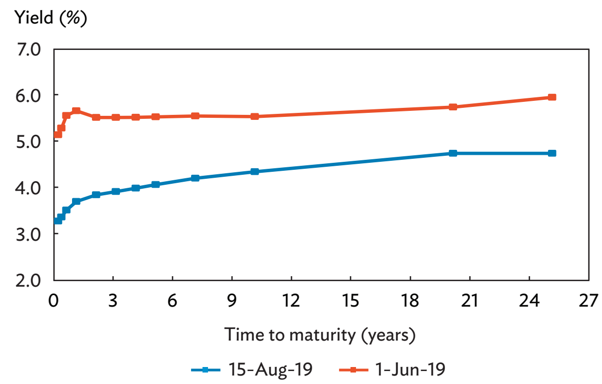
Philippines

Yield Movements

Between 1 June and 15 August, local currency (LCY) government bond yields in the Philippines fell for all tenors (**Figure 1**). The decline in yields was most pronounced for tenors of 1 year and less at an average of 195 basis points (bps). Yields for bonds with tenors of 2 years up to 25 years, excluding the 20-year which fell 100 bps, fell an average of 143 bps. The spread between the 2-year and 10-year yields widened to 50 bps from 2 bps as the Philippine yield curve normalized following a slight inversion earlier in the year when yields in the middle to longer-end of the curve saw sharper declines than those at the shorter-end, which saw minimal movement.

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



Source: Based on data from Bloomberg LP.

Yields fell in the Philippines during the review period due to monetary easing by the Bangko Sentral ng Pilipinas (BSP) in August and the United States (US) Federal Reserve in July, as well as the dovish stances of central banks in other major economies. Yields have been on a downward trend since June due to expectations of a policy rate cut by the BSP amid easing inflation. In addition, the remaining 100 bps in the 200-bps cut in reserve requirement ratios, announced by the BSP on 16 May, which took effect via two 50-bps cuts (28 June and 26 July) also contributed to additional liquidity in the market, further boosting demand for government securities.

Easing inflation, lower-than-expected second quarter (Q2) gross domestic product growth results, and statements by the central bank governor bolstered expectations of further rate cuts by the BSP during the remainder of the year. A slowdown in US economic growth and continued trade tensions with the People's Republic of China have led to expectations of a more neutral stance or the possibility of another rate cut by the Federal Reserve. These developments have also driven the downward trend in Philippine yields.

On 8 August, the BSP cut the interest rate on its overnight reverse repurchase facility by 25 bps to 4.25%. The interest rates for the overnight deposit and lending facilities were also reduced by 25 bps each to 3.75% and 4.75%, respectively. The BSP stated that the decision to cut rates was due to easing inflation, with baseline forecasts expected to remain in the central bank's target range of 2.0%–4.0% until 2021. Risks to the inflation outlook remain balanced for the next 2 years and are expected to be on the downside in 2021 due to weak global economic growth prospects. The outlook for domestic economic growth remains firm as household spending is expected to recover along with the government's accelerated implementation of its infrastructure spending program. The BSP also stated that these developments give them room for further rate cuts as a preemptive move to address risks related to weakening global growth.

Inflation eased toward the end of Q2 2019, rising slightly from 3.0% y-o-y in April to 3.2% y-o-y in May before slowing to 2.7% y-o-y in June. Inflation eased further in July to 2.4% y-o-y, primarily driven by the deceleration in price increases for food and nonalcoholic beverages. Year-to-date average inflation was 3.3% y-o-y at the end of July, which was within the government's target range for full-year 2019.

The Philippines' real gross domestic product growth slightly eased to 5.5% y-o-y in Q2 2019 from 5.6% y-o-y in the first quarter (Q1) of 2019. Slower economic growth continued due to the delayed passage of the 2019 budget and the government's infrastructure spending program. By type of expenditure, all categories posted slower annual growth rates in Q2 2019 except for investment, which declined 8.5% y-o-y during the quarter to reverse the 8.0% y-o-y growth posted in the previous quarter. Growth in private consumption, government consumption, and exports also eased in Q2 2019.

The Philippine peso strengthened in both June and July, hovering at the lower half of the PHP51 per US dollar level. This was due to a weaker US dollar and easing inflation supporting expectations of a policy rate cut by the BSP. However, the Philippine peso depreciated sharply in the first half of August to the PHP52 per US dollar level as a result of renewed investor risk aversion toward emerging markets. This negative sentiment resulted from the rate cut by the Federal Reserve, the resumption of the trade dispute between the People's Republic of China and the US, the devaluation of the Chinese renminbi, the results of Argentina's elections, and fears of a global economic recession following the inversion of the yield curve in the US.

