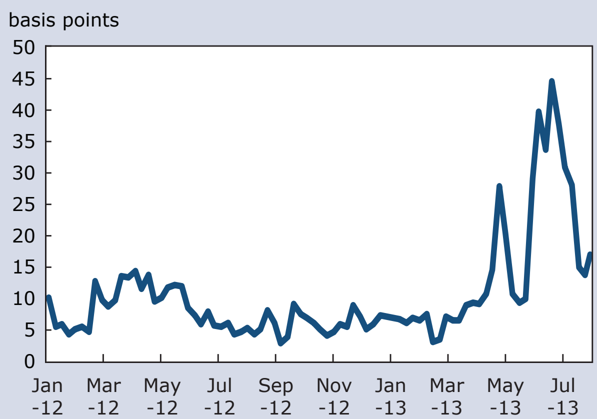


Note: PDEx reports one side of the trade only.
Source: Philippine Dealing and Exchange Corporation (PDEx).

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 in the Philippine market from 6 January 2012 to 31 July 2013. 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 4)**. From January through July, bid–ask spreads averaged 16 bps. The average bid–ask spread stood at 7 bps in 1Q13 before increasing to 23 bps in 2Q13 due to rising risk aversion amid speculation that the US Federal Reserve would start to taper its quantitative easing program. For the month of July, bid–ask spreads narrowed to an average of 21 bps on renewed risk appetite resulting from the announcement of Moody's Investors Service (Moody's) that it would undertake a review of the Philippine government's rating for a possible upgrade to investment grade.

Figure 4: Weekly Average Bid–Ask Spreads of the Philippines' Most Active Government Securities



Note: The following were included among the monitored government securities: (i) FXTN 7-51, (ii) FXTN 10-42, (iii) RTB 10-2, (iv) FXTN 10-54, (v) FXTN 10-55, (vi) RTB15-1, (vii) RTB15-2, (viii) FXTN 20-17, (ix) RTB 20-1, (x) FXTN RTB 25-1, and (xi) FXTN 25-8.
Source: *AsianBondsOnline*.

From 1 April to 31 July, the two series with the tightest bid–ask spreads were FXTN 20-17 and RTB 25-1, with an average of 12 bps and 15 bps, respectively. The other series considered the most liquid were (i) RTB 15-1 (15.8 bps), (ii) RTB 20-1 (17 bps), (iii) RTB 10-2 (18.7 bps), and (iv) FXTN 10-54 (19.5 bps). FXTN 25-08 and FXTN 10-55 had bid–ask spreads of 21.3 bps and 22.5 bps, respectively.

Investor Profile

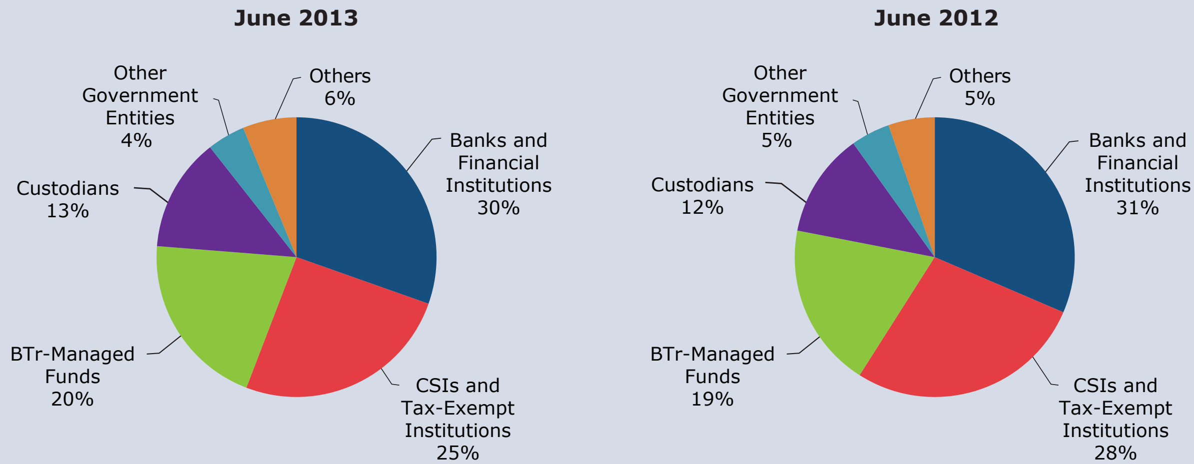
The largest grouping of investors of government securities in 2Q13 comprised banks and financial institutions with 30.4% of the total **(Figure 5)**. This was slightly lower than its share of 31.4% in 2Q12. Contractual savings institutions—including the Social Security System (SSS), Government Service 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 2Q13, 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, increased to 20.5% in 2Q13 from 19.0% in 2Q12. The participation of custodians increased to 13.2% from 12.1% in the same period. Other government entities and other investors, which include individuals and private corporations, increased to 10.6% in 2Q13 from 9.9% in 2Q12.

