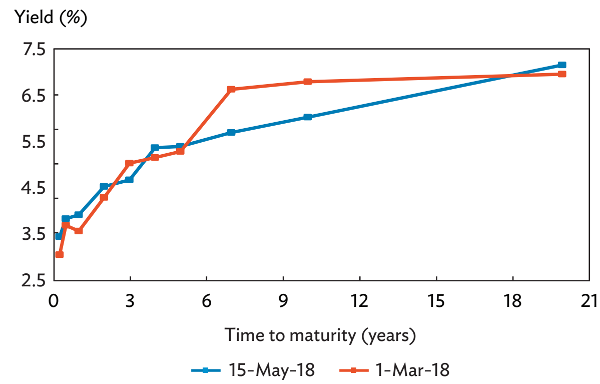
Philippines

Yield Movements

Between 1 March and 15 May, local currency (LCY) government bond yields in the Philippines rose for all tenors except the 3-year, 7-year, and 10-year maturities, which fell 36 basis points (bps), 94 bps, and 77 bps, respectively (**Figure 1**). The yield for the 3-month tenor increased the most, rising 39 bps, followed by the 1-year bond yield, which increased 35 bps. The 5-year maturity experienced the smallest yield increase at just 11 bps. The yield spread between the 2-year and 10-year tenors narrowed 101 bps during the period.

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



Source: Based on data from Bloomberg LP.

According to the Bureau of the Treasury, interest rates continued to trend upward as some investors anticipate additional rate hikes by the Bangko Sentral ng Pilipinas (BSP) following the most recent increase on 10 May. Moreover, demand for higher rates for longer tenors reflects investor concerns about inflation. In the BSP's monetary board meeting on 10 May, it updated its full-year 2018 inflation forecast to 4.6% from the previous forecast of 3.9%.

Consumer prices in the Philippines grew at a faster rate of 4.5% year-on-year (y-o-y) in April compared with 4.3% y-o-y in March. The inflation rate has accelerated since the start of the year, resulting in year-to-date inflation of 4.1% y-o-y through April, exceeding the BSP's target of 2.0%–4.0% for 2018. The BSP expects inflation to remain elevated throughout the year before eventually tapering toward the midpoint of the target range in 2019.

In its monetary policy meeting on 10 May, the BSP's monetary board hiked key interest rates 25 bps in response to year-to-date inflation through April having breached the central bank's target range. The overnight reverse repurchase rate was increased to 3.25%, while the overnight lending and deposit rates were raised to 3.75% and 2.75%, respectively. According to the central bank, inflation and elevated risks prompted the board to act, and the move will help temper the buildup in inflation expectations. It noted, however, that the rate hike may prevent the government from achieving its target of 7.0%–8.0% economic growth for full-year 2018.

The gross domestic product (GDP) of the Philippines grew 6.8% y-o-y during the first quarter (Q1) of the year. On the demand side, public construction, government consumption, and capital formation exhibited upbeat performances. Domestic demand is likely to increase following the recently approved tax reform package, which is expected to boost personal income and consumption. On the supply side, growth in the industrial sector was backed by expansion in the manufacturing and construction subsectors, owing to the government's Build, Build, Build program. Despite the challenges, the National Economic and Development Authority continues to believe that the country's growth rate implies that the Philippines has the potential to become an upper-middle-income economy.

The Philippine peso breached the PHP52 per USD1 level in mid-February and it has been hovering at this level since then. After Standard & Poor's Global Ratings upgraded its credit outlook for the Philippine economy from stable to positive in April, the peso began to strengthen against the greenback, staying below the PHP52 per USD1 level. The International Monetary Fund has not expressed concern about foreign exchange pressures since it is mostly tighter global conditions rather than domestic factors that are putting pressure on the peso. However, trade tensions between the People's Republic of China and the United States should

