Philippines

Yield Movements

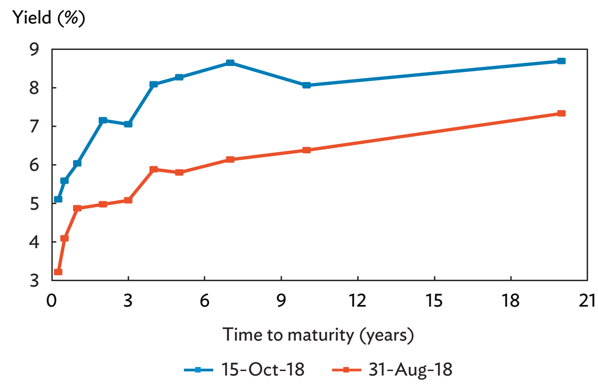
Between 31 August and 15 October, the yields of Philippine local currency (LCY) bonds of all tenors jumped an average of 189 basis points (bps) (**Figure 1**). The 7-year maturity increased the most (250 bps), followed by the 5-year maturity (247 bps). The 1-year tenor registered the smallest increase at 116 bps. The yield spread between 2-year and 10-year government bonds contracted 50 bps.

The jump in interest rates was spurred by concerns over high inflation and expectations of additional policy rate hikes before the end of the year from both the Bangko Sentral ng Pilipinas (BSP) and the United States (US) Federal Reserve at their next respective monetary policy meetings. Given these expectations, investors preferred short-term tenors over long-term tenors. The Bureau of the Treasury (BTr) frequently rejected Treasury bond bids as investors asked higher than expected rates.

Inflation, which has been rising since the start of the year, continued to soar in the third quarter (Q3) of 2018, prompting the BSP to revise its average full-year inflation in September projection to 4.9% from 4.5% previously. Price inflation for basic goods and services surged to 6.7% year-on-year (y-o-y) in September from 6.4% y-o-y in August. The rise in prices was mainly led by food and nonalcoholic beverages. Transportation costs rose 8.0% y-o-y as oil prices continued to increase.

During its policy meeting on 27 September, the Monetary Board of the BSP decided to raise its key interest rates by 50 bps on expectations of a sustained pick-up in inflation. The overnight reverse repurchase rate stood at 4.5% at the end of September, while the overnight lending and deposit rates were 5.0% and 4.0%, respectively. Second-round effects of inflation are also expected to contribute to price pressures. The BSP noted that nonmonetary measures are needed to help prevent further inflation since price pressures are being driven by supply-side forces. The BSP has hiked interest rates at four consecutive policy meetings, increasing interest rates by a total of 150 bps so far this year.

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



Source: Based on data from Bloomberg LP.

The Philippines' gross domestic product expanded an average of 6.3% year-on-year (y-o-y) during the first half of 2018, below the government's target range of 7.0%–8.0% for full-year 2018. This prompted country's economic managers to revise their gross domestic product target to 6.5%–6.9% for full-year 2018.

Together with currencies in the rest of the region, the Philippine peso continued to weaken, breaching the PHP54–USD1 exchange rate in September. The weakness of the peso was attributed to concerns regarding the country's trade deficit, which surged 171.0% y-o-y to USD3.6 billion in July from USD1.3 billion a year earlier. The central bank continued to tap its international reserves to temper the peso's depreciation. From USD76.7 billion in July, international reserves were down to USD75.2 billion in September. However, the peso slowly recovered in October as the US dollar weakened due to disappointing domestic retail data in the US and negative investor sentiments on Wall Street.

Philippine equities have also been battered, with the Philippine Stock Exchange Index reaching its lowest level in 2018 of 6,884.4 on 11 October, down from an all-time high of 9,058.6 in January. At its lowest, the index had registered a loss of 21.1% since the start of 2018. The fall in the index followed the losses experienced by US stocks over concerns about the trade war between the People's Republic of China and the US, and rising US Treasury yields.

Size and Composition

The Philippines' LCY bond market marginally expanded 0.9% q-o-q in Q3 2018, compared with 0.8% q-o-q growth during the same period in the previous year (**Table 1**). Total LCY bonds amounted to PHP5,792 billion (USD107 billion) at the end of September, up from PHP5,741 billion in the second quarter (Q2) of 2018. The increase was supported by growth in the corporate bond market.

