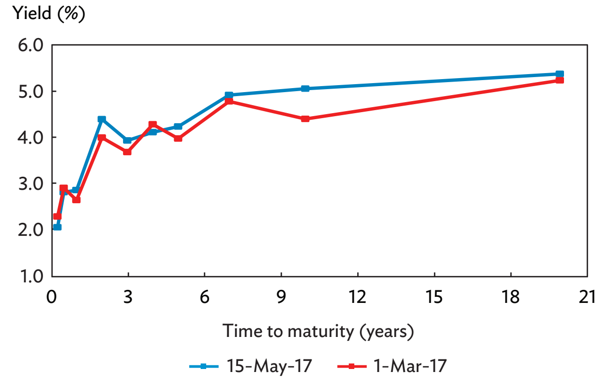
Philippines

Yield Movements

Between 1 March and 15 May, local currency (LCY) government bond yields in the Philippines rose for all tenors except the 3-month, 6-month, and 4-year maturities, whose yields fell by 24, 9, and 17 basis points (bps), respectively (**Figure 1**). Yields increased for government bonds with 1-, 2-, 3-, 5-, 7-, 10-, and 20-year maturities. The largest increase was seen in the yield for 10-year bonds, which advanced 65 bps. The yield spread between 2-year and 10-year tenors widened by 26 bps during the review period.

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



Source: Based on data from Bloomberg LP.

The demand for shorter-dated securities was strong because the market is in a wait-and-see position. Investors will not risk locking up their funds in long-term maturities as they remain on the lookout for policy leads on both the local and external fronts. Strong demand has bid up bond prices at the short-end, resulting in lower yields. On the other hand, advancing yields for most tenors reflect the general perception that interest rates will rise amid expectations of accelerating inflation and hawkish moves by the Bangko Sentral ng Pilipinas (BSP) toward the second half of the year.

Consumer prices in the Philippines rose 3.4% year-on-year (y-o-y) in April, the same pace of inflation from the previous month. Inflation has been trending upward since November 2016, reaching its highest level in more than 2 years in March. Year-to-date through April, the average inflation rate was 3.2% y-o-y, which was within the government's target range of 2%–4% for full-year 2017.

BSP kept its monetary policy unchanged during its meeting on 11 May, leaving the policy rate at 3.0% as it assessed that inflation remained manageable. Rates on the overnight lending and deposit facilities were also unchanged at 3.5% and 2.5%, respectively. Market expectations remained anchored to the inflation target over the policy horizon and the latest inflation forecasts for 2017 and 2018 remained within the target band of 2%–4%. The central bank flagged the proposed tax reform program and possible further adjustments in transport fares and electricity rates as upside risks to inflation. Inflation in the Philippines, while hovering near the upper end, remains within the BSP target band, thus providing enough room to delay a rate hike. The outlook for the domestic economy continued to be optimistic despite some downside risks emanating from external developments.

The Philippine peso barely moved against the United States (US) dollar year-to-date through 15 May. The peso did, however, breach the PHP50 per dollar level in mid-February, where it remained until early April. The peso reached a 10-year low in March against the backdrop of persistent uncertainty associated with the timing of the US Federal Reserve's interest rate hike and the volatile market sentiments surrounding Brexit. Consequently, the US dollar has been strengthening against currencies in Asia as investors resorted to safe-haven buying. In May, the peso began to strengthen against the greenback as the market trimmed expectations of an interest hike from the US Federal Reserve amid weaker-than-expected US inflation.

The Philippines' gross domestic product (GDP) grew at a weaker-than-expected pace of 6.4% y-o-y in the first quarter (Q1) of 2017. GDP growth in Q1 2017 was slower than that posted in the fourth quarter (Q4) of 2016 (6.6% y-o-y) and in Q1 2016 (6.9% y-o-y). It was the slowest expansion of the Philippine economy since recording 6.2% y-o-y growth in the third quarter of 2015. According to the National Economic and Development Authority, the slowing growth in Q1 2017 could be explained by the high base effects from election spending in 2016. Furthermore, the reorientation of government programs, which typically takes some time in a new administration, slowed government spending during the quarter. On the demand side, strong exports helped keep the economy afloat, while on the supply side, the services sector remained the main growth driver. Despite the slower growth, the government still sees the economy broadly in line with its full-year 2017 target GDP growth rate of 6.5%–7.5% as the government has set an ambitious infrastructure program.