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q1 2017		Q4 2017		Q1 2018		Q1 2017		Q1 2018	
	PHP	USD	PHP	USD	PHP	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**4,943**	**98**	**5,475**	**110**	**5,593**	**107**	**1.5**	**5.0**	**2.1**	**13.1**
Government	4,011	80	4,456	89	4,479	86	0.8	3.0	0.5	11.7
Treasury Bills	286	6	314	6	332	6	(0.6)	2.6	5.7	16.2
Treasury Bonds	3,656	73	4,101	82	4,106	79	1.0	3.3	0.1	12.3
Others	69	1	40	1	40	1	0.003	(8.4)	(0.01)	(42.0)
Corporate	932	19	1,020	20	1,114	21	4.6	14.6	9.2	19.5

( ) = 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.

be monitored carefully as an escalation could lead to a sudden tightening in global liquidity.

Size and Composition

Total LCY bonds in the Philippines reached PHP5,593 billion (USD107 billion) at the end of March on growth of 2.1% quarter-on-quarter (q-o-q) and 13.1% y-o-y (**Table 1**). The increase in outstanding bonds in the LCY bond market is supported by increases in both the government and corporate bond segments. At the end of March, government bonds represented 80.1% of total outstanding bonds, while corporate bonds comprised only 19.9%.

Government bonds. LCY government bonds outstanding registered growth of 0.5% q-o-q and 11.7% y-o-y in Q1 2018, amounting to PHP4,479 billion at the end of March. Treasury bills mainly supported the q-o-q growth of LCY government bonds, expanding 5.7% q-o-q, while Treasury bonds grew at a slower pace of 0.1% q-o-q. The bonds of government-owned and -controlled corporations declined on a q-o-q and y-o-y basis in Q1 2018 as some bonds matured and there were no new issuances during the quarter.

Total LCY issuance during Q1 2018 amounted to PHP296.4 billion, a decline of 37.2% q-o-q and 7.4% y-o-y. The Government of the Philippines issued just PHP233.2 billion during the quarter, about half of what was issued in the last quarter of 2017, representing a decline of 47.2% q-o-q. The notable dip in issuance was due to the massive amount of Retail Treasury Bonds offered in the last quarter of 2017, amounting to PHP130 billion and resulting in a high base, and the government's move to borrow more from abroad in 2018. In 2017, the cabinet-level Development Budget Coordination Committee raised from 20% to 26% the share of external borrowings for 2018, while it kept the 80:20 ratio in favor of domestic sources for 2019–2022. Treasury bill issuance stood at PHP165.2 billion in Q1 2018, while issuance of Treasury bonds reached PHP68.0 billion.[18]

Auctions for Treasury bills were generally met with strong demand during Q1 2018. The auction of 91-day Treasury bills was a mix of being partially and fully awarded. On the other hand, the 182-day and 364-day Treasury bills were all partially awarded. For Treasury bonds, all auctions of 5-year, 10-year, and 20-year bonds were partially awarded. The 7-year bond auction was completely rejected.

The Bureau of the Treasury plans to issue a total of PHP195 billion of Treasury bills and PHP130 billion of Treasury bonds during the second quarter (Q2) of 2018.

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

Corporate bonds. The LCY corporate bond market continued to be active during Q1 2018, growing 9.2% q-o-q and 19.5% y-o-y, reaching a size of PHP1,114 billion.

The banking sector continued to be the dominant issuer in the Philippines in Q1 2018, accounting for 28.8% of the LCY corporate bond market at the end of March (**Figure 2**). This was an increase over its 26.1% share at the end of March 2017. The property and utilities sectors increased their market shares during the review period to 27.6% and 11.3% from 25.2% and 10.6%, respectively. On the other hand, holding firms and the transport and telecommunications sectors declined in terms of market share to 21.3%, 2.8%, and 3.5% from 22.5%, 4.5%, and 4.1%, respectively.

