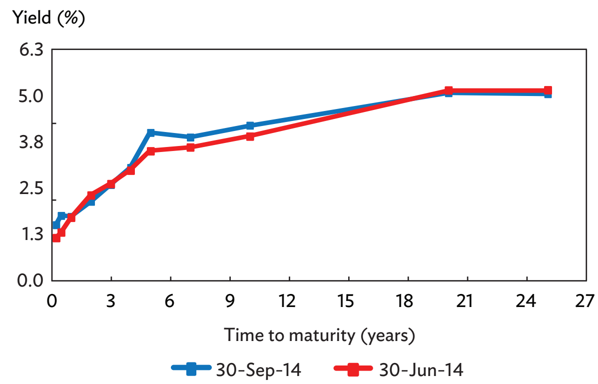
Philippines

Yield Movements

Between end-June and end-September, yields rose for most tenors of Philippine local currency (LCY) bonds **(Figure 1)**. Yields for the 3-month and 6-month tenors rose 35 basis points (bps) and 45 bps, respectively. Yields for bonds with tenors of between 5 years and 10 years rose 27 bps–50 bps. Meanwhile, yields for the 20-year and 25-year tenors fell 7 bps and 11 bps, respectively. The rise in yields was a result of inflationary concerns amid speculation over continued monetary tightening by the Bangko Sentral ng Pilipinas (BSP).

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



LCY = local currency.
Source: Bloomberg LP.

On 31 July, the BSP raised its key policy rates 25 bps each, bringing the overnight borrowing rate to 3.75% and the overnight lending rate to 5.75%. On 11 September, the BSP decided to raise by an additional 25 bps the (i) overnight borrowing rate to 4.0%; (ii) the overnight lending rate to 6.0%; and (iii) interest rates on term reverse repurchases, repurchases, and the special deposit account facility. Reserve requirement ratios were left unchanged. According to the BSP, it raised rates because its 2015 inflation target of 3.0±1% was at risk due to rising food prices and a potential upward adjustment to utility prices.

Inflation remained elevated in 3Q14, accelerating to 4.9% year-on-year (y-o-y) in July from 4.4% in June. Inflation remained steady at 4.9% in August before slowing to 4.4% again in September. Average inflation for the first 9 months of the year was 4.4%, which is at the upper-end of the BSP's 2014 target range of 4.0±1%.

The Philippines' real gross domestic product (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. For the first half of 2014, real GDP grew 6.0% y-o-y.

Size and Composition

The Philippine LCY bond market grew 2.3% quarter-on-quarter (q-o-q) in 3Q14, led by Treasury and corporate bonds, to reach PHP4,595 billion (US$102 billion) at end-September **(Table 1)**. Government securities accounted for the majority of bonds outstanding, totaling PHP3,846 billion, while corporate bonds summed to PHP749 billion. On a y-o-y basis, the LCY bond market had grown 6.7% as of end-September.

Government Bonds. Outstanding fixed-income instruments issued by the Philippine government and government-controlled companies slightly increased 0.7% q-o-q and 2.2% y-o-y to close at PHP3,846 billion at end-September. Treasury bills decreased 1.2% q-o-q and 8.0% y-o-y to stand at PHP285 billion at end-September. The Bureau of the Treasury (BTr) rejected some of its Treasury bill auctions as the market continued to seek higher yields amid rising inflationary concerns and policy rate hikes.

Treasury bonds increased 0.9% q-o-q and 3.2% y-o-y to PHP3,445 billion. In August, BTr conducted another bond exchange program as part of its domestic liability management exercise. The total issue size of PHP140 billion included PHP122 billion worth of exchange offers from existing bondholders. The resulting increase from this program and from bond auctions was capped, given that PHP55 billion worth of retail Treasury bonds also matured in 3Q14. Meanwhile, fixed-income instruments issued by government-controlled companies remained unchanged in 3Q14 at PHP116 billion.