Government bonds. The amount of LCY government bonds outstanding stood at PHP4,593 billion at the end of September on marginal growth of 0.04% q-o-q, supported by Treasury bills, which rose 15.3% q-o-q as the BTr fully awarded most Treasury bills in its weekly auctions. However, this growth was partially offset by Treasury bonds, which declined 1.2% q-o-q due to maturing 7-year bonds and very few successful Treasury bond auctions. Despite the surge in outstanding Treasury bills, these bills comprised only PHP439 billion, or about 10% of total outstanding government bonds. Treasury bonds amounting to PHP4,121 billion, or 90% of total government securities, form the bulk of outstanding government bonds.

LCY government bonds worth PHP215.8 billion were issued in Q3 2018, down from PHP376.2 billion recorded in Q2 2018. This corresponds to a decline of 42.6% q-o-q due to a high issuance base from the issuance of Retail Treasury Bonds in June and also due to a number of unsuccessful Treasury auctions during the quarter.

Most weekly Treasury bills auctions were fully awarded in Q3 2018, amid rising yields for 91-day, 182-day, and 364-day Treasury bills. However, at the last auction for the quarter, the BTr rejected all bids as average yields were higher than expected. This happened just a few days before the monetary board of the BSP hiked its key policy rates.

In the fourth quarter of 2018, the BTr plans to continue the weekly auction of 91-day, 182-day, and 364-day Treasury bills totalling of PHP180 billion. Together with Treasury bonds (PHP90 billion), it plans to borrow PHP270 billion during Q4 2018, down from PHP300 billion in Q3 2018. Treasury bond auctions will continue to be held every other week.

Corporate bonds. LCY corporate bonds grew 4.3% q-o-q during Q3 2018 and total bonds outstanding increased to PHP1,198 billion from PHP1,149 billion in the previous quarter.

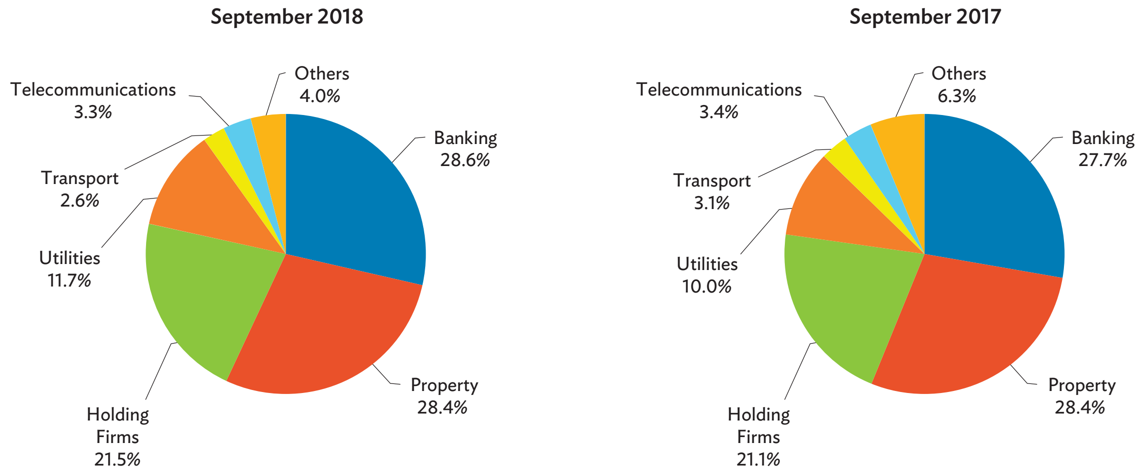
At the end of September 2018, the top three sectors in terms of LCY corporate bonds outstanding were banking (PHP342.5 billion or 28.6% of the total), property (PHP340.1 billion or 28.4%), and holding firms (PHP257.6 billion or 21.5%) (**Figure 2**). These same sectors dominated the amount of LCY corporate bonds outstanding in September 2017 as well, but the banking sector overtook the property sector in September 2018. During the review period, the sectoral shares of utilities, banking, and holding firms increased, while the sectoral shares of transport, telecommunications, and property decreased.

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q3 2017		Q2 2018		Q3 2018		Q3 2017		Q3 2018	
	PHP	USD	PHP	USD	PHP	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**5,210**	**102**	**5,741**	**108**	**5,792**	**107**	**0.8**	**8.5**	**0.9**	**11.2**
Government	4,212	83	4,592	86	4,593	85	0.04	6.5	0.04	9.0
Treasury Bills	340	7	381	7	439	8	7.0	16.0	15.3	29.2
Treasury Bonds	3,822	75	4,170	78	4,121	76	(0.5)	6.6	(1.2)	7.8
Others	50	1	40	0.8	34	0.6	(0.6)	(33.5)	(16.2)	(33.0)
Corporate	998	20	1,149	22	1,198	22	4.2	18.1	4.3	20.1

( ) = negative, LCY = local currency, 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 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.