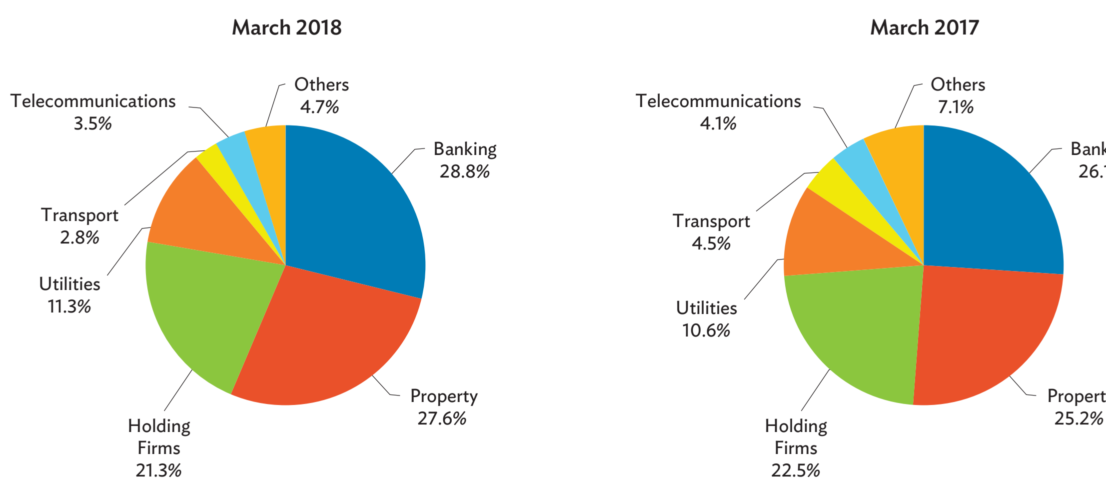
At the end of March 2018, the LCY corporate bonds outstanding of the top 30 issuers amounted to PHP978.1 billion, representing 87.8% of the Philippines' LCY corporate bond market (**Table 2**). Property firms Ayala Land and SM Prime Holdings topped the list with PHP94.7 billion and PHP93.8 billion of LCY bonds outstanding, respectively. By sector, banks accounted for the majority of outstanding bonds among the top 30 issuers with PHP397.6 billion, followed by the property sector with PHP264.4 billion.

A total of PHP63.2 billion worth of LCY corporate bonds were issued during Q1 2018 on growth of 108.7% q-o-q and 20.8% y-o-y. SM Prime Holdings, San Miguel, and Maynilad together accounted for PHP58.5 billion, or 92.5% of all new issuances for the quarter. SM Prime Holdings offered 5-year and 7-year bonds, while San Miguel and Maynilad both issued 5-year, 7-year, and 10-year bonds. Three other companies tapped the local bond market for funding purposes during the quarter: Union Bank, Phoenix Petroleum, and SL Agritech. SM Prime Holdings issued bonds for the expansion of its real estate projects, while San Miguel planned to use the proceeds to refinance debt and fund investment in various businesses.

Notable corporate issuers in Q1 2018 are listed in **Table 3**. Water service provider Maynilad had the largest bond issuance amounting to PHP14.8 billion for a 5-year bond carrying a coupon rate of 6.56%. The issuance comprised 23.4% of all LCY corporate bond issuance during the quarter. Holding firm San Miguel and property firm SM Prime Holdings likewise also each issued 5-year corporate bonds. San Miguel's issue amounted to PHP13.15 billion with a coupon rate of 6.25%. SM Prime Holdings issued a PHP10.0 billion bond with a 5.66% coupon rate.

Foreign currency bonds. The Government of the Philippines issued a USD2.0 billion 10-year global bond with a 3.0% coupon in January, USD1.25 billion of which was allocated for a 1-day accelerated switch tender offer, while the remaining USD0.75 billion was allocated to raise fresh money. The bond offering marked the Philippines'

