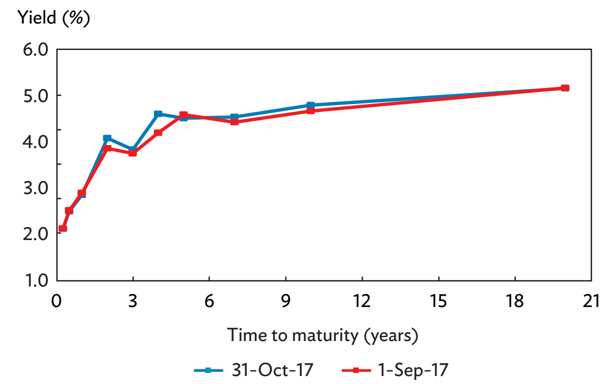
Philippines

Yield Movements

Between 1 September and 31 October, yields movements for Philippine local currency (LCY) government bonds were mixed (**Figure 1**). Yields at the short-end of the curve (maturities of 1 year or less) fell by an average of 2.1 basis points (bps). Yields for all maturities between 2 years and 20 years rose except for the 5-year and 20-year tenors, which fell 7.8 bps and 0.8 bps, respectively. Those tenors with increases in yields rose by 19.1 bps on average, with the largest increase in 4-year tenor of 40.8 bps. The yield spread between the 2-year and 10-year tenors narrowed from 81 bps to 71 bps during the review period.

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



Source: Based on data from Bloomberg LP.

The decline in yields at the short-end of the curve and the rise in yields of most long-tenor bonds suggests that market participants are being cautious ahead of widely expected interest rate hike from the United States (US) Federal Reserve in December. In its Federal Open Market Committee meeting on 31 October–1 November, the Federal Reserve stated that the US economy is expanding at a solid rate while the labor market continues to improve, which will likely pave the way for a rate hike before the end of the year even if inflation remains low. Therefore, investors buying long-term government securities are bidding for higher yields and are being more cautious in taking positions along that segment of the yield curve. The increase in yields observed during the review period is also reflective of the local market looking to movements in US Treasury yields as a guide. Nonetheless, ample liquidity in the market could absorb any sell-off that might curb further yield advances.

The Bangko Sentral ng Pilipinas (BSP) kept the overnight reverse repurchase interest rate unchanged at 3.00% during its monetary policy meeting on 09 November. The central bank assessed that inflation remained manageable and that expectations remained anchored within the government's target range of 2.0%–4.0%. Domestic economic activities remained firm, while an improvement in the economy's absorptive capacity seems to have mitigated inflationary pressures from credit expansion. The global economy continued to improve but lingering risks emanating from the advanced economies' policy directions and geopolitical concerns may negatively growth.

Consumer price inflation in the Philippines accelerated to 3.5% year-on-year (y-o-y) in October from 3.4% y-o-y in September, driven by faster price adjustments for food items and fuel. The October inflation rate is the highest since posting 3.7% in November 2014. Average inflation for January–September was 3.1%. While this is within the government's full-year target of 2.0%–4.0%, the National Economic Development Authority cited several upside risks to inflation in the near term such as higher domestic fuel prices and a weaker peso.

The Philippine peso lost 3.8% against the US dollar year-to-date through 31 October. According to the BSP, the weak peso can be attributed to the effects of higher corporate demand for imports and trade financing. Moreover, continued expectations of another rate hike from the Federal Reserve and expectations of a new chairperson when Janet Yellen's term ends in February have also contributed to the peso's weakness. Despite this, the BSP said the depreciation of the local currency remains manageable.

The gross domestic product of the Philippines expanded 6.5% y-o-y in the second quarter (Q2) of 2017, up from 6.4% y-o-y in the previous quarter, helped by the acceleration of government spending. The government's growth target range for full-year 2017 is 6.5%–7.5%. The BSP has said that the target is attainable given the Philippines' strong macroeconomic fundamentals and upbeat domestic economic activity backed by the implementation of key infrastructure projects and a rebound in exports.

Size and Composition

The Philippines' LCY bonds outstanding expanded in the third quarter (Q3) of 2017 at rates of 0.8% q-o-q and 8.5% y-o-y, which were down from 4.6% q-o-q and 10.2% y-o-y in Q2 2017 (**Table 1**). The LCY bond market reached a size of PHP5,210 billion (USD102 billion) at the end of September, lifted by both the government and corporate segments, which comprised 80.8% and 19.2% of the total, respectively.