Figure 2: Local Currency Corporate Bonds Outstanding by Sector



Source: Based on data from Bloomberg LP.

Property developers continued to lead the top 30 issuers in terms of outstanding LCY corporate bonds at the end of September. Ayala Land had an outstanding amount of PHP104.7 billion, while SM Prime Holdings had PHP93.8 billion (**Table 2**). Holding firm San Miguel was the third-largest issuer with LCY corporate bonds outstanding worth PHP60.0 billion. Companies in the banking sector continued to dominate the top of the list, comprising 31.5% of the outstanding issues of the largest corporate issuers. This was followed by the property sector with 27.3% and holding firms with 22.7%. Altogether, the top 30 issuers of LCY corporate bonds accounted for PHP1,036.3 billion, or 86.5% of all outstanding corporate issuances at the end of September.

In Q3 2018, PHP47.9 billion worth of LCY corporate bonds were issued, which represented a small decline of 0.3% q-o-q from the PHP48.0 billion issued in Q2 2018. Uncertainties in local and international financial markets continued to affect market sentiment, leading to only a few companies issuing LCY corporate bonds.

One of the notable corporate issuances in Q3 2018 was SMC Global's PHP15 billion 5-year callable bond with a 6.75% coupon (**Table 3**). SMC Global , one of the largest power companies in the Philippines, issued the bond to refinance its debts. Chinabank, on the other hand, issued PHP10.25 billion worth of 6-year long-term negotiable certificates of time deposit with a coupon rate of 4.55%. The proceeds from the issuance, the largest for the banking industry so far in 2018, will be used for Chinabank's expansion programs. Property developer Vista Land issued 7-year and 10-year callable bonds with coupon rates of 7.49% and 7.71%, respectively, the highest rates for issuances during the quarter. Finally, NLEX Corporation, a privately owned toll-road company, issued a 7-year bond with a coupon of 6.64% in order to fund capital expenditure requirements.

Investor Profile

Banks and investment houses dominated the LCY government bond investor base at the end of September, accounting for a 41.9% share of all investors (**Figure 3**). They comprised the largest group of investors in September 2017 as well. Contractual savings and tax-exempt institutions followed with a 27.2% share, down from a 31.6% share in September 2017. Brokers, custodians, and depositories increased their share to 11.3% from 7.2% in September 2017. The share of BTr-managed funds decreased to 9.4% at the end of September from 11.3% a year earlier. Investors from government-owned or -controlled corporations and local government units maintained their respective shares of the total.

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	1.9	No	Yes	Property
2.	SM Prime Holdings	93.8	1.7	No	Yes	Property
3.	San Miguel	60.0	1.1	No	Yes	Holding Firms
4.	Metropolitan Bank	59.2	1.1	No	Yes	Banking
5.	BDO Unibank	58.6	1.1	No	Yes	Banking
6.	SM Investments	51.4	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	0.6	No	No	Brewery
11.	Maynilad	33.6	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.	SMC Global Power	30.0	0.6	No	No	Electricity, Energy, and Power
15.	Filinvest Land	29.0	0.5	No	Yes	Property
16.	Manila Electric Company	28.8	0.5	No	Yes	Electricity, Energy, and Power
17.	Vista Land	28.1	0.5	No	Yes	Property
18.	East West Banking	27.7	0.5	No	Yes	Banking
19.	Rizal Commercial Banking Corporation	27.2	0.5	No	Yes	Banking
20.	Chinabank	26.2	0.5	No	Yes	Banking
21.	GT Capital	22.0	0.4	No	Yes	Holding Firms
22.	PLDT	20.6	0.4	No	Yes	Telecommunications
23.	Petron	18.6	0.3	No	Yes	Electricity, Energy, and Power
24.	Bank of the Philippine Islands	17.2	0.3	No	Yes	Banking
25.	Union Bank of the Philippines	17.0	0.3	No	Yes	Banking
26.	Doubledragon	15.0	0.3	No	Yes	Property
27.	Philippine Savings Bank	14.5	0.3	No	Yes	Banking
28.	Aboitiz Power	13.0	0.2	No	Yes	Electricity, Energy, and Power
29.	Globe Telecom	12.5	0.2	No	Yes	Telecommunications
30	Megaworld	12.0	0.2	No	Yes	Property
Total Top 30 LCY Corporate Issuers		**1,036.3**	**19.2**			
Total LCY Corporate Bonds		**1,198.2**	**22.2**			
Top 30 as % of Total LCY Corporate Bonds		**86.5%**	**86.5%**			