Size and Composition

The Philippines' LCY bond market had bonds outstanding at the end of March amounting to PHP4,943 billion (USD98 billion), an increase of 1.5% quarter-on-quarter (q-o-q) and 5.0% y-o-y compared with a q-o-q decline and a slower y-o-y growth at the end of March 2016 (**Table 1**). The increase in the bond stock was supported by gains in both the LCY government and corporate bond segments. At the end of March, government bonds comprised 81.1% of total LCY bonds outstanding and corporate bonds comprised 18.9%.

Government Bonds. LCY government bonds outstanding registered 0.8% q-o-q growth, reaching a total of PHP4,011 billion. The q-o-q expansion was buoyed by Treasury bonds, which increased 1.0% q-o-q, but was dampened by the 0.6% q-o-q decrease in Treasury bills. The size of Treasury bonds increased because of higher issuance in Q1 2017, which was accompanied by low redemptions, while the amount of Treasury bills slightly decreased due to the partial awarding of offers in most auctions during the period. On a y-o-y basis, LCY government bonds outstanding increased 3.0%, driven by 3.3% growth in Treasury bonds and 2.6% growth in Treasury bills. On the other hand, government-owned or -controlled corporation bonds outstanding declined on a y-o-y basis as some bonds matured and there were no new issuances in Q1 2017.

Total LCY bonds issued during Q1 2017 amounted to PHP320.1 billion, up 56.0% q-o-q and 69.0% y-o-y. The government issued PHP267.8 billion of LCY securities during the quarter, more than doubling issuance in Q4 2016 and 51.0% higher compared with Q1 2016. The sharp increases reflect the government capitalizing on the local debt market to finance its ambitious infrastructure plan. Treasury bond issuance reached PHP90 billion and Treasury bill issuance reached PHP177.8 in Q1 2017.[27]

Auctions for Treasury bonds and bills were met with strong demand. However, shorter-dated Treasury bills were partially awarded by the government in most of the auctions due to investors seeking higher rates and the government being more discerning with its rates as it has enough of a cash balance. Longer-dated Treasury bonds were fully awarded as the government sought to lock in lower borrowing costs amid expectations of rate hikes in the second half of the year from the US Federal Reserve and the BSP.

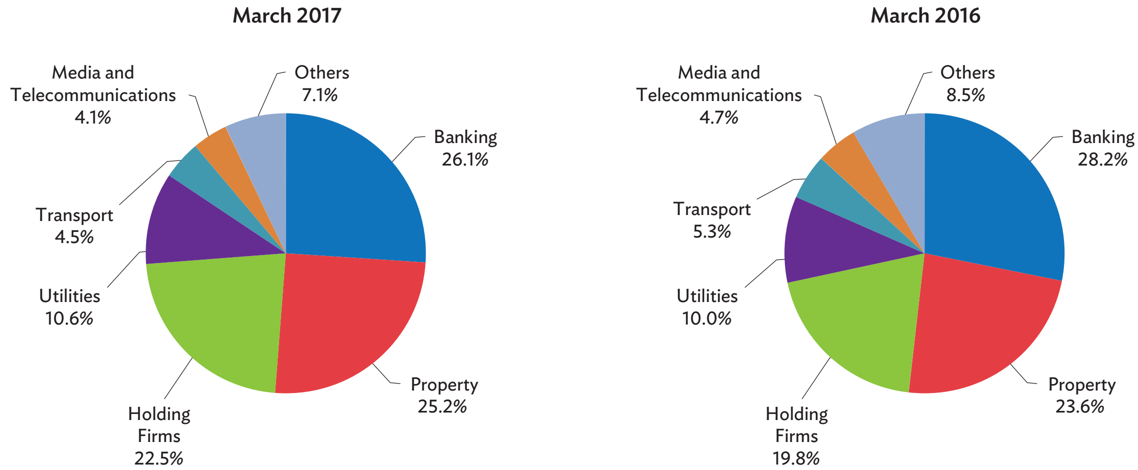
Table 1: Size and Composition of the Local Currency Bond Market in the Philippines