Rating Changes

S&P Raises the Philippines' Long-Term FCY Debt to Investment Grade

Standard & Poor's (S&P) upgraded its rating for the Philippines' long-term foreign currency (FCY)-denominated debt to BBB– from BB+, with a stable outlook. S&P stated that the upgrade reflected a strengthening external profile, moderating inflation, and the government's declining reliance on FCY debt. S&P expects the Philippines to

Figure 5: LCY Government Bonds Investor Profile



BTr = Bureau of the Treasury, CSIs = contractual savings institutions, LCY = local currency.
Source: Bloomberg LP.

move toward a near-balanced external position because of persistent current account surpluses being driven by large net transfers from Filipinos working abroad that more than offset ongoing trade deficits.

R&I Raises the Philippines' FCY Issuer Rating Outlook to Positive

Rating and Investment Information (R&I) raised its outlook for the Philippines' FCY issuer rating of BBB– from stable to positive. R&I cited the country's strong growth due to robust consumption being driven by remittances from overseas Filipino workers, rising public investment and exports, and stable inflation as contributors to the change in outlook. R&I also stated that it will consider a rating upgrade if the fundamentals for economic growth are solidified and steady increases in per capita income become more promising.

Policy, Institutional, and Regulatory Developments

BSP Further Limits Access to SDA Facility

On 9 May, the Monetary Board of BSP approved revised guidelines on the access of banks and trust departments and entities (acting as trustees) to the BSP's Special Deposit Account (SDA) facility. BSP will gradually reduce the SDA placements of investment management accounts of trust entities until the end of the year. The Monetary Board also stated that the low inflation environment and strong domestic growth prospects provided flexibility for BSP to restructure its monetary policy tools.

BSP Approves Further Amendments to Regulations on FX Transactions

On 5 July, BSP released additional amendments to the Manual of Regulations on Foreign Exchange (FX) Transactions. To broaden investment options available in the domestic capital market, BSP will allow (i) custodian banks to register non-resident investments in PSE-listed equity securities of non-residents and (ii) non-resident issuers to convert the peso proceeds from the onshore sale of their PSE-listed equity securities to FX, conditional upon prior BSP approval. To facilitate legitimate banking transactions that require payment in FX, BSP will allow prepayment of BSP-registered short-term loans.

BSP Maintains Policy Rates

On 25 July, the Monetary Board of BSP decided to keep its key policy rates—the overnight borrowing and lending rates—steady at 3.5% and 5.5%, respectively. The reserve requirement ratios and the interest rate for its SDA facility were also left unchanged. The decision to hold the policy rates at their current levels reflected the Monetary Board's assessment that the inflation environment remains benign, with inflation expected to remain on target through the remainder of 2013 and all of 2014. The Monetary Board also noted possible upside pressures to inflation, which include the modest pace of global economic growth, power rate adjustments, and continued increases in liquidity due to capital inflows.

Philippine BTr Raises PHP150 Billion From Sale of RTBs

On 5 August, BTr ended the offer period for RTBs after raising a total of PHP150 billion. The RTBs carry a maturity of 10 years and a yield of 3.25%. The banks were given until 13 August to sell the RTBs to the public. Banks were also required to sell at least 20% of the RTBs to retail buyers, net of the PHP26.9 billion sold to government-owned corporations. Philippine Treasurer Rosalia De Leon stated that the success of the offer reflected the level of liquidity in the market.