Philippines

Yield Movements

Between end-March and end-July, yield movements were volatile for Philippine local currency (LCY) bonds **(Figure 1)**. The yield for the 3-month tenor fell 13 basis points (bps), while yields for the 6-month and 1-year tenors rose 33 bps and 55 bps, respectively. Yields for medium-term tenors of 3- and 4-years fell 18 bps and 22 bps, respectively, while yields for 5- and 7-year tenors increased 13 bps and 11 bps, respectively. Yields on the longer-end of the curve fell between 5 bps and 29 bps.

Between end-March and end-April, yields rose for most tenors due to speculation over possible monetary tightening by the Bangko Sentral ng Pilipinas (BSP) generated by inflation concerns. Yields for tenors between 6 months and 7 years increased 3 bps–90 bps. In contrast, the yield for the 3-month tenor fell 20 bps as the market favored the shorter-end of the curve.

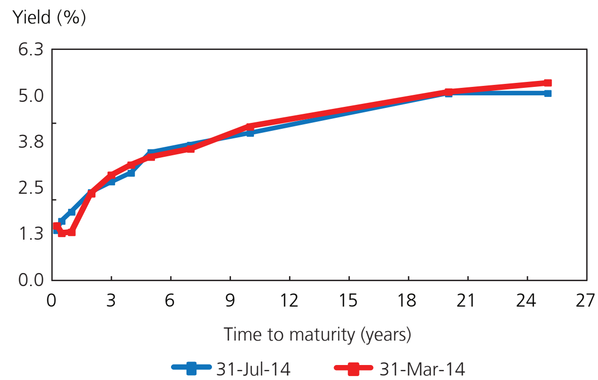
Yields fell 23 bps–54 bps across the length of the curve between end-April and end-May due to Standard & Poor's (S&P) upgrade of the Philippines to BBB from BBB–. Lower-than-expected gross domestic product (GDP) growth in 1Q14 suggests that the BSP may keep policy rates unchanged.

Yields rose again between end-May and end-July as inflation accelerated to 4.5% year-on-year (y-o-y) in May from 4.1% in April. On 19 June, the BSP raised the special deposit account rate by 25 bps to dampen inflation risks arising from increased liquidity in the market. As a result, the yield for the 3-month tenor rose 31 bps, yields for tenors of 5 years and above rose 13bps–32bps.

On 31 July, the BSP raised its key policy rates by 25 bps—bringing the overnight reverse repurchase rate to 3.75% and the overnight repurchase rate to 5.75%—in response to rising inflation expectations.

Inflation fell slightly in June to 4.4% before accelerating again to 4.9% in July. Average inflation for the first 7 months of the year was 4.3%, which is at the upper end of the BSP's 2014 target range of 3%–5%. Current

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



LCY = local currency.
Source: Bloomberg LP.

inflationary pressures are coming from elevated food prices, volatile oil prices, and pending rate adjustments in energy and transport prices.

The Philippines' real GDP growth accelerated to 6.4% y-o-y in 2Q14, following 5.6% growth in 1Q14. However, this was down from the 7.9% growth posted in the same period last year. Growth in 2Q14 was mainly driven by the industrial and services sectors, which expanded 7.8% and 6.0% y-o-y, respectively.

Size and Composition

The Philippine LCY bond market grew 8.8% y-o-y at end-June, led by Treasury and corporate bonds **(Table 1)**. Total LCY bonds reached PHP4,492 billion (US$103 billion), up 1.4% from end-March's level of PHP4,429 billion. Government securities accounted for the majority of bonds outstanding, totaling PHP3,819 billion, while corporate bonds summed to PHP673 billion.

Government Bonds. Outstanding fixed-income instruments issued by the Philippine government and government-controlled companies rose 1.9% quarter-on-quarter (q-o-q) and 6.5% y-o-y to close at PHP3,819 billion at end-June. Treasury bills decreased 1.6% q-o-q and 6.4% y-o-y to stand at PHP288 billion at end-June. The Bureau of the Treasury (BTr) rejected some of its Treasury bill auctions as investors

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

	Outstanding Amount (billion)						Growth Rate (%)			
	2Q13		1Q14		2Q14		2Q13		2Q14	
	PHP	US$	PHP	US$	PHP	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	**4,128**	**96**	**4,429**	**99**	**4,492**	**103**	**3.0**	**13.2**	**1.4**	**8.8**
Government	3,587	83	3,749	84	3,819	87	3.2	13.8	1.9	6.5
Treasury Bills	308	7	293	7	288	7	6.4	20.9	(1.6)	(6.4)
Treasury Bonds	3,165	73	3,340	75	3,415	78	3.0	14.2	2.2	7.9
Others	113	3	116	3	116	3	0.0	(8.5)	0.0	2.1
Corporate	541	13	680	15	673	15	1.7	9.3	(1.1)	24.4