Government bonds. Total LCY government bonds outstanding amounted to PHP4,212 billion at the end of September, barely unchanged on a q-o-q basis but up 6.5% y-o-y. Treasury bonds amounted to PHP3,822 billion, reflecting an increase on a y-o-y basis but a slight decrease on a q-o-q basis as bonds that matured in Q3 2017 exceeded issuances. On the other hand, Treasury bills outstanding grew 7.0% q-o-q and 16.0% y-o-y on the back of increased issuance during the quarter.

The government issued a total of PHP270.2 billion in Q3 2017, lower than in Q2 2017, which was largely lifted by the issuance of Retail Treasury Bonds.[21] The issuance of Treasury bonds amounted to PHP75 billion in Q3 2017, falling short of the PHP90 billion target set by the Bureau of the Treasury (BTr) as it rejected bids in one of its auctions during the quarter. Treasury bill issuance amounted to PHP95.2 billion in Q3 2017, also falling short from the PHP105 billion target as some auctions were partially awarded by the BTr. Even so, Treasury bills issued in Q3 2017 were higher compared with Q2 2017 as a result of more auctions during the quarter.

The Government of the Philippines is targeting its initial issuance of Chinese renminbi-denominated bonds, or panda bonds, in November. The bond sale is in its final regulatory preparation and the government has tapped the assistance of the Bank of China for government approval in the People's Republic of China. The government plans to issue USD200 million in 3-year and 5-year tenors. The BTr is timing its issuance based on the pricing environment, demand, and geopolitical developments that might affect investor sentiments.

Market players expect that the government's ambitious infrastructure plan will increase the supply of local government bonds in the market given the need to borrow more to fund these projects. However, the increase in issuance also partly depends on the outcome of the government's tax reform package. If the revenue-generating provisions are passed close to the original version of the Department of Finance, the government may not need to borrow more as its revenue will already be augmented, thus limiting the impact of infrastructure

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q3 2016		Q2 2017		Q3 2017		Q3 2016		Q3 2017	
	PHP	USD	PHP	USD	PHP	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**4,800**	**99**	**5,168**	**102**	**5,210**	**102**	**2.4**	**1.6**	**0.8**	**8.5**
Government	3,955	82	4,211	83	4,212	83	1.9	0.4	0.04	6.5
Treasury Bills	293	6	318	6	340	7	1.8	3.7	7.0	16.0
Treasury Bonds	3,587	74	3,842	76	3,822	75	2.0	0.3	(0.5)	6.6
Others	76	2	51	1	50	1	0.0	(5.6)	(0.6)	(33.5)
Corporate	845	17	957	19	998	20	4.6	7.7	4.2	18.1

( ) = negative, LCY = local currency, PHP = Philippine peso, q-o-q = quarter-on-quarter, Q1 = first quarter, Q2 = second 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.

[21] Government bond issuance includes issuance of special bills.

development on the local bond market. Otherwise, the government may need to issue additional debt securities to ensure sufficient funds for its spending

Corporate bonds. The LCY corporate bond market remained upbeat in Q3 2017, with bonds outstanding increasing 4.2% q-o-q and 18.1% y-o-y to reach PHP998 billion at the end of September. Growth in the corporate segment was faster than in the government segment on both a q-o-q and y-o-y basis.

The property sector continued to comprise the largest share of total outstanding corporate bonds at the end of September at 28.4% (**Figure 2**). This was followed by banks (27.7%) and holding firms (21.1%). Media and communications, transport, utilities, and other sectors saw declines in shares at the end of September from a year earlier.

The combined outstanding bonds of the top 30 corporate issuers amounted to PHP853.8 billion or the equivalent of 85.6% of total LCY corporate bonds outstanding. The top 30 issuers comprise 26 listed firms and 4 unlisted firms, and are led by firms in the property sector (**Table 2**). Property giant Ayala Land occupied the top spot with bonds outstanding reaching PHP91.6 billion at the end of September, up from PHP87.3 billion at the end of June.

In Q3 2017, issuers from the corporate sector raised a total of PHP49.8 billion from the bond market, which was less than the amount issued in Q2 2017. BDO Unibank had the largest issuance during the quarter with a PHP11.8 billion 6-year bond carrying a coupon rate of 3.63%. Other notable issuances in Q3 2017 are listed in **Table 3**.