	Outstanding Amount (billion)						Growth Rate (%)			
	Q1 2016		Q4 2016		Q1 2017		Q1 2016		Q1 2017	
	PHP	USD	PHP	USD	PHP	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**4,706**	**102**	**4,869**	**98**	**4,943**	**98**	**(1.1)**	**0.5**	**1.5**	**5.0**
Government	3,893	85	3,978	80	4,011	80	(1.3)	(0.6)	0.8	3.0
Treasury Bills	279	6	288	6	286	6	5.5	0.2	(0.6)	2.6
Treasury Bonds	3,539	77	3,621	73	3,656	73	(1.6)	(0.2)	1.0	3.3
Others	76	2	69	1	69	1	(12.2)	(17.3)	0.0	(8.4)
Corporate	813	18	891	18	932	19	(0.1)	6.3	4.6	14.6

( ) = negative, LCY = local currency, PHP = Philippine peso, q-o-q = quarter-on-quarter, Q1 = first quarter, Q4 = fourth quarter, USD = United States dollar, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg end-of-period LCY–USD 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) are not included.
Sources: Bloomberg LP and Bureau of the Treasury.

[27] Treasury bonds and bills include reissues and special bills.

Figure 2: Local Currency Corporate Bonds Outstanding by Sector



Source: Based on data from Bloomberg LP.

In 2017, the government plans to borrow up to PHP631.3 billion, with 80% coming from local creditors and 20% from foreign creditors.

Corporate Bonds. The LCY corporate bond market was more active in Q1 2017 in terms of growth. LCY corporate bonds outstanding at the end of March increased 4.6% q-o-q and 14.6% y-o-y, reaching PHP932 billion. Compared to the same period in 2016, the q-o-q growth was a turnaround from a decline while y-o-y growth was faster.

The banking sector remained the largest source of LCY corporate bonds outstanding at the end of March, accounting for 26.1% of the total, even though its share fell from 28.2% a year earlier (**Figure 2**). On the other hand, the property sector increased its share to 25.2% at the end of March from 23.6% a year earlier. The expansion in the property sector can be attributed to robust demand for housing units and office space that prompted property firms to tap the debt market. Banking and property remained the top two sectors in terms of the amount of bonds outstanding. Sectors that saw an increase in their share of LCY corporate bonds outstanding during the review period include utilities and holding firms, while media and telecommunications, transport, and other sectors experienced declines.

LCY bonds outstanding of the top 30 corporate issuers amounted to PHP793 billion at the end of March, which represented 89.0% of the Philippines' LCY corporate bond market (**Table 2**). Property firm Ayala Land topped the list with a total of PHP80.3 billion of outstanding bonds. By sector, banks led the group with PHP202.8 billion LCY bonds outstanding, followed closely by property firms with PHP197.2 billion.

Corporate bond issuance in Q1 2017 dropped 27.2% q-o-q but more than tripled on a y-o-y basis. The q-o-q drop can be attributed to the high base in Q4 2016 and the wait-and-see position of companies amid uncertainty surrounding the timing and direction of domestic and external policies. In comparison to Q4 2016's q-o-q growth rate, corporate bond issuance increased 60.0% q-o-q, which can be attributed to very high expectations from market participants that the US Federal Reserve would increase its policy rate in December 2016, prompting companies to cash in on relatively low interest rates to manage borrowing costs ahead of the interest rate hike.

Notable corporate issuers in Q1 2017 are listed in **Table 3**. Property firm Megaworld had the largest bond issuance during the quarter from the single sale of 7-year bonds amounting to PHP12 billion and carrying a coupon rate of 5.35%. This comprised 22.9% of all corporate bonds issued in Q1 2017.

The Philippine Dealing and Exchange Corporation is also looking at the feasibility of opening an alternative funding