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

	Outstanding Amount (billion)						Growth Rate (%)			
	3Q13		2Q14		3Q14		3Q13		3Q14	
	PHP	US$	PHP	US$	PHP	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	**4,307**	**99**	**4,492**	**103**	**4,595**	**102**	**4.3**	**13.3**	**2.3**	**6.7**
Government	3,763	87	3,819	87	3,846	86	4.9	14.5	0.7	2.2
Treasury Bills	310	7	288	7	285	6	0.6	18.4	(1.2)	(8.0)
Treasury Bonds	3,339	77	3,415	78	3,445	77	5.5	15.2	0.9	3.2
Others	113	3	116	3	116	3	0.0	(8.8)	0.0	2.1
Corporate	544	13	673	15	749	17	0.6	5.8	11.3	37.6

( ) = 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-September 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 PHP6.2 billion of outstanding multi-currency Treasury Bonds as of end-September 2014.
Sources: Bloomberg LP and Bureau of the Treasury.

In terms of issuance, 3Q14 saw higher volume at PHP257 billion compared with PHP177 billion in 2Q14, primarily due to the PHP140.4 billion bond swap held in August. The government has programmed LCY borrowing of PHP135 billion through its regular auction schedule in 4Q14: PHP60 billion of Treasury bills with 91-, 182-, and 364-day tenors; and PHP75 billion of Treasury bonds with 3-, 5-, and 7-year tenors.

Corporate Bonds. Total outstanding LCY corporate bonds increased 11.3% q-o-q and 37.6% y-o-y to reach PHP749 billion. Total corporate bond issuance in 3Q14 stood at PHP66.2 billion. Seven companies issued bonds and Tier 2 notes. SM Prime Holdings was the largest issuer in 3Q14, raising PHP20 billion worth of bonds, GT Capital was second with PHP12 billion, followed by Aboitiz Power and Security Bank with PHP10 billion each **(Table 2)**.

Table 2: Notable LCY Corporate Bond Issuance in 3Q14

Corporate Issuers	Coupon Rate (%)	Issued Amount (PHP billion)
SM Prime Holdings		
5.5-year bond	5.10	15.04
7-year bond	5.20	2.36
10-year bond	5.74	2.60
GT Capital Holdings		
5-year bond	4.71	3.00
7-year bond	5.20	5.00
10-year bond	5.63	4.00
Aboitiz Power		
7-year bond	5.21	6.60
12-year bond	6.10	3.40
Security Bank		
10-year Tier 2 note	5.38	10.00
Metrobank		
10-year Tier 2 note	5.25	6.50
East West Bank		
10-year Tier 2 note	5.50	5.00
Century Properties		
3-year bond	6.00	1.19
5.5-year bond	6.69	1.39
7-year bond	6.98	0.12

LCY = local currency.
Source: Bloomberg LP.

There were 53 companies that had outstanding stock of bonds as of end-September. The top 31 issuers accounted for 87.9% of the total amount of LCY corporate bonds outstanding at end-September **(Table 3)**. Out of the top 31 bond issuers, only eight companies were privately held corporations and the rest were publicly listed with the Philippine Stock Exchange (PSE). Ayala Land remained the largest corporate issuer in the country with PHP57.9 billion of outstanding debt at end-September. SM Investments was the next largest borrower with PHP41.9 billion outstanding. Ayala Corporation was in the third spot with PHP40.0 billion of outstanding bonds.