LCY = local currency, PHP = Philippine peso, USD = United States dollar.
Notes:
1. Data as of 30 September 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 Third Quarter of 2018

Corporate Issuers	Coupon Rate (%)	Issued Amount (PHP billion)
SMC Global		
5-year bond	6.75	15.00
Chinabank		
6-year LTNCD	4.55	10.25
Vista Land		
7-year bond	7.49	2.20
10-year bond	7.71	6.00
NLEX		
7-year bond	6.64	4.00

LTNCD = long-term negotiable certificates of deposit, PHP = Philippine peso.
Source: Bloomberg LP.

Policy, Institutional, and Regulatory Developments

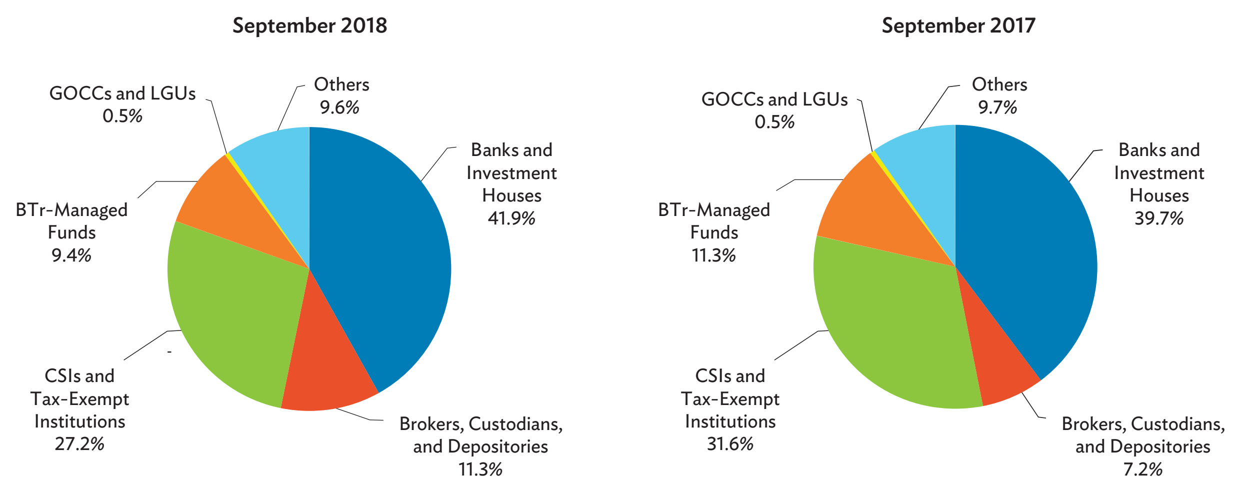
BSP Approves Rules on Bond Issuance

On 10 August, the BSP enhanced rules on bond issuances in order to develop the LCY bond market. Aside from complying with the Securities Regulations Code, universal banks, commercial banks, and quasi-banks need to satisfy additional criteria to be eligible to issue bonds and commercial paper. They must have a CAMELS (Capital Adequacy, Asset Quality, Management Quality, Earnings, Liquidity, Sensitivity) rating of at least 3, with a management rating not lower than 3. They must not have major risk management and compliance concerns, must be compliant with BSP rules, and must not have pending enforcement actions from the BSP. For quasi-banks, they must have at least an acceptable RAS (Rating Assessment Service) rating. In order to promote security, price transparency, and price discovery, the bonds to be issued must be traded in a Securities and Exchange Commission-recognized market. An issuance does not need approval from the central bank. The concerned bank need only submit a certification that they have complied with and met all criteria for issuing bonds. The additional rules aim to help promote an efficient debt market that protects investors.

BTr Implements New National Registry for Government Securities Auctions

On 20 August, the BTr launched the National Registry of Scripless Securities for the submission, confirmation, and settlement of government securities auctions by government securities-eligible dealers. The online platform will promote efficiency in processing bids during auctions for government securities. The previous Automated Debt Auction Processing System will be used only for the purpose of business continuity.

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.