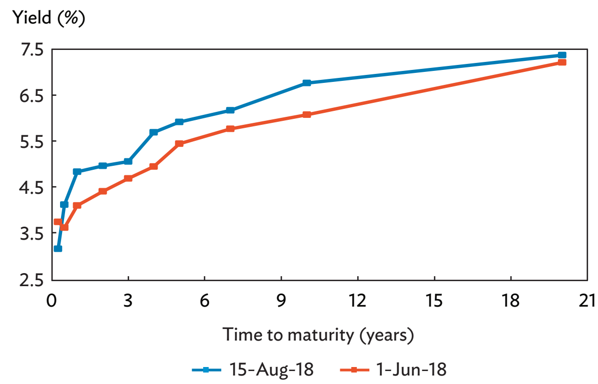
Philippines

Yield Movements

Between 1 June and 15 August, the yields of Philippine local currency (LCY) bonds of all tenors increased except for the 3-month tenor, which decreased 58 basis points (bps) (**Figure 1**). The 4-year maturity increased the most (74 bps), followed by the 1-year maturity (73 bps). The 20-year tenor registered the smallest increase of 16 bps. The yield spread between 2-year and 10-year government bonds expanded 13 bps.

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



Source: Based on data from Bloomberg LP.

Uncertainties weighed heavily on investor decisions, resulting in a preference for short-dated Treasury bills, particularly the 3-month tenor, as investors chose caution while awaiting the outcomes of domestic and international events. The higher yields also point to the risks that investors see in the long-term. Domestically, buyers were mindful of the Philippines' high inflation and slowing economic growth, coupled with negative sentiments in the foreign exchange market. Investors are also anticipating additional rate hikes by the Bangko Sentral ng Pilipinas (BSP). Internationally, rising oil prices and the trade war between the People's Republic of China (PRC) and the United States (US) affected investor sentiments.

In the second quarter (Q2) of 2018, inflation stayed above the central bank's 2018 inflation target band of 2.0%–4.0%, prompting the BSP to revise its full-year inflation projection to 4.6% from 4.3%. Price inflation for basic goods and services in the Philippines jumped to 5.7% y-o-y in July from 5.2% y-o-y in June, mainly due to higher costs of alcoholic beverages and tobacco attributed to the government's tax reform law, which taxed sin products heavily. On the international scene, oil prices increased due to global oil supply concerns, affecting domestic fuel prices.

Continued increases in the prices of consumer goods and services led the BSP to hike its key interest rates in order to curb inflation and mitigate potential second-round effects. On 9 August, the monetary board of the BSP decided to hike key interest rates by 50 bps each, bringing the total rate hike for policy rates this year to 100 bps. The overnight lending rate stood at 4.5%, while the overnight reverse repurchase and deposit rate stood at 4.0% and 3.5%, respectively. The decision came amid expectations that inflation is expected to remain high through the end of the year. The latest interest rate increase, which came on the heels of back-to-back 25 bps rate hikes in May and June, was deemed necessary to ease price pressures. Furthermore, the central bank noted that the sustained economic growth allows room for future rate hikes.

The Philippines' gross domestic product expanded 6.0% year-on-year (y-o-y) in Q2 2018, down from 6.6% y-o-y growth recorded in the first (Q1) of 2018, due to slower growth in the services and mining sectors. Despite the slowdown, the Philippines remained one of the fastest-growing economies in the region, just behind Viet Nam at 6.8% y-o-y and the PRC at 6.7% y-o-y. Various organizations like the Organisation for Economic Co-operation and Development, International Monetary Fund, and World Bank have all projected the country's 2018 gross domestic product growth to fall below the government's target range of 7.0%–8.0% for 2018.

Despite the interest rate hikes and good economic growth, the Philippine peso continued to weaken, breaching the PHP53-to-USD1 exchange rate during the second half of June. The weakness of the peso was also attributed to global events, including the ongoing trade war between the US and the PRC, and the strengthening of the US dollar. The central bank has tapped its foreign reserves to temper the peso's depreciation, with the country's gross international reserves declining since the start of the year. From USD81.2 billion in January, the foreign reserves were down to USD76.7 billion in July. The depreciating peso and price pressures on basic goods and services were also the result of ongoing concerns regarding the Philippines' current account deficit spurred by expanding trade deficits during the first half of 2018. The trade deficit reached USD3.2 billion in June, bringing the total deficit for the first half of 2018 to USD18.9 billion.

Size and Composition

Growth in the Philippines' LCY bond market eased to 2.6% quarter-on-quarter (q-o-q) in Q2 2018 from 4.6% q-o-q in Q2 2017 (**Table 1**). Total LCY bonds amounted to PHP5,741 billion (USD108 billion) at the end of Q2 2018, up from PHP5,593 billion at the end of Q1 2018. The increase was supported by growth in both government and corporate bonds, with the former comprising 80% of total outstanding bonds.