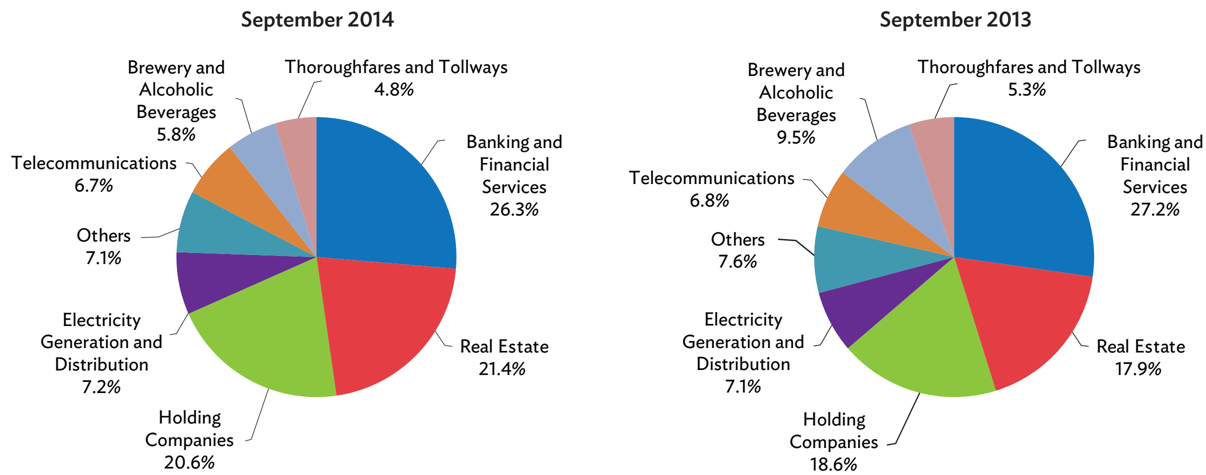
The diversity of LCY corporate bond issuers in 3Q14 was comparable with that in 3Q13 **(Figure 2)**. Banks and financial services, including investment houses, remained the leading issuers of debt in 3Q14 with 26.3% of the total, down from a share of 27.2% in 3Q13. The market share of most industries remained relatively unchanged, except for real estate, which increased to 21.4% from 17.9%; holding companies, which increased to 20.6% from 18.6%; and brewery and alcoholic beverages, which decreased to 5.8% from 9.5%. Firms from industries as diverse as electricity generation and distribution,

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.	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	No	Brewery
6.	Metrobank	32.5	0.7	No	Yes	Banking
7.	Philippine Long Distance Telephone	29.8	0.7	No	Yes	Telecommunications
8.	Philippine National Bank	27.6	0.6	No	Yes	Banking
9.	RCBC	25.0	0.6	No	Yes	Banking
10.	SM Prime Holdings	25.0	0.6	No	Yes	Real Estate
11.	Meralco	23.5	0.5	No	Yes	Electricity Distribution
12.	Security Bank	23.0	0.5	No	Yes	Banking
13.	GT Capital Holdings	22.0	0.5	No	Yes	Investment Companies
14.	Filinvest Land	21.5	0.5	No	Yes	Real Estate
15.	BDO Unibank	20.0	0.5	No	Yes	Banking
16.	Energy Development Corporation	19.0	0.4	No	Yes	Electricity Generation
17.	Globe Telecom	17.0	0.4	No	Yes	Telecommunications
18.	Maynilad Water Services	16.5	0.4	No	No	Water
19.	MCE Leisure	15.0	0.3	No	No	Casino Services
20.	SM Development	14.3	0.3	No	Yes	Real Estate
21.	Manila North Tollways	13.0	0.3	No	No	Transport Services
22.	First Metro Investment	12.0	0.3	No	No	Investment Banking
23.	MTD Manila Expressway	11.5	0.3	No	No	Transport Services
24.	South Luzon Tollway	11.0	0.3	No	No	Transport Services
25.	Aboitiz Power	10.5	0.2	No	Yes	Electricity Generation
26.	United Coconut Planters Bank	9.5	0.2	No	No	Banking
27.	East West Bank	9.3	0.2	No	Yes	Banking
28.	Filinvest Development	8.8	0.2	No	Yes	Real Estate
29.	Petron	8.4	0.2	No	Yes	Oil Refining and Marketing
30.	Allied Bank	8.0	0.2	No	Yes	Banking
31	Aboitiz Equity Ventures	8.0	0.2	No	Yes	Diversified Operations
Total Top 31 LCY Corporate Issuers		**658.5**	**15.1**			
Total LCY Corporate Bonds		**749.1**	**17.2**			
Top 31 as % of Total LCY Corporate Bonds		**87.9%**	**87.9%**			

LCY = local currency.
Notes:
1. Data as of end-September 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



