

Philippines

Yield Movements

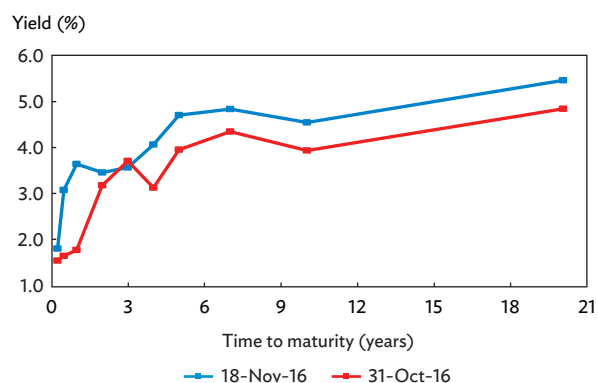
Between 31 October and 18 November, Philippine local currency (LCY) government bond yields rose for all tenors except the 3-year tenor, which fell 14 basis points (bps) (**Figure 1**). Yields rose the most for the 6-month and 1-year tenors, which soared 142 bps and 186 bps, respectively. Yields for tenors between 2-years and 20-years rose 61 bps on average. The yield spread between the 2-year and 10-year tenors widened to 108 bps on 18 November from 75 bps on 31 October.

Yields have been on an upward trend since an uptick was observed in the middle of September ahead of central bank monetary policy meetings in Japan, the Philippines, and the United States (US). Yields likewise rose in October amid expectations of higher US inflation and an increased probability of a US policy rate hike at the end of the year. Yields jumped in November following the outcome of the US presidential election. Markets expect higher inflation in the US as the new administration has expressed its desire to increase fiscal spending. This has further strengthened the case for the US Federal Reserve to push through with a federal funds rate hike in December and it may continue raising rates in 2017 more quickly than previously expected.

The Monetary Board of the Bangko Sentral ng Pilipinas (BSP) decided during its 22 September and 10 November meetings to keep the interest rate on the overnight reverse repurchase facility at 3.0%. The board also kept interest rates on the overnight deposit and lending facilities unchanged and maintained the reserve requirement ratios at their current levels. However, in its 10 November monetary policy meeting, the BSP announced its expectations for inflation to rise to the midpoint of its target range in 2017 and 2018. The BSP noted upward pressures on inflation coming from pending adjustments in power rates and the proposed tax policy reform program. Inflation remained benign in the third quarter (Q3) of 2016 at 1.9% y-o-y in July, 1.8% y-o-y in August, and a 2.3% y-o-y in September. In October, inflation was unchanged at 2.3% y-o-y.

The Philippines' economy grew 7.1% y-o-y in Q3 2016, following growth of 7.0% y-o-y in the second quarter

Figure 1: Philippines' Benchmark Yield Curve—Local Currency Government Bonds



Source: Based on data from Bloomberg LP.

of 2016, and remained the fastest-growing economy in the region. Growth continues to be supported by private consumption, which grew 7.3% y-o-y, and robust investment, which increased 20.0% y-o-y. By industry, the economy's expansion was driven primarily by sustained growth in the industry and services sectors.

Size and Composition

The Philippine LCY bond market expanded in Q3 2016 by 2.4% quarter-on-quarter (q-o-q) and 1.6% y-o-y to reach PHP4,800 billion (USD99 billion) at the end of September (**Table 1**). The government bond market, with an outstanding size of PHP3,955 billion at the end of September, grew 1.9% q-o-q and 0.4% y-o-y in Q3 2016, buoyed by increases in Treasury bills and bonds. The corporate bond market registered relatively high growth rates of 4.6% q-o-q and 7.7% y-o-y in Q3 2016 for a total of PHP845 billion worth of outstanding bonds at the end of September.