Size and Composition

The size of the Philippine bond market rose 1.8% quarter-on-quarter (q-o-q) to PHP6,707 billion (USD131 billion) at the end of June from PHP6,588 billion at the end of March (**Table 1**). The growth was driven by both the government and corporate segments, which posted increases of 1.7% q-o-q and 2.3% q-o-q, respectively.

Government bonds. The amount of LCY government bonds outstanding inched up 1.7% q-o-q in Q2 2019 to PHP5,290 billion, which was slower than the 8.8% q-o-q growth posted in Q1 2019. The slower growth was primarily driven by the high base in Q1 2019 due to the large issuance of Retail Treasury Bonds, which also resulted in minimal growth in Treasury bonds of only 1.2% q-o-q to PHP4,616 billion at the end of June. Meanwhile, the stock of Treasury bills rose 7.4% q-o-q to PHP652 billion, and bonds issued by government-related entities declined more than a third to PHP22 billion due to maturing bonds and no new issuances during the quarter.

Issuance of government bonds in Q2 2019 fell by more than half to PHP312 billion from PHP675 billion in the previous quarter. This was mainly due to the large issuance volume of Retail Treasury Bonds of PHP236 billion in Q1 2019. The government also had a lower planned issuance volume in Q2 2019 compared with the previous quarter. In addition, one offer of PHP20 billion worth of Treasury bonds was rejected in April due to the high rates sought by market participants and given that the Bureau of Treasury (BTr) already had a huge cash buffer from the high volume raised in Q1 2019.

Corporate bonds. The corporate bond market posted growth of 2.3% q-o-q in Q2 2019 to reach a size of PHP1,417 billion at the end of June on a surge in issuance during the quarter. Banks with aggregate bonds outstanding of PHP492 billion accounted for the largest share in the Philippine corporate bond market at 34.7%

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2018		Q1 2019		Q2 2019		Q2 2018		Q2 2019	
	PHP	USD	PHP	USD	PHP	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**5,741**	**108**	**6,588**	**125**	**6,707**	**131**	**2.6**	**11.1**	**1.8**	**16.8**
Government	4,592	86	5,203	99	5,290	103	2.5	9.0	1.7	15.2
Treasury Bills	381	7	608	12	652	13	14.6	19.9	7.4	71.2
Treasury Bonds	4,170	78	4,562	87	4,616	90	1.6	8.5	1.2	10.7
Others	40	1	34	1	22	0.4	(0.01)	(20.5)	(35.5)	(45.9)
Corporate	1,149	22	1,385	26	1,417	28	3.2	20.0	2.3	23.3

( ) = negative, 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 local currency–USD rates are used.
3. Growth rates are calculated from local currency 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 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.

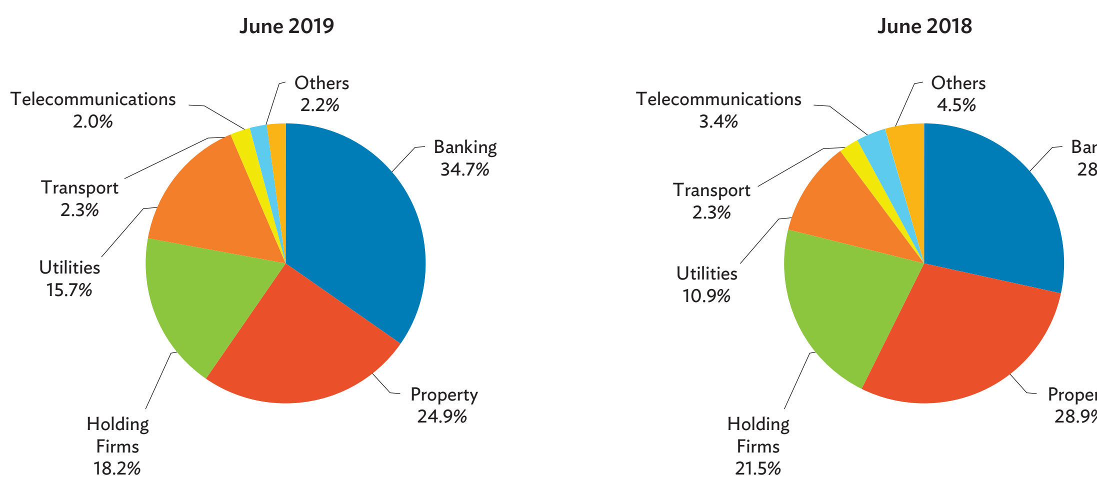
at the end of June, a 6-percentage-point increase from its share in the same period in 2018 (**Figure 2**). Meanwhile, the share of property firms (PHP353 billion) declined to 24.9% at the end of June from 28.9% a year earlier. The share of holding firms (PHP259 billion) also declined to 18.2% from 21.5% during the review period, while that of utility companies (PHP222 billion) rose to 15.7% from 10.9%.