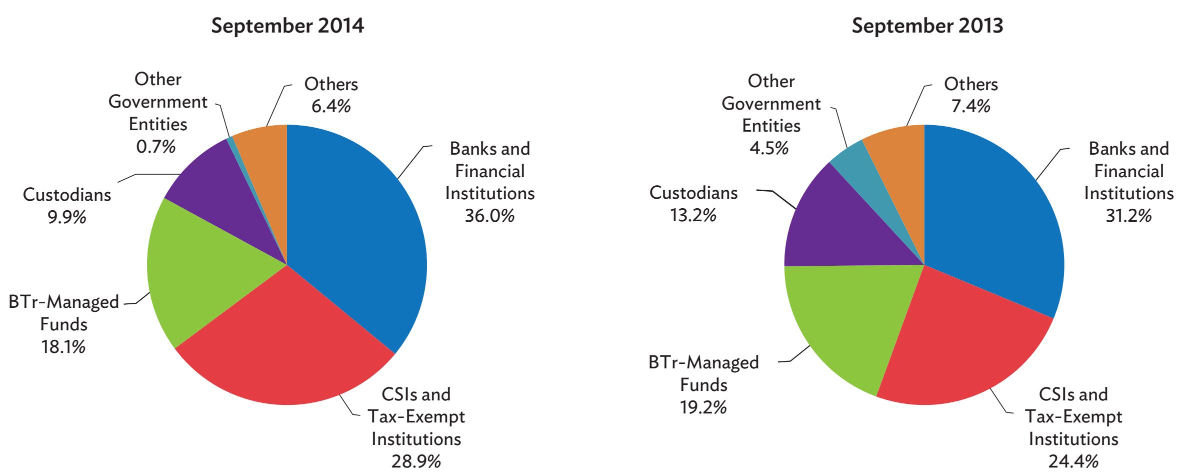
LCY = local currency.
Source: Bloomberg LP.

telecommunications, and thoroughfares and tollways continued to have shares of total corporate bonds outstanding in the single-digit levels.

Investor Profile

The largest grouping of investors in government securities in 3Q14 comprised banks and financial institutions with a 36.0% share of the total **(Figure 3)**, this was up from a 31.2% share in 3Q13. 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 3Q14, up from 24.4% in 3Q13. The shares of funds being managed by BTr, including the Bond Sinking Funds, and custodians fell slightly to 18.1% in 3Q14 from 19.2% in 3Q13. The participation of custodians also decreased to 9.9% from 13.2%. The share of other government entities and

Figure 3: LCY Government Bonds Investor Profile



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

other investors, which include individuals and private corporations, also decreased to 7.1% in 3Q14 from 11.9% in 3Q13.

Policy, Institutional, and Regulatory Developments

BTr Issues Circular for LCY Government Securities Secondary Market

On 22 September, BTr issued a circular on the Revised Rules and Regulations for the Issuance, Placement, Sale, Service, and Redemption of Treasury Bills and Bonds under Republic Act No. 245 (as amended). The circular provides guidance on the implementation of non-restricted trading across tax categories in the secondary market for Philippine LCY coupon-bearing government securities, with the intention of deepening liquidity in the bond market and providing additional investment avenues for tax-exempt institutions and individuals. The circular also covered the tax-tracking mechanisms and operating guidelines to be used in the trading and settlement of the bonds. These include the establishment and opening of a Securities Account for Tax Tracking (SATT), the monitoring of the balances in the SATT, the assignment of an Investor Code associated with the SATT, and the reimbursement of any final withholding tax—to be calculated by a tax-tracking facility—that may have been deducted from the proceeds of the tax exempt holder or seller. The circular is targeted to take effect on 27 October.

Bank of Japan and BSP Sign Third Bilateral Swap Arrangement

On 17 October, the Bank of Japan and the Bangko Sentral ng Pilipinas signed their third Bilateral Swap Arrangement, which is an expansion of a prior agreement. The new arrangement allows a swap between US dollars and Philippine pesos of up to US$12 billion from Japan, and allows the swap between US dollars and Japanese yen of up to US$500 million from the Philippines. The arrangement also includes a crisis prevention scheme to address possible liquidity needs.

BSP Increases Minimum Capital Requirement for Banks

On 20 October, the Monetary Board of the BSP decided to increase the minimum capital requirement for all bank categories to further strengthen the banking system. The BSP noted that this is different from the Basel III requirements as implemented by previous BSP circulars. The new minimum capital requirement for universal and commercial banks will be tiered based on a bank's network size, as measured by the number of branches. For thrift, rural, and cooperative banks, the head office location and size of the physical network are to be considered in the tiering. Banks that will not immediately comply with the new capital requirement may avail of a 5-year transition period. These banks will be required to submit an acceptable capital build-up program. The banks that fail to submit an acceptable program and those that fail to comply with the new capital requirements shall be subject to restrictions on future expansion plans.