The top 30 issuers in the LCY corporate bond market had combined bonds outstanding of PHP751.3 billion at the end of September, which amounted to 89% of total LCY corporate bonds outstanding (**Table 2**). The top three LCY corporate issuer groups in the Philippines are banks, property companies, and holding firms, with bonds outstanding that comprise 27.5%, 24.4%, and 20.1%, respectively, of the total market (**Figure 2**). Across all issuer groups, banks posted the biggest y-o-y drop in their

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q3 2015		Q2 2016		Q3 2016		Q3 2015		Q3 2016	
	PHP	USD	PHP	USD	PHP	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	4,723	101	4,688	99	4,800	99	1.7	2.8	2.4	1.6
Government	3,939	84	3,880	82	3,955	82	1.1	2.4	1.9	0.4
Treasury Bills	282	6	288	6	293	6	2.6	(0.9)	1.8	3.7
Treasury Bonds	3,577	77	3,517	75	3,587	74	1.0	3.8	2.0	0.3
Others	80	2	76	2	76	2	0.0	(30.9)	0.0	(5.6)
Corporate	784	17	808	17	845	17	4.7	4.8	4.6	7.7

() = negative, PHP = Philippine peso, q-o-q = quarter-on-quarter, Q2 = second quarter, Q3 = third quarter, USD = United States dollar, y-o-y = year-on-year.

Notes:

1. Calculated using data from national sources.

2. Bloomberg end-of-period local currency-USD rates are used.

3. Growth rates are calculated from a local currency 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) are not included.

Sources: Bloomberg LP and Bureau of the Treasury.

respective share of the total while utility firms recorded the largest y-o-y increase.

LCY bond issuance surged 103.0% q-o-q but dropped 17.3% y-o-y to PHP369.9 billion in Q3 2016. Issuance of government securities, which include Treasury bills and bonds, soared 85.6% q-o-q but plunged 19.9% y-o-y to PHP325.0 billion. The largest issuance of government securities during the quarter was September's sale of Retail Treasury Bonds worth PHP100 billion maturing in 10 years and carrying a 3.5% coupon.

Issuance of corporate bonds increased on both a q-o-q and y-o-y basis in Q3 2016, gaining 540.7% q-o-q and 9.4% y-o-y to total PHP44.9 billion. Among the notable corporate bond issues during Q3 2016 were (i) SMC Global Power Holdings' PHP15 billion triple-tranche fixed-rate bonds sale in July, (ii) Ayala Corporation's PHP10 billion 7-year fixed-rate bonds sold in July, (iii) SM Prime Holdings' PHP10 billion 10-year fixed-rate bonds issued in July, and (iv) Metropolitan Bank & Trust Company's (Metrobank) PHP8.65 billion long-term negotiable certificates of time deposit maturing in 7 years that were sold in September (**Table 3**). The bonds of Ayala Corporation and SM Prime Holdings were part of an enhanced shelf registration program, launched in November 2015, that allows corporate issuers of securities to time their fund-raising activities as needed and/or to take advantage of favorable market conditions. According to the Securities and Exchange Commission, the shelf registration program has helped boost the issuance of corporate securities thus far in 2016.

Investor Profile

Banks and investment houses were the most dominant investor group in the Philippine government bond market, with their holdings of government securities comprising 37.0% of the total at the end of September (**Figure 3**). The second-largest holder of government securities were contractual savings institutions (specifically insurance companies) and tax-exempt institutions with a combined holdings share of 31.4%. Among all investor groups shown in Figure 3, the three that experienced increases in their respective holdings shares between September 2015 and September 2016 were (i) contractual savings institutions and tax-exempt institutions; (ii) banks and investment houses; and (iii) brokers, custodians, and depositories.

Ratings Update

S&P Global Ratings announced in September that it had affirmed its long-term and short-term sovereign credit ratings for the Philippines at BBB and A-2, respectively, with a stable outlook for both ratings. The credit rating agency has likewise affirmed its Association of Southeast Asian Nations (ASEAN) regional scale rating for the Philippines at axA/axA-2. S&P Global Ratings stated that its ratings on the Philippines were the result of the country's "strong external position, which features rising foreign reserves and low and declining external debt" that offset the country's "lower middle-income economy and rising uncertainties surrounding the stability, predictability, and accountability of its new government."