Only 57 companies are actively tapping the bond market in the Philippines. The top 30 issuers accounted for 88.8% of total LCY corporate bonds outstanding at the end of June (**Table 2**). Out of the top 30 bond issuers, only four companies were privately held corporations and the rest were publicly listed with the Philippine Stock Exchange. Banks comprised a third of the list, followed by property firms and holding companies. Ayala Land and SM Prime Holdings remained the largest corporate issuers in the Philippines with approximately PHP104 billion of outstanding bonds each at the end of June. Metrobank was the next largest borrower with roughly the same outstanding amount as as the top two issuers at PHP103 billion.

Issuance of corporate bonds more than doubled in Q2 2019 compared with the previous quarter, with total issuance amounting to PHP126 billion as companies took advantage of declining interest rates. **Table 3** lists the corporate bond issuances in Q2 2019. SMC Global Power was the largest bond issuer for the quarter, issuing PHP30 billion worth of 3-year, 5-year, and 7-year bonds. Universal banks—Security Bank, Metrobank, and Philippine National Bank—also issued medium-term bonds at volumes of PHP18 billion, PHP17.5 billion, and PHP14 billion, respectively.

Foreign currency bonds. In an effort to diversify funding sources, the Government of the Philippines successfully raised funds via two offshore issuances in Q2 2019. In May, the government raised EUR750 million (USD842 million) worth of 8-year bonds priced at 0.875%, or a 70-bps spread over benchmark, the first EUR-denominated issuance in 13 years. The BTr stated that the bonds had high demand and were oversubscribed, which led the government to raise the initial offer volume from EUR500 million. In the same month, the government issued its second panda bonds, or CNY-denominated bonds; the first was in March 2018. The government raised CNY2.5 billion via the issuance of a 3-year bond with a coupon rate of 3.58% that was priced at a spread of 32 bps over benchmark. In August, the government returned to the offshore market to issue JPY92 billion (USD855 million) worth of samurai bonds. The offer included a JPY30.4 billion 3-year bond, JPY21 billion 5-year bond, JPY18 billion 7-year bond, and JPY23 billion 10-year bond. The bonds were priced at 0.18%, 0.28%, 0.43%, and 0.59%, respectively.

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	103.9	2.0	No	Yes	Property
2.	SM Prime Holdings	103.7	2.0	No	Yes	Property
3.	Metropolitan Bank	103.3	2.0	No	Yes	Banking
4.	BDO Unibank	89.8	1.8	No	Yes	Banking
5.	SMC Global Power	80.0	1.6	No	No	Electricity, Energy, and Power
6.	San Miguel	60.0	1.2	No	Yes	Holding Firms
7.	Philippine National Bank	54.6	1.1	No	Yes	Banking
8.	Security Bank	47.4	0.9	No	Yes	Banking
9.	SM Investments	47.3	0.9	No	Yes	Holding Firms
10.	Petron	42.9	0.8	No	Yes	Electricity, Energy, and Power
11.	Rizal Commercial Banking Corporation	41.2	0.8	No	Yes	Banking
12.	Ayala Corporation	40.0	0.8	No	Yes	Holding Firms
13.	Vista Land	38.0	0.7	No	Yes	Property
14.	Bank of the Philippine Islands	37.2	0.7	No	Yes	Banking
15.	Aboitiz Equity Ventures	37.0	0.7	No	Yes	Holding Firms
16.	Maynilad	33.3	0.6	No	No	Water
17.	Union Bank of the Philippines	30.8	0.6	No	Yes	Banking
18.	JG Summit	30.0	0.6	No	Yes	Holding Firms
19.	East West Banking	28.8	0.6	No	Yes	Banking
20.	China Bank	26.2	0.5	No	Yes	Banking
21.	Aboitiz Power	23.2	0.5	No	Yes	Electricity, Energy, and Power
22.	Manila Electric Company	23.0	0.4	No	Yes	Electricity, Energy, and Power
23.	GT Capital	22.0	0.4	No	Yes	Holding Firms
24.	Filinvest Land	22.0	0.4	No	Yes	Property
25.	San Miguel Brewery	22.0	0.4	No	No	Brewery
26.	Doubledragon	15.0	0.3	No	Yes	Property
27.	PLDT	15.0	0.3	No	Yes	Telecommunications
28.	Philippine Savings Bank	14.5	0.3	No	Yes	Banking
29.	NLEX Corporation	13.9	0.3	No	No	Transport
30.	Robinsons Land	12.0	0.2	No	Yes	Property
Total Top 30 LCY Corporate Issuers		**1,258.0**	**24.5**			
Total LCY Corporate Bonds		**1,416.9**	**27.6**			
Top 30 as % of Total LCY Corporate Bonds		**88.8%**	**88.8%**			