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	94.7	1.8	No	Yes	Property
2.	SM Prime Holdings	93.8	1.8	No	Yes	Property
3.	Metrobank	59.2	1.1	No	Yes	Banking
4.	BDO Unibank	58.8	1.1	No	Yes	Banking
5.	SM Investments	52.3	1.0	No	Yes	Holding Firms
6.	San Miguel	50.0	1.0	No	Yes	Holding Firms
7.	Philippine National Bank	47.5	0.9	No	Yes	Banking
8.	Ayala Corporation	40.0	0.8	No	Yes	Holding Firms
9.	San Miguel Brewery	34.8	0.7	No	No	Brewery
10.	Maynilad	33.9	0.6	No	No	Water
11.	Aboitiz Equity Ventures	32.0	0.6	No	Yes	Holding Firms
12.	Security Bank	31.6	0.6	No	Yes	Banking
13.	JG Summit	30.0	0.6	No	Yes	Holding Firms
14.	Meralco	29.3	0.6	No	Yes	Electricity, Energy, and Power
15.	Filinvest Land	29.0	0.6	No	Yes	Property
16.	East West Bank	26.8	0.5	No	No	Banking
17.	RCBC	23.6	0.5	No	Yes	Banking
18.	GT Capital	22.0	0.4	No	Yes	Holding Firms
19.	PLDT	20.6	0.4	No	Yes	Telecommunications
20.	Vista Land	19.9	0.4	No	Yes	Property
21.	Petron	18.6	0.4	No	Yes	Electricity, Energy, and Power
22.	Bank of the Philippine Islands	17.2	0.3	No	Yes	Banking
23.	Union Bank	17.0	0.3	No	Yes	Banking
24.	Chinabank	15.9	0.3	No	Yes	Banking
25.	Doubledragon	15.0	0.3	No	Yes	Property
26.	SMC Global Power	15.0	0.3	No	No	Electricity, Energy, and Power
27.	Aboitiz Power	13.0	0.2	No	Yes	Electricity, Energy, and Power
28.	Globe Telecom	12.5	0.2	No	Yes	Telecommunications
29.	NLEX Corporation	12.1	0.2	No	No	Transport
30	Megaworld	12.0	0.2	No	Yes	Property
Total Top 30 LCY Corporate Issuers		**978.1**	**18.7**			
Total LCY Corporate Bonds		**1,113.8**	**21.3**			
Top 30 as % of Total LCY Corporate Bonds		**87.8%**	**87.8%**			

LCY = local currency, PHP = Philippine peso, USD = United States dollar.
Notes:
1. Data as of 31 March 2018.
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.

return to the international bond market for the first time since 2014 as part of the government's liability management exercise, which seeks significant cost savings by reducing overall interest expenses. The proceeds from the issuance will support the government's Build, Build, Build program; increase its presence in the global market; and promote financial inclusion for all Filipinos.

In March, the Philippines became the first Association of Southeast Asian Nations sovereign to issue renminbi-

Table 3: Notable Local Currency Corporate Bond Issuance in the First Quarter of 2018

Corporate Issuers	Coupon Rate (%)	Issued Amount (PHP billion)
Maynilad		
5-year bond	6.56	14.80
San Miguel		
5-year bond	6.25	13.15
SM Prime Holdings		
5-year bond	5.66	10.00
7-year bond	6.08	10.00

PHP = Philippine peso.
Source: Bloomberg LP.

denominated bonds, which are also known as panda bonds. The issuance, which amounted to CNY1.46 billion, has a tenor of 3 years with a coupon rate of 5.00%. The issuance allowed the private sector to access the onshore Chinese bond market. Moreover, the successful issuance, which was rated AAA by the China Lianhe Credit Rating, reflected investors' confidence in the growth prospects and creditworthiness of the economy. The panda bonds were oversubscribed, indicating a good reception in the People's Republic of China and other offshore markets.