Table 2: Top 30 Issuers of Local Currency Corporate Bonds in the Philippines

	Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
		LCY Bonds (PHP billion)	LCY Bonds (USD billion)			
1.	Ayala Land	70.3	1.5	No	Yes	Property
2.	Metrobank	55.4	1.1	No	Yes	Banking
3.	SM Prime	55.0	1.1	No	Yes	Property
4.	Ayala Corporation	50.0	1.0	No	Yes	Holding Firms
5.	San Miguel Brewery	37.8	0.8	No	No	Brewery
6.	BDO Unibank	37.5	0.8	No	Yes	Banking
7.	Aboitiz Equity Ventures	32.0	0.7	No	Yes	Holding Firms
8.	Filinvest Land	32.0	0.7	No	Yes	Property
9.	JG Summit	30.0	0.6	No	Yes	Holding Firms
10.	Philippine National Bank	29.1	0.6	No	Yes	Banking
11.	SM Investments	27.3	0.6	No	Yes	Holding Firms
12.	Meralco	23.5	0.5	No	Yes	Electricity, Energy, and Power
13.	Security Bank	23.0	0.5	No	Yes	Banking
14.	Rizal Commercial Banking Corporation	22.1	0.5	No	Yes	Banking
15.	GT Capital	22.0	0.5	No	Yes	Holding Firms
16.	South Luzon Tollway	18.3	0.4	No	No	Transport
17.	Globe Telecom	17.0	0.4	No	Yes	Telecommunications
18.	East West Bank	16.8	0.3	No	Yes	Banking
19.	Maynilad Water Services	16.2	0.3	No	No	Water and Wastewater Services
20.	MCE Leisure (Philippines)	15.0	0.3	No	No	Casinos and Gaming
21.	Philippine Long Distance Telephone Company	15.0	0.3	No	Yes	Telecommunications
22.	SMC Global Power	15.0	0.3	No	No	Electricity, Energy, and Power
23.	Union Bank of the Philippines	14.0	0.3	No	Yes	Banking
24.	First Metro Investment Corporation	12.0	0.2	No	No	Banking
25.	Robinsons Land	12.0	0.2	No	Yes	Property
26.	Manila North Tollways	11.9	0.2	No	No	Transport
27.	MTD Manila Expressway	11.5	0.2	No	No	Transport
28.	Energy Development Corporation	10.5	0.2	No	Yes	Electricity, Energy, and Power
29.	Aboitiz Power	10.0	0.2	No	Yes	Electricity, Energy, and Power
30.	8990 Holdings	9.0	0.2	No	Yes	Property
Total Top 30 LCY Corporate Issuers		751.3	15.5			
Total LCY Corporate Bonds		845.0	17.4			
Top 30 as % of Total LCY Corporate Bonds		88.9%	88.9%			

LCY = local currency, PHP = Philippine peso, USD = United States dollar.

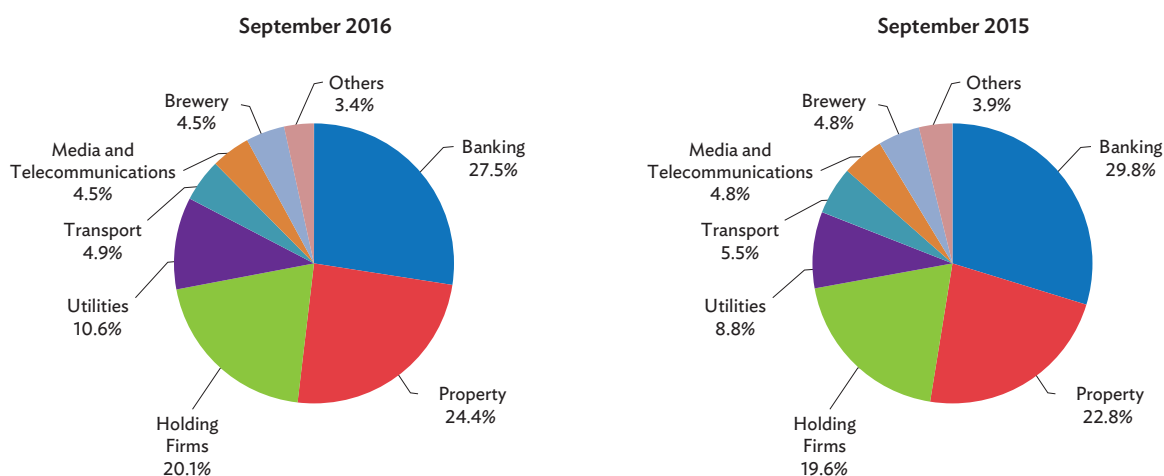
Notes:

1. Data as of end-September 2016.

2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.