Government bonds. The amount of LCY government bonds stood at PHP4,592 billion at the end of June on growth of 2.5% q-o-q, supported by Treasury bills and bonds, which rose 14.6% q-o-q and 1.6% q-o-q, respectively. Despite the surge in outstanding Treasury bills, they only accounted for PHP381 billion of total outstanding government bonds at the end of Q2 2018. Treasury bonds amounting to PHP4,170 billion at the end of June, or 90.8% of outstanding government bonds, formed the bulk of the government bond market.

A total of PHP376.2 billion worth of LCY government bonds were issued in Q2 2018, up from the PHP233.2 billion recorded in Q1 2018, corresponding to growth of 61.3% q-o-q. This includes reissued Treasury bills and bonds. The growth was supported by the Bureau of the Treasury's issuance of PHP121.8 billion worth of 3-year Retail Treasury Bonds.

During weekly auctions, 91-day Treasury bills were usually fully awarded. On the other hand, most of the longer-tenored 364-day Treasury bills were partially awarded as investors' bids were too high, forcing the Bureau of the Treasury to reject some bids in order to keep rates low. These actions reflected investors' desire for short-term instruments as they wait for events to unfold in domestic and international markets.

Under its program to finance the government's infrastructure program and fund the budget deficit, the Bureau of the Treasury's issuance plans to continue weekly auctions of 91-day, 182-day, and 364-day Treasury bills in the third quarter of 2018. In terms of total Treasury bills and bonds, it plans to borrow PHP300 billion during the quarter, which would be a little lower than the PHP325 billion debt program in Q2 2018. Treasury bond auctions will be held every other week instead of the weekly auctions that were conducted in Q2 2018.

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2017		Q1 2018		Q2 2018		Q2 2017		Q2 2018	
	PHP	USD	PHP	USD	PHP	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**5,168**	**102**	**5,593**	**107**	**5,741**	**108**	**4.6**	**10.2**	**2.6**	**11.1**
Government	4,211	83	4,479	86	4,592	86	5.0	8.5	2.5	9.0
Treasury Bills	318	6	332	6	381	7	11.1	10.4	14.6	19.9
Treasury Bonds	3,842	76	4,106	79	4,170	78	5.1	9.3	1.6	8.5
Others	51	1	40	1	40	1	(27.0)	(33.1)	(0.01)	(20.5)
Corporate	957	19	1,114	21	1,149	22	2.7	18.5	3.2	20.0

( ) = 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.

Corporate bonds. LCY corporate bonds grew 3.2% q-o-q during Q2 2018. Total LCY corporate bonds outstanding increased to PHP1,149 billion from PHP1,114 billion in the previous quarter.

At the end of June 2018, the top three sectors comprising LCY corporate bonds outstanding were the property sector (PHP331.9 billion or 28.9%), the banking sector (PHP326.8 billion or 28.4%), and holding firms (PHP247.1 billion or 21.5%) (**Figure 2**). These same sectors dominated the LCY corporate bond market at the end of June 2017. The banking, property, and utilities sectors increased their respective shares of LCY corporate bonds outstanding during the review period, while holding firms, the telecommunications sector, and transport sector all saw a decline.

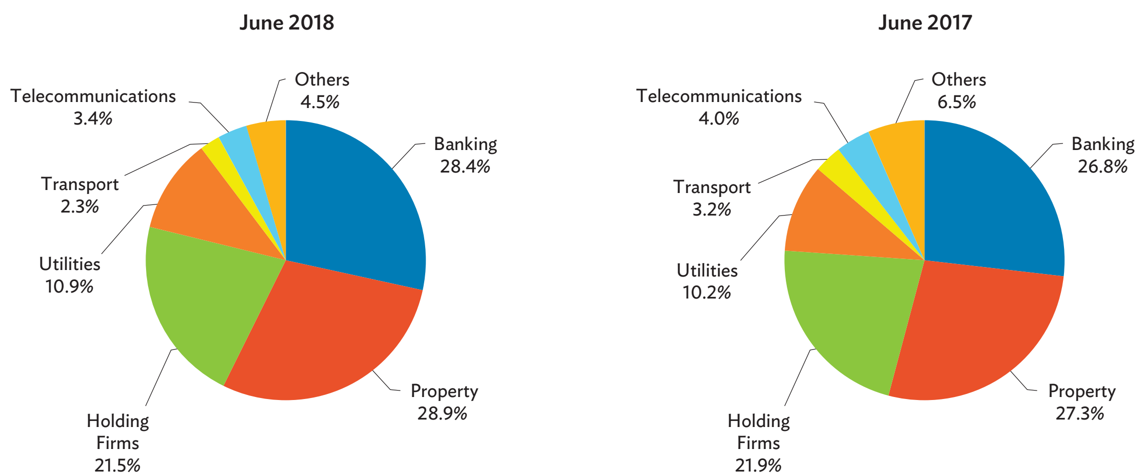
In Q2 2018, PHP48.0 billion worth of LCY corporate bonds were issued, down from the PHP63.2 billion issued in Q1 2018, for a decline of 24.0% q-o-q. Uncertainties in domestic and international financial markets led to fewer companies issuing LCY corporate bonds.