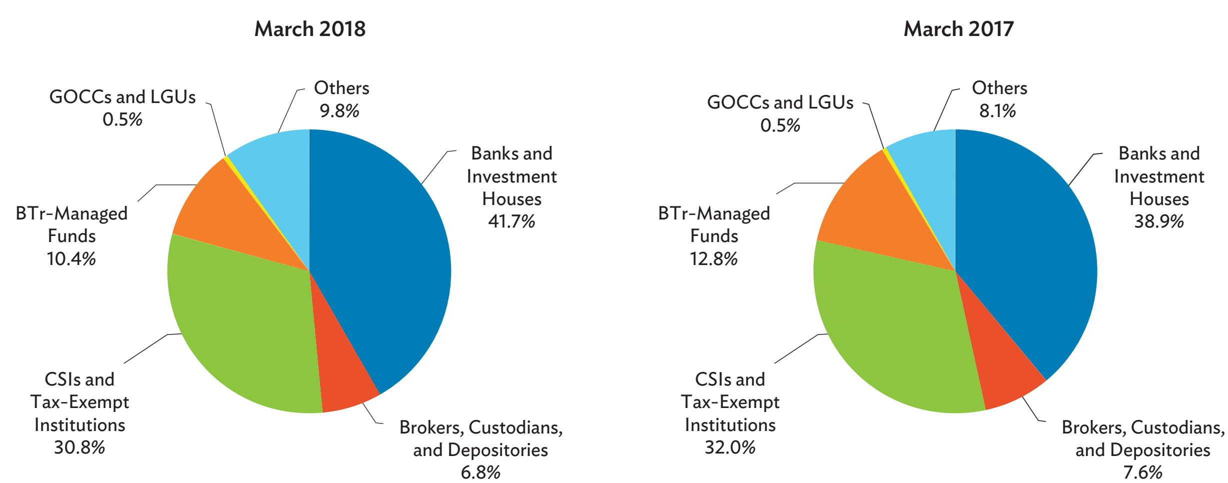
Investor Profile

Banks and investment houses continued to be the largest investors in LCY government bonds in Q1 2018, comprising a share of 41.7% of all investors at the end of March (**Figure 3**). This was followed by contractual savings and tax-exempt institutions with a 30.8% share of all investors. Government-owned and -controlled corporations and local government units accounted for the smallest share among all investor groups with only 0.5% of total investments. In nominal terms, the LCY government bond holdings of banks and investment houses registered the highest growth rate at 20.5% y-o-y, followed by growth of 18.1% y-o-y for government-owned and -controlled corporations and local government units. The LCY government bond holdings of contractual savings and tax-exempt institutions grew 8.3% y-o-y, while those of brokers, custodians, and depositories expanded only 0.5% y-o-y. The Bureau of the Treasury's bond holdings declined, registering negative growth of 8.9% y-o-y.

Ratings Update

Standard & Poor's raised its credit rating outlook for the Philippines to positive from stable while retaining its current BBB rating. According to the credit rating agency, the country has exhibited strong economic growth, a healthy external position, and improved policy-making. It is expected that the Philippines will have sustainable public finances and balanced growth over the next 24 months. Furthermore, Standard & Poor's hailed the country's effective fiscal policies as evidenced by the improved quality of expenditures and limited fiscal deficits. In spite of the administration's Build, Build, Build program, which will entail significant infrastructure

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.

spending, the recently passed comprehensive tax reform program will ensure that government finances are sustainable.

Policy, Institutional, and Regulatory Developments

BSP Reduces Reserve Requirement Ratio

At its 24 May meeting, as part of its financial market reform agenda, the Monetary Board of the BSP made an operational adjustment by reducing the reserve requirement ratio for banks by 1 percentage point to 18.0%. The BSP had recently lowered the reserve requirement ratio to 19.0% from 20.0% in March. The gradual reduction is intended to make the BSP less reliant on reserve requirements in managing liquidity risk in the financial system. The reduction will be implemented starting 1 June 2018.

The Philippines to Borrow PHP325 billion in Q2 2018

The Government of the Philippines plans to issue a total of PHP325 billion in Q2 2018, comprising PHP195 billion of Treasury bills and PHP130 billion of Treasury bonds. This compares with the Q1 2018 offering of PHP240 billion, which consisted of PHP120 billion each of Treasury bills and Treasury bonds. Auctions in Q2 2018 will be conducted on a weekly basis. The increase in domestic borrowing during the past few quarters has funded the growth of the national budget and supported the infrastructure spending program of the current administration.