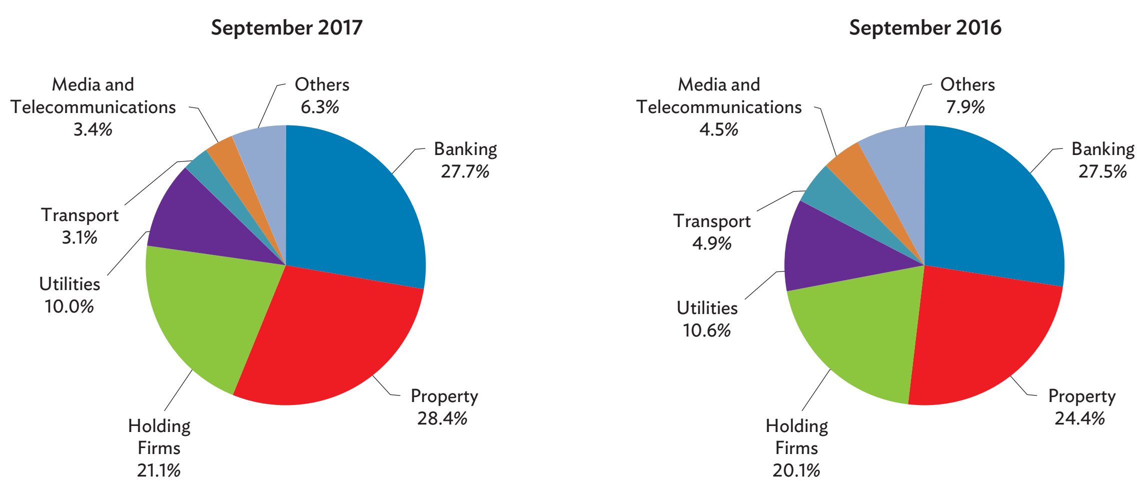
Investor Profile

Banks and investment houses remained the largest holder group of LCY government bonds among all investor groups, with holdings comprising 39.7% of the total market at the end of September, up from 37.0% a year earlier (**Figure 3**). Contractual savings and tax-exempt institutions were the second largest holders of government bonds with a 31.6% share of the total at the end of September, marginally up from 31.4% a year earlier. On the other hand, the holding shares of BTr-managed funds; brokers, custodians, and depositories; and government-owned or -controlled corporations and local government units each saw declines at the end of September from a year earlier.

Ratings Update

On 6 September, RAM Ratings revised its outlook on the Philippines' global and ASEAN-scale sovereign ratings from stable to positive on the back of stronger-than-expected economic growth in 2016 and the sustained inflow of foreign direct investment. The Philippines holds a global rating of $_{g}BBB_{3}$(pi) and an ASEAN-scale rating

Figure 2: Local Currency Corporate Bonds Outstanding by Sector



Source: Based on data from Bloomberg LP.

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	91.6	1.8	No	Yes	Property
2.	SM Prime	73.8	1.5	No	Yes	Property
3.	Metrobank	59.2	1.2	No	Yes	Banking
4.	BDO Unibank	49.3	1.0	No	Yes	Banking
5.	SM Investments	47.3	0.9	No	Yes	Holding Firms
6.	Ayala Corporation	40.0	0.8	No	Yes	Holding Firms
7.	Philippine National Bank	35.1	0.7	No	Yes	Banking
8.	San Miguel Brewery	34.8	0.7	No	No	Brewery
9.	San Miguel	30.0	0.6	No	Yes	Holding Firms
10.	JG Summit Holdings	30.0	0.6	No	Yes	Holding Firms
11.	Filinvest Land	29.0	0.6	No	Yes	Property
12.	East West Bank	26.8	0.5	No	Yes	Banking
13.	Aboitiz Equity Ventures	24.0	0.5	No	Yes	Holding Firms
14.	Meralco	23.5	0.5	No	Yes	Electricity, Energy, & Power
15.	Security Bank	23.0	0.5	No	Yes	Banking
16.	GT Capital	22.0	0.4	No	Yes	Holding Firms
17.	Rizal Commercial Banking Corporation	20.8	0.4	No	Yes	Banking
18.	Vista Land and Lifescapes	20.0	0.4	No	Yes	Property
19.	Petron	18.6	0.4	No	Yes	Electricity, Energy, & Power
20.	China Bank	15.9	0.3	No	Yes	Banking
21.	Maynilad Water Services	15.7	0.3	No	No	Water
22.	Double Dragon Properties	15.0	0.3	No	Yes	Property
23.	MCE Leisure (Philippines)	15.0	0.3	No	No	Casinos & Gaming
24.	Philippine Long Distance Telephone Company	15.0	0.3	No	Yes	Telecommunications
25.	SMC Global Power Holdings	15.0	0.3	No	No	Electricity, Energy, & Power
26.	Union Bank of the Philippines	14.0	0.3	No	Yes	Banking
27.	Aboitiz Power	13.0	0.3	No	Yes	Electricity, Energy, & Power
28.	Globe Telecom	12.5	0.2	No	Yes	Telecommunications
29.	Megaworld	12.0	0.2	No	Yes	Property
30	Robinsons Land	12.0	0.2	No	Yes	Property
Total Top 30 LCY Corporate Issuers		**853.8**	**16.8**			
Total LCY Corporate Bonds		**997.9**	**19.6**			
Top 30 as % of Total LCY Corporate Bonds		**85.6%**	**85.6%**			