Property developers topped the issuers of LCY corporate bonds at the end of June. Ayala Land issued PHP104.7 billion while SM Prime Holdings issued PHP93.8 billion (**Table 2**). The country's largest bank, BDO Unibank, was the third-largest issuer with PHP63.6 billion of bonds outstanding. Companies in the banking sector comprised the largest sectoral bloc among the top 30 list, cumulatively accounting for 30.2% of all outstanding LCY bonds among the 30 largest corporate issuers. This was followed by the property sector with a 28.6% share, and holding firms with a 23.6% share. Altogether, the top 30 issuers of LCY corporate bonds accounted for PHP1,003.0 billion, or 87.3% of all corporate bonds outstanding at the end of June.

Property companies issued the most notable corporate bonds in Q2 2018 (**Table 3**). Among all corporates, Ayala Land and San Miguel issued the largest amount of corporate bonds during the quarter at PHP10 billion each. Property company Ayala Land issued a 10-year bond with a 5.92% coupon rate in order to cover its capital spending for the year, while food and beverage conglomerate San Miguel issued a 2-year bond with a 5.25% coupon for refinancing its debts and investing in its core business. Philippine Primark Properties offered the highest coupon rate of Q2 2018 at 7.69% for its PHP7 billion 10-year bond. This was followed by Sta. Lucia Land whose 7-year bond had a 7.48% coupon rate. Finally, Ortigas and Company issued PHP3 billion worth of 10-year bonds with a coupon rate of 6.26%.

Foreign currency bonds. On 8 August, the Philippines returned to the samurai bond market after a long hiatus, offering three tranches of JPY-denominated bonds totaling JPY154.2 billion. It offered 3-, 5-, and 10-year samurai bonds with coupon rates of 0.38%, 0.54%, and 0.99%, respectively. Proceeds from the JPY107.2 billion

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	104.7	2.0	No	Yes	Property
2.	SM Prime Holdings	93.8	1.8	No	Yes	Property
3.	BDO Unibank	63.6	1.2	No	Yes	Banking
4.	San Miguel	60.0	1.1	No	Yes	Holding Firms
5.	Metropolitan Bank	59.2	1.1	No	Yes	Banking
6.	SM Investments	52.3	1.0	No	Yes	Holding Firms
7.	Philippine National Bank	41.5	0.8	No	Yes	Banking
8.	Ayala Corporation	40.0	0.7	No	Yes	Holding Firms
9.	Security Bank	37.4	0.7	No	Yes	Banking
10.	San Miguel Brewery	34.8	0.7	No	No	Brewery
11.	Maynilad	33.9	0.6	No	No	Water
12.	Aboitiz Equity Ventures	32.0	0.6	No	Yes	Holding Firms
13.	JG Summit	30.0	0.6	No	Yes	Holding Firms
14.	Filinvest Land	29.0	0.5	No	Yes	Property
15.	Manila Electric Company	28.8	0.5	No	Yes	Electricity, Energy, and Power
16.	East West Banking	27.7	0.5	No	Yes	Banking
17.	Rizal Commercial Banking Corporation	23.6	0.4	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	0.3	No	Yes	Electricity, Energy, and Power
22.	Bank of the Philippine Islands	17.2	0.3	No	Yes	Banking
23.	Union Bank of the Philippines	17.0	0.3	No	Yes	Banking
24.	China Bank	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.	Megaworld	12.0	0.2	No	Yes	Property
30	Robinsons Land	12.0	0.2	No	Yes	Property
Total Top 30 LCY Corporate Issuers		**1,003.0**	**18.8**			
Total LCY Corporate Bonds		**1,149.0**	**21.5**			
Top 30 as % of Total LCY Corporate Bonds		**87.3%**	**87.3%**			

LCY = local currency, PHP = Philippine peso, USD = United States dollar.
Notes:
1. Data as of 30 June 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.

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

Corporate Issuers	Coupon Rate (%)	Issued Amount (PHP billion)
Ayala Land		
10-year bond	5.92	10.00
San Miguel		
7-year bond	5.25	10.00
Philippine Primark Properties		
10-year bond	7.69	7.00
Sta. Lucia Land		
7-year bond	7.48	5.00
Ortigas and Company		
10-year bond	6.26	3.00

PHP = Philippine peso.
Source: Bloomberg LP.