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	80.3	1.6	No	Yes	Property
2.	Metrobank	55.4	1.1	No	Yes	Banking
3.	SM Prime	53.8	1.1	No	Yes	Property
4.	Ayala Corporation	50.0	1.0	No	Yes	Holding Firms
5.	SM Investments	47.3	0.9	No	Yes	Holding Firms
6.	San Miguel Brewery	37.8	0.8	No	No	Brewery
7.	BDO Unibank	37.5	0.7	No	Yes	Banking
8.	Philippine National Bank	31.4	0.6	No	Yes	Banking
9.	JG Summit Holdings	30.0	0.6	No	Yes	Holding Firms
10.	Filinvest Land	29.0	0.6	No	Yes	Property
11.	Aboitiz Equity Ventures	24.0	0.5	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	0.4	No	Yes	Banking
15.	GT Capital	22.0	0.4	No	Yes	Holding Firms
16.	San Miguel	20.0	0.4	No	Yes	Holding Firms
17.	East West Bank	19.5	0.4	No	Yes	Banking
18.	Petron	18.6	0.4	No	Yes	Electricity, Energy, and Power
19.	South Luzon Tollway	18.3	0.4	No	No	Transport
20.	Globe Telecom	17.0	0.3	No	Yes	Telecommunications
21.	Maynilad Water Services	15.9	0.3	No	No	Water
22.	MCE Leisure (Philippines)	15.0	0.3	No	No	Casinos and Gaming
23.	Philippine Long Distance Telephone Company	15.0	0.3	No	Yes	Telecommunications
24.	SMC Global Power Holdings	15.0	0.3	No	No	Electricity, Energy, and Power
25.	Union Bank of the Philippines	14.0	0.3	No	Yes	Banking
26.	Megaworld	12.0	0.2	No	Yes	Property
27.	Robinsons Land	12.0	0.2	No	Yes	Property
28.	Manila North Tollways	11.9	0.2	No	No	Transport
29.	MTD Manila Expressways	11.5	0.2	No	No	Transport
30	Vista Land and Lifescapes	10.2	0.2	No	Yes	Property
Total Top 30 LCY Corporate Issuers		**793.0**	**15.8**			
Total LCY Corporate Bonds		**891.2**	**17.8**			
Top 30 as % of Total LCY Corporate Bonds		**89.0%**	**89.0%**			

LCY = local currency, PHP = Philippine peso, USD = United States dollar.
Notes:
1. Data as of end-March 2017.
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.

avenue for public–private entities to issue project bonds to support the government's infrastructure push.

Foreign Currency Bonds. The Government of the Philippines issued USD-denominated Global Bonds in February amounting to USD2.0 billion with a tenor of 25 years and a coupon rate of 3.70%. This marked the Philippines' successful return to the international capital market where the bonds were met with strong demand amid financial market volatility. The Global Bonds comprised a USD1.5 billion switch tender offer for liability management and USD0.5 billion in "new money."

The Government of the Philippines is considering the sale of USD200 million in the second half of 2017 of panda bonds, or Chinese yuan-denominated securities, with tenors of 3 years and 5 years.

Table 3: Notable Local Currency Corporate Bond Issuance in the First Quarter of 2017

Corporate Issuers	Coupon Rate (%)	Issued Amount (PHP billion)
Megaworld		
7-year bond	5.35	12.00
Ayala Corporation		
8-year bond	4.82	10.00
San Miguel		
5-year bond	4.82	6.69
7-year bond	5.28	7.29
10-year bond	5.76	6.02

PHP = Philippine peso.
Source: Bloomberg LP.