( ) = 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 an LCY base and do not include currency effects.
4. "Others" comprise bonds issued by government agencies, entities, and corporations for which repayment is guaranteed by the Government of the Philippines. This includes bonds issued by Power Sector Assets and Liabilities Management (PSALM) and the National Food Authority, among others.
5. Peso Global Bonds (PHP-denominated bonds payable in US dollars) and multi-currency Retail Treasury Bonds (RTBs) are not included. As of end-June 2014, the Government of the Philippines and Petron Corporation had PHP129.7 billion and PHP20.0 billion of outstanding Peso Global Bonds, respectively. There was a total of PHP9.0 billion of outstanding multi-currency Treasury Bonds as of end-June 2014.

Sources: Bloomberg LP and Bureau of the Treasury.

sought higher yields given rising inflationary concerns. Treasury bonds increased 2.2% q-o-q and 7.9% y-o-y to PHP3,415 billion. Fixed-income instruments issued by government-controlled companies remained unchanged at PHP116 billion.

In terms of issuance, 2Q14 saw higher volume at PHP177 billion compared to PHP150 billion in 1Q14, due to more successful government bond auctions by BTr. The government has programmed LCY borrowing of PHP135 billion through its regular auction schedule in 3Q14: PHP60 billion of Treasury bills with 91-, 182-, and 364-day tenors; and PHP75 billion of Treasury bonds with 7-, 10-, and 20-year tenors.

Corporate Bonds. Total outstanding LCY corporate bonds increased 24.4% y-o-y to reach PHP673 billion at end-June, but declined 1.1% on a quarterly basis.

Table 2: Notable LCY Corporate Bond Issuance in 2Q14

Corporate Issuers	Coupon Rate (%)	Issued Amount (PHP billion)
San Miguel Brewery		
7-year bond	5.50	12.46
10-year bond	6.00	2.54
SM Investments		
7-year bond	5.30	11.67
10-year bond	5.61	3.33
Ayala Land		
11-year bond	5.63	8.00
RCBC		
10-year Tier 2 note	5.38	7.00
Cebu Holdings		
7-year bond	5.32	5.00
Vista Land		
5.5-year bond	5.65	4.32
7-year bond	5.94	0.67
Philippine Savings Bank		
10-year Tier 2 note	5.50	3.00

LCY = local currency.
Source: Bloomberg LP.

Total corporate bond issuance in 2Q14 stood at PHP58 billion. Seven companies issued bonds and Tier 2 notes. San Miguel Brewery and SM Investments were the largest issuers in 2Q14, raising PHP15 billion worth of bonds each, Ayala Land was third with PHP8 billion, and RCBC was fourth with PHP7 billion **(Table 2)**.

Only 54 companies are actively tapping the bond market in the Philippines. The top 30 issuers accounted for 88.5% of total LCY corporate bonds outstanding at end-June **(Table 3)**. Out of this group, only seven companies were privately-held corporations and the rest were publicly listed with the Philippine Stock Exchange. Ayala Land was the largest corporate issuer in the country as of end-June with PHP57.9 billion of outstanding debt, SM Investments was the next largest borrower (PHP41.9 billion) and Ayala Corporation was third (PHP40.0 billion).

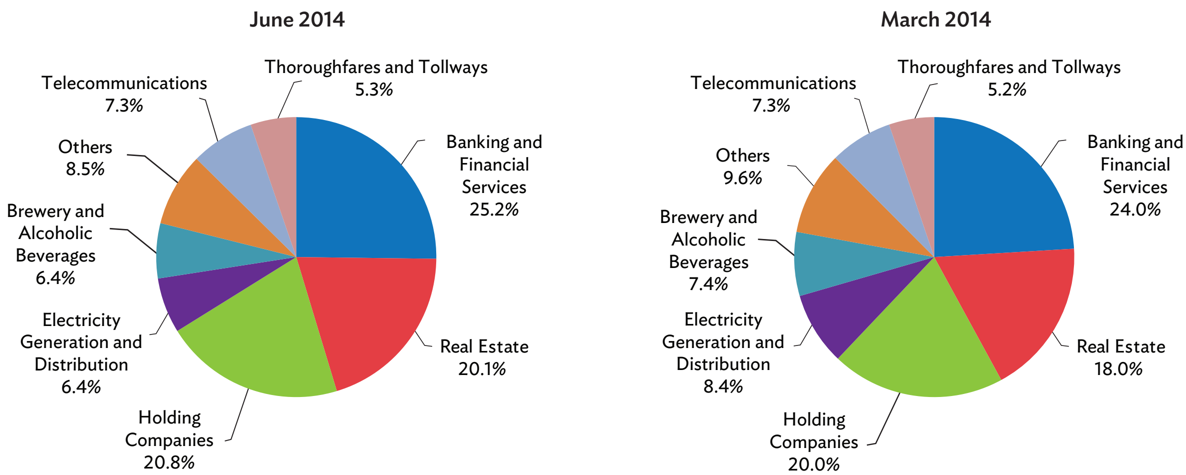
The diversity of LCY corporate bond issuers in 2Q14 was comparable with that in 1Q14 **(Figure 2)**. Banks and financial services, including investment houses, remained the leading issuers of debt in 2Q14 with 25.2% of the total as the BSP moved toward more stringent liquidity and capital requirements. The market share of most industries remained unchanged, except for real estate, which increased to 20.1% from 18.0%. Firms from industries as diverse as electricity generation and distribution, telecommunications, and thoroughfares and tollways