3-year bond, JPY6.2 billion 5-year bond, and JPY40.8 billion 10-year bond will be used to support the government's ambitious infrastructure program known as "Build, Build, Build." This came after the Government of the Philippines issued global bonds in January and panda bonds in March.

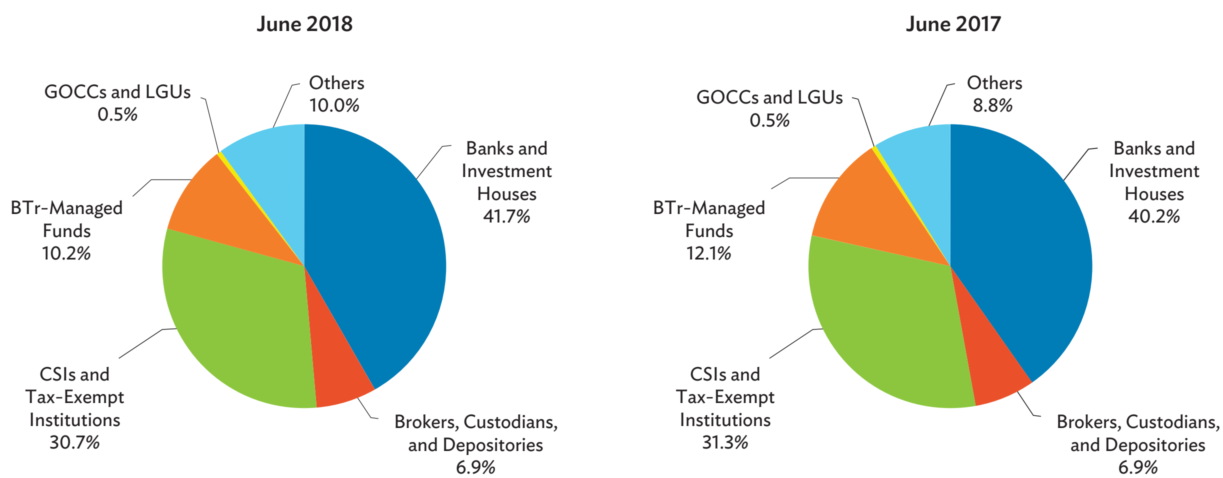
Investor Profile

Banks and investment houses were the single-largest investor category in the LCY government bond market at the end of June with a 41.7% share (**Figure 3**). This was up slightly from 40.2% in June 2017 when they were also the largest investor group. Contractual savings and tax-exempt institutions followed with a 30.7% share at the end of June, a slight dip from a 31.3% share in June 2017. Bureau of the Treasury-managed funds saw a decline in their investment share during the review period to 10.2% from 12.1%. Investors from government-owned or -controlled corporations and local government units, and brokers, custodians, and depositories maintained their shares of the LCY government bond market.

Ratings Update

Fitch Ratings affirmed the Philippines' long-term foreign currency issuer default investment-grade rating of BBB with a stable outlook. The rating agency expects strong domestic economic growth to be maintained, supported by the infrastructure program of the government. It also cited the Philippines' sound banking sector and economic policy framework as basis for the affirmation. Rising inflation, the depreciating peso, and a widening trade deficit were identified as causes for concern, although Fitch Ratings acknowledged the central bank's measures to keep these challenges in check. The stable outlook implies that the rating will likely go unchanged over the next 12–18 months.

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.

Policy, Institutional, and Regulatory Developments

BSP Relaxes Rules on Foreign Exchange

On 18 May, the BSP announced that the conversion of foreign currency loans to pesos and the transfer of such loans to regular banking unit books no longer requires prior central bank approval, provided that the concerned bank understands the risks inherent in such actions. It must have proper risk management policies in place to mitigate risks in managing such transactions. The move is part of the central bank's efforts to liberalize foreign exchange rules.

Asian Central Banks Launch Asian Bond Fund Pan-Asia Bond Fund Index Fund Securities Lending

On 26 June, central bank members of the Executives' Meeting of East Asia-Pacific launched the securities lending facility for the Asian Bond Fund Pan-Asia Bond Fund Index Fund (PAIF). PAIF is an exchange-traded bond index fund that invests in LCY government bonds in eight Asian markets and tracks the Markit iBoxx ABF Pan-Asia Index. Starting 10 July, financial firms can borrow LCY bonds under the PAIF in exchange for posting collateral. Through the lending facility, the Executives' Meeting of East Asia-Pacific hope to have improved liquidity and price discovery in the regional bond market.