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

of $_{sea}$A1(pi) from RAM. Continued economic growth and the successful implementation of growth-supporting measures such as a tax reform package and infrastructure projects, as well as the streamlining of business processes, could lead to a ratings upgrade. On the other hand, the deterioration of domestic finances and external position, as well as the failure of growth-enhancing initiatives, could trigger a ratings downgrade.

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

Corporate Issuers	Coupon Rate (%)	Issued Amount (PHP billion)
BDO Unibank		
6-year bond	3.63	11.80
Double Dragon Properties		
7-year bond	6.10	9.70
Cyberzone Properties		
6-year bond	5.05	6.00

PHP = Philippine peso.
Source: Bloomberg LP.

Policy, Institutional, and Regulatory Developments

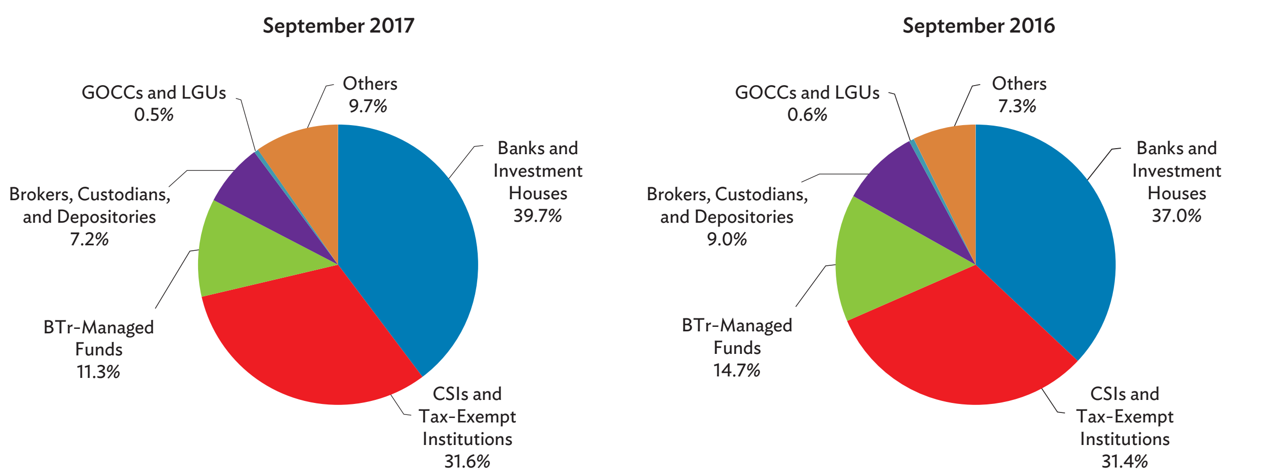
Bangko Sentral ng Pilipinas Streamlines Regulations on Bank and Quasi-Bank Bond Issuance

On 6 October, BSP amended its regulations on the issuance of bonds and commercial paper by banks and quasi-banks in order to streamline requirements and provide greater flexibility in tapping the capital market as an alternative funding source. According to the central bank, the amendments include removal of the minimum bond features, such as the requirement on eligible collateral, which can constrain banks and quasi-banks from issuing debt securities. The revised regulations reiterate compliance with the securities law and its implementing rules and regulations.

Bangko Sentral ng Pilipinas, Bureau of the Treasury, and the Securities and Exchange Commission Set to Launch a Repurchase Market for Banks in November

In October, BSP announced the rollout of the repurchase market for banks in November. Together with the BTr and the Securities and Exchange Commission, this initiative forms part of the capital market road map presented by government agencies in August with the goal of deepening the domestic debt market. These agencies are targeting to implement a series of financial reforms within 18 months. According to the BSP, the initial phase would focus on improving benchmark markets as this is critical for pricing risk assets and other capital market instruments. In addition, the BTr has also been assessing the performance of Government Securities Eligible Dealers in the primary and secondary markets, which will be the basis for recognizing market-makers. The BTr will announce the preliminary market-makers and launch the enhanced Government Securities Eligible Dealers program early next year.

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.