Table 3: Top 30 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.	Ayala Land	57.9	1.3	No	Yes	Real Estate
2.	SM Investments	41.9	1.0	No	Yes	Diversified Operations
3.	Ayala Corporation	40.0	0.9	No	Yes	Diversified Operations
4.	JG Summit Holdings	39.0	0.9	No	Yes	Diversified Operations
5.	San Miguel Brewery	37.8	0.9	No	Yes	Brewery
6.	Philippine Long Distance Telephone	29.8	0.7	No	Yes	Telecommunications
7.	Philippine National Bank	27.6	0.6	No	Yes	Banking
8.	Metrobank	26.0	0.6	No	Yes	Banking
9.	Meralco	23.5	0.5	No	Yes	Electricity Distribution
10.	RCBC	22.0	0.5	No	Yes	Banking
11.	Filinvest Land	21.5	0.5	No	Yes	Real Estate
12.	BDO Unibank	20.0	0.5	No	Yes	Banking
13.	Energy Development Corporation	19.0	0.4	No	Yes	Electricity Generation
14.	Globe Telecom	17.0	0.4	No	Yes	Telecommunications
15.	Maynilad Water Services	16.6	0.4	No	No	Water
16.	MCE Leisure	15.0	0.3	No	No	Casino Services
17.	SM Development	14.3	0.3	No	Yes	Real Estate
18.	Manila North Tollways	13.0	0.3	No	No	Transport Services
19.	Security Bank	13.0	0.3	No	Yes	Banking
20.	First Metro Investment	12.0	0.3	No	No	Investment Banking
21.	MTD Manila Expressway	11.5	0.3	No	No	Transport Services
22.	South Luzon Tollway	11.0	0.3	No	No	Transport Services
23.	GT Capital Holdings	10.0	0.2	No	Yes	Investment Companies
24.	United Coconut Planters Bank	9.5	0.2	No	No	Banking
25.	Filinvest Development	8.8	0.2	No	Yes	Real Estate
26.	Petron	8.4	0.2	No	Yes	Oil Refining and Marketing
27.	Aboitiz Equity Ventures	8.0	0.2	No	Yes	Diversified Operations
28.	Allied Bank	8.0	0.2	No	Yes	Banking
29.	Union Bank of the Philippines	6.8	0.2	No	Yes	Banking
30.	Megaworld	6.4	0.1	No	Yes	Real Estate
Total Top 30 LCY Corporate Issuers		**595.3**	**13.6**			
Total LCY Corporate Bonds		**673.0**	**15.4**			
Top 30 as % of Total LCY Corporate Bonds		**88.5%**	**88.5%**			

LCY = local currency.
Notes:
1. Data as of end-June 2014.
2. Petron has PHP20 billion of Global Peso Bonds outstanding that were 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



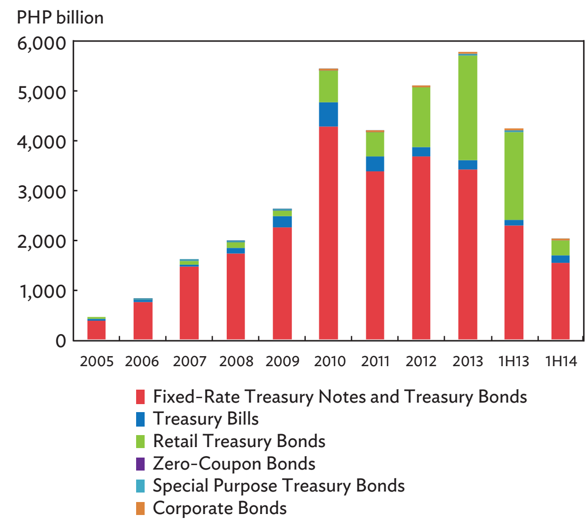
LCY = local currency.
Source: Bloomberg LP.

had 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 captures the secondary trading of listed fixed-income issues. The volume of secondary trading of government securities surged from PHP438 billion in 2005 to PHP5,732 billion in 2013 **(Figure 3)**.