Source: *AsianBondsOnline* calculations based on Bloomberg LP data.

Figure 2: Local Currency Corporate Bonds Outstanding by Sector



Source: Based on data from Bloomberg LP.

Table 3: Notable Local Currency Corporate Bond Issuance in Q3 2016

Corporate Issuers	Coupon Rate (%)	Issued Amount (PHP billion)
SMC Global Power		
5-year bond	4.35	6.15
7-year bond	4.76	4.09
10-year bond	5.18	4.76
Ayala Corporation		
7-year bond	3.92	10.00
SM Prime Holdings		
10-year bond	4.20	10.00
Metrobank		
7-year bond	3.50	8.65

PHP = Philippine peso, Q3 = third quarter.
Source: Bloomberg LP.

RAM Ratings, a Malaysian credit rating agency, announced in October that it has upgraded the Philippines' ASEAN-scale rating to $_{sea}A_{1(p)}$ /Stable from $_{sea}A_{2(p)}$ /Positive. The ratings upgrade was based on the rating agency's assessment of the Philippine economy's

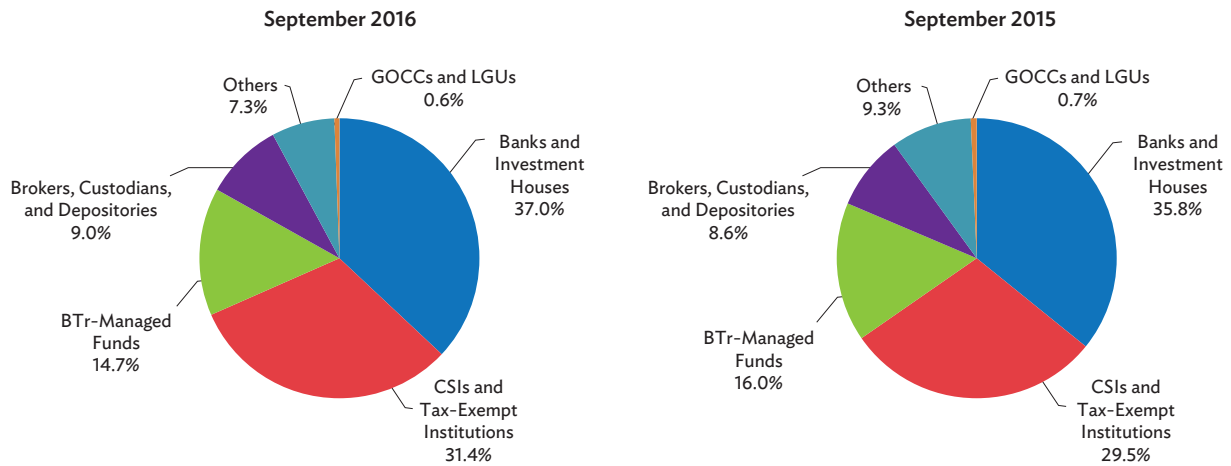
resilience, specifically in terms of favorably "withstanding external volatilities" relative to ASEAN peers as well as the government's "impressive progress" in implementing key administrative and legislative reforms.

Policy, Institutional, and Regulatory Developments

First Tax Reform Package Submitted to Congress in September

The Department of Finance announced in September that it had submitted its first of four tax reform packages to Congress. The proposed tax reform measures include restructuring the personal income tax system, widening the tax base, and adjusting excise taxes on automobiles and petroleum products. The comprehensive tax reform program will enable the government to raise the additional funds needed to increase public infrastructure spending and investments in human capital and social protection.

Figure 3: Local Currency Government Bonds Investor Profile



BTr = Bureau of the Treasury, CSIs = contractual savings institutions, GOCCs = government-owned or -controlled corporations, LGUs = local government units.
 Source: Bureau of the Treasury.