LCY = local currency, PHP = Philippine peso, USD = United States dollar.
Notes:
1. Data as of 30 June 2019.
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 2019

Corporate Issuers	Coupon Rate (%)	Issued Amount (PHP billion)
SMC Global Power		
3-year bond	6.84	13.84
5-year bond	7.18	9.23
7-year bond	7.60	6.92
Security Bank		
2-year bond	5.88	18.00
Metrobank		
3-year bond	6.30	17.50
Philippine National Bank		
2-year bond	6.30	13.87
SM Prime Holdings		
3-year bond	6.22	10.00
Rizal Commercial Banking		
2-year bond	6.15	8.00
BDO Unibank		
6-year bond	5.38	7.32
Ayala Land		
7-year bond	6.37	7.01
Unionbank Philippines		
3-year bond	6.00	5.80
Aboitiz Equity Ventures		
5-year bond	6.02	3.35
10-year bond	6.32	1.65
Century Properties		
3-year bond	7.82	3.00

PHP = Philippine peso.
Source: Bloomberg LP.

Investor Profile

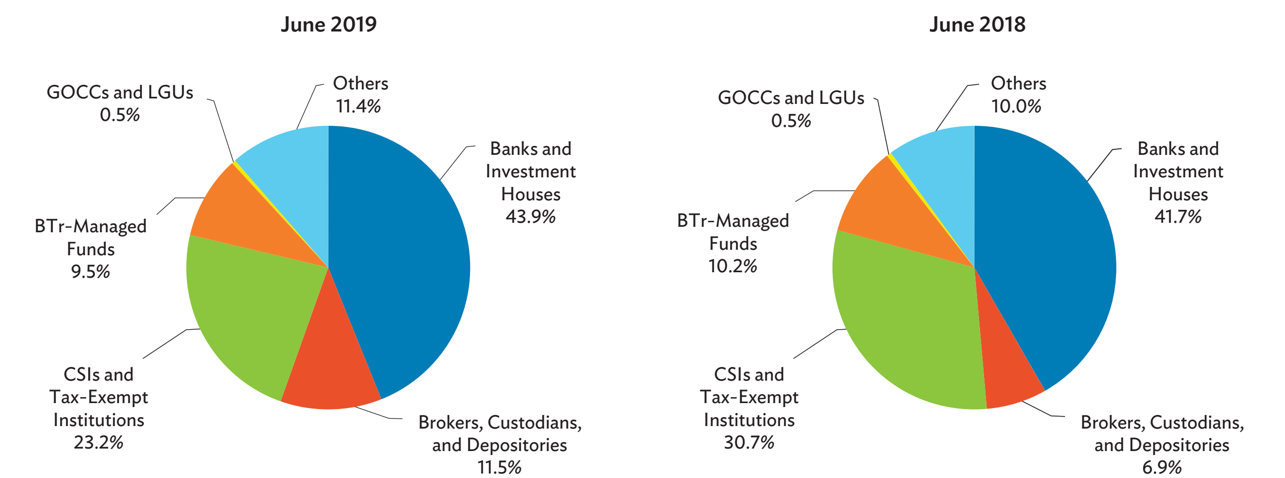
Banks and investment houses continued to be the largest holder of Philippine LCY government bonds, with a share inching up to 43.9% at the end of June from 41.7% at the end of June 2018 (**Figure 3**). On the other hand, the share of contractual savings institutions—including the Social Security System, Government Service Insurance System, Pag-IBIG, and life insurance companies—and tax-exempt institutions, such as trusts and other tax-exempt entities, declined to 23.2% from 30.7% during the same period. The share of custodians rose to 11.5% from 6.9% during the review period, while that of BTr-managed funds slightly fell to 9.5% from 10.2%.

Policy, Institutional, and Regulatory Developments

Bangko Sentral ng Pilipinas Issues Risk Management Guidelines for Investments

In August, the BSP issued risk management guidelines for investments made by banks and quasi-banks, given their exposures on bonds issued by emerging economies, complex structured products, and other tradable assets. The BSP guidelines highlight the need for due diligence prior to investing as well as on an ongoing basis.

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.

They consider lessons from the global financial crisis and the guidelines included in the Basel Core Principles for Effective Banking Supervision. In particular, banks and quasi-banks with significant holdings of foreign-currency-denominated securities are required to determine whether these firms have sufficient capital to cover risks that may arise from currency conversion restrictions imposed by relevant foreign governments.