Total trading volume of bonds for the first half of 2014 dropped 52.0% y-o-y to PHP2,003 billion from PHP4,180 billion in the same period in 2013, as the market remained cautious due to domestic inflation concerns and tapering by the United States Federal Reserve. Between January 2005 and June 2014, Treasury bonds accounted for the largest share of total trading volume at about 76%, followed by Retail Treasury Bonds at about 17%.

Figure 3: PDEx Trade Volume Trends—Government Securities

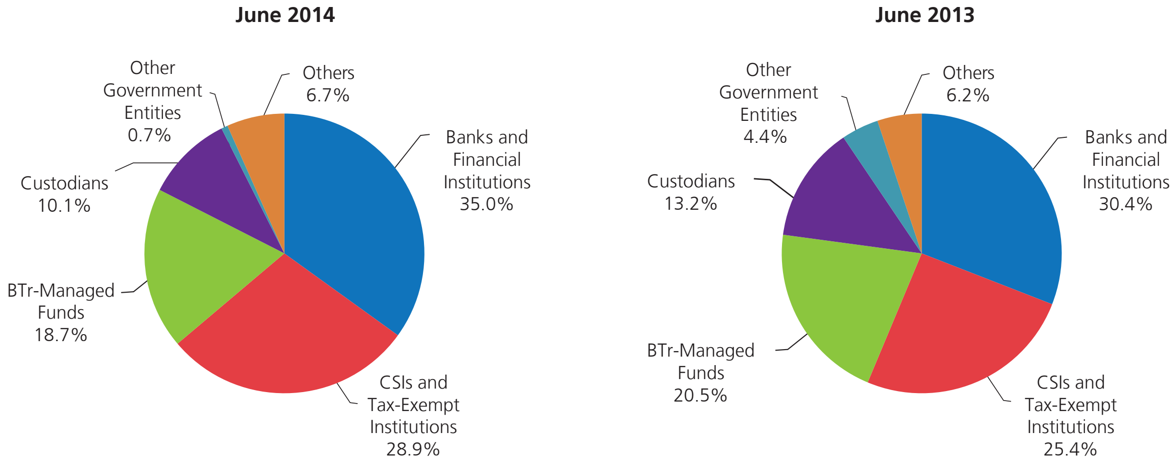


Notes:
1. PDEx reports one side of the trade only.
2. Data on Corporate Bonds started in 2010.
Source: Philippine Dealing and Exchange Corporation (PDEx).

Investor Profile

The largest grouping of investors in government securities in 2Q14 comprised banks and financial institutions, with a 35.0% of the total **(Figure 4)**. This was up slightly from a share of 30.4% in 2Q13. Contractual savings institutions—including the Social Security System, Government Service Insurance System, Pag-ibig, and life insurance companies—and tax-exempt institutions—such as trusts and other tax-exempt entities—accounted for 28.9% of the total in 2Q14, up from 25.4% in 2Q13. The share of funds being managed by BTr, which includes the Bond Sinking Fund, fell to 18.7% in 2Q14 from 20.5% in 2Q13. The participation of custodians slightly decreased to 10.1% from 13.2%. The share of other government entities and other investors, which include individuals and private corporations, also decreased to 7.4% in 2Q14 from 10.6% in 2Q13.

Figure 4: LCY Government Bonds Investor Profile



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

Rating Changes

On 7 May, S&P upgraded its long-term sovereign credit rating for the Philippines to BBB from BBB–, and its short-term rating to A-2 from A-3, with a stable outlook for both. S&P raised both ratings based on expectations that the government will be able to maintain its structural, administrative, institutional, and governance reforms after the presidential election in 2016. The ratings also reflect the Philippines' sustained low level of inflation and low interest rates, strong external liquidity and international investment positions, and effective monetary policy framework.

Policy, Institutional, and Regulatory Developments

BSP to Monitor Banks' Real Estate Exposure

On 11 June, the Monetary Board of the BSP approved preemptive macroprudential policy measures to monitor the exposure of the banking system to real estate development. This policy, which includes stress tests, reinforces the requirement for banks to have sufficient capital to withstand shocks that could affect their credit risk exposure to real estate. The stress tests are in accordance with international standards under the Basel Accords. Universal, commercial, and thrift banks are required to meet a Capital Adequacy Ratio of 10% of qualifying capital (QC) after adjusting for the stress test results. Universal and commercial banks, and their thrift bank subsidiaries are also required to maintain a level of Common Equity Tier 1 equivalent to at least 6% of QC after adjusting for the stress test. For stand-alone thrift banks, a Tier 1 ratio of 6% of QC is required.