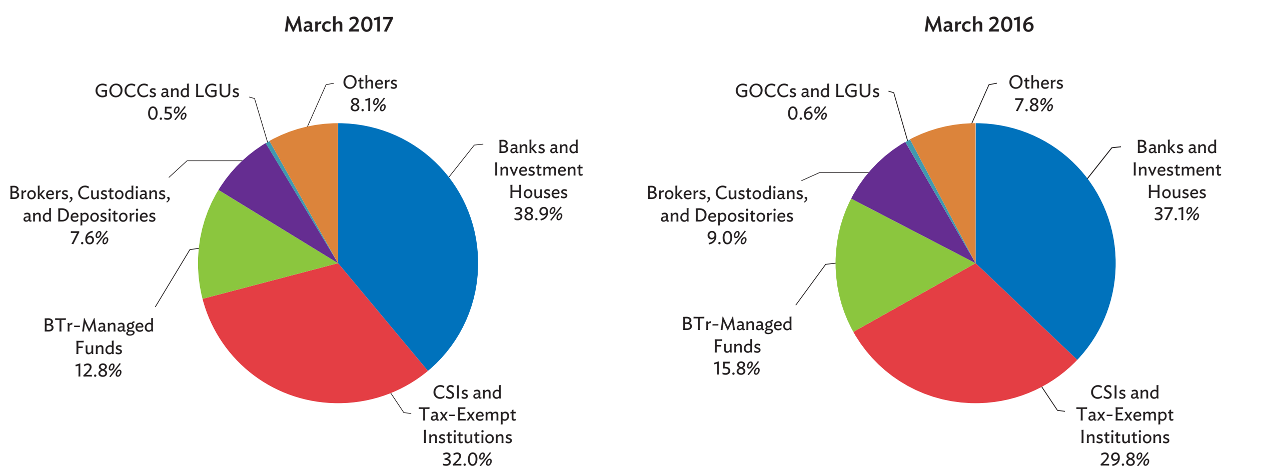
Investor Profile

Banks and investment houses remained the largest investor in LCY government bonds with a total investment of PHP1,545 billion, or a 38.9% share of all investor holdings, at the end of March (**Figure 3**). This was followed by contractual savings institutions and tax-exempt institutions with a total holding of PHP1,268 billion, accounting for 32.0% of the LCY government bond market. Government-owned and -controlled corporations and local government units had the smallest holdings at PHP20 billion. Among investor groups, banks and investment houses, contractual savings institutions and tax-exempt institutions, and "other" investor group saw y-o-y increases, gaining 8.4%,10.9%, and 8.4%, respectively. All other groups experienced y-o-y declines with the highest drop seen in the holdings of the Bureau of the Treasury-managed funds of 15.9% y-o-y.

Ratings Update

Fitch Ratings affirmed the Philippines' investment credit rating with a positive outlook in March. The ratings agency maintained the market's long-term FCY and LCY issuer default ratings at BBB– with a positive outlook. Fitch cited the Philippines' sustained strong economic

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.

growth performance, robust external credit position, and low debt levels compared to similarly rated economies to back the rating affirmation. However, relatively weak governance standards, a narrow government revenue base, and relatively low levels of per capita income and human development took a toll on the rating. Fitch also said that the government's tax reform plan, which can broaden the tax base, alongside the market's resilience to external shocks, could lead to a potential ratings upgrade, while deteriorations in governance standards and implementation risks with regard to tax reform were flagged as having the potential to lead to a downgrade from a positive outlook to stable.

Standard and Poor's (S&P) Global Ratings also maintained its investment grade rating for the Philippines with a stable outlook in April, citing the market's sufficient foreign exchange reserves and low external debt as well as policy environment remaining conducive to sustaining economic growth translating into a stable fiscal position. The Philippines' BBB long-term and A-2 short-term sovereign credit ratings are both a notch above investment grade. S&P stated that improvement in investment and economic growth prospects resulting from the newly calibrated fiscal program could lead to a potential ratings upgrade but warned that if the reform agenda stalls or if the recalibrated fiscal program leads to higher-than-expected deficits, it might lower the ratings.

Policy, Institutional, and Regulatory Developments

Securities and Exchange Commission Raises Minimum Public Float

The Securities and Exchange Commission (SEC) released a draft memorandum circular stating that it will increase the public float of Philippine-listed companies to at least 20% of the companies' issued and outstanding shares from the current 10% starting 1 July. Companies applying for an initial public offering should immediately comply with the minimum public ownership requirement, while currently listed companies should increase their public float to at least 15% by the end of 2018 and eventually increase this to at least 20% by the end of 2020. According to the SEC, the higher public float requirement will increase market depth and is essential for sustaining a continuous market for listed securities in order to provide liquidity, which in turn will attract high-quality, long-term investors.

The Philippines to Borrow PHP180 Billion in the Second Quarter of 2017

The Government of the Philippines plans to borrow PHP180 billion domestically in the second quarter (Q2) of 2017, the same amount as planned borrowing in Q1 2017. The offer will comprise up to PHP90 billion each of Treasury bills and Treasury bonds to be sold in six scheduled auctions. The Q2 2017 planned borrowing is higher than the PHP135 billion target in Q2 2016. Treasury bonds will have longer maturities of 7, 10, and 20 years, as the government wants to stretch its liability amid a rising interest rate environment, especially as the US Federal Reserve has signaled two more rate hikes this year. In Q1 2017, the government sold PHP150.6 billion of government securities.

ASEAN Banking Integration Framework Negotiations Conclude between Bangko Sentral ng Pilipinas and Bank Negara Malaysia

The BSP and Bank Negara Malaysia signed in April the Declaration of Conclusion of Negotiations under the Association of Southeast Asian Nations (ASEAN) Banking Integration Framework. This marked the completion of negotiation between the central banks, allowing the entry of Qualified ASEAN Banks between the two countries. Under the agreement, these banks will have greater access to each other's markets and more operational flexibility in banking activities. The BSP has also signed a Letter of Intent with the Bank of Thailand to begin similar discussions on the ASEAN Banking Integration Framework.