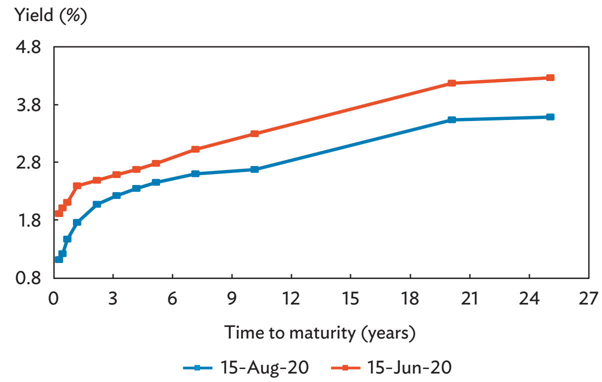
Philippines

Yield Movements

The yields of local currency (LCY) government bonds in the Philippines fell for all tenors, shifting the yield curve downward, between 15 June and 15 August (**Figure 1**). Yields of bonds with shorter maturities (1-month to 1-year tenors) dropped the most, averaging a decline of 71 basis points (bps). Yields for securities with 10- to 25-year tenors dropped an average of 64 bps. Relatively smaller yield declines, averaging 37 bps, were observed for securities with 2- to 7-year maturities. The yield spread between the 2-year and 10-year tenors narrowed during the review period from 80 bps to 60 bps.

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



Source: Based on data from Bloomberg LP.

The downward bias of yield movement remains, reflecting a flight to safety amid a weak economic outlook and uncertainty posed by the coronavirus disease (COVID-19) pandemic, as well as abundant liquidity in the market as the Bangko Sentral ng Pilipinas (BSP) has been accommodative in its policy stance through rate and reserve requirement cuts to support the economy. With the pandemic ongoing, risk aversion will persist, resulting in higher buying interest for government securities and lower rates. Broader yield declines at the short-end of the curve indicate investors' preference for short-dated securities as they are on the lookout for market leads.

A deeper-than-expected contraction in the Philippines' gross domestic product (GDP) occurred in the second quarter (Q2) of 2020. The economy plunged 16.5% year-on-year (y-o-y) after declining 0.7% y-o-y in the first quarter (Q1). It was the largest quarterly drop since 1981 and put the economy into recession after nearly 3 decades of uninterrupted growth.[7] Strict lockdown measures implemented in Q2 2020 curtailed the typical growth drivers, household consumption and investment, leading to declines of 15.5% y-o-y and 53.5% y-o-y, respectively. Exports and imports also saw double-digit y-o-y declines in Q2 2020. On the other hand, government expenditure accelerated 22.1% y-o-y as a result of massive fiscal measures to keep the economy afloat.

The BSP kept its policy rate steady at 2.25% in its monetary policy meeting on 20 August as inflation remained benign and within the government's target of 2.0%–4.0%. The BSP also stated that the pause will enable the rate reductions and other monetary relief measures to fully take effect in the economy. On June 25, the central bank unexpectedly cut its overnight reverse repurchase facility rate by 50 bps. This brought down the key policy rate to a record low of 2.25% with an accumulated 175-bps cut thus far in 2020 to prop up the economy amid expectations of a protracted domestic and global recovery. The BSP also reduced the reserve requirement rates of thrift banks, and rural and cooperative banks by 100 bps each to 3.0% and 2.0%, respectively, effective 31 July. The move is expected to release PHP10 billion (USD204 million) in the system.

Consumer price inflation remained benign, which is also a factor that kept yields at bay. The inflation rate in August slowed to 2.4% y-o-y after upticks in June (2.5% y-o-y) and July (2.7% y-o-y). The decrease was largely driven by the deceleration in food prices. The year-to-date inflation rate is 2.5% y-o-y and still falls within the government target. The BSP sees inflation to tilt toward the downside amid weak domestic demand and disruptions in economic activities caused by the pandemic.

[7] Philippine Statistics Authority. 2020. GDP Growth Rate Drops by 16.5 Percent in the Second Quarter of 2020. 6 August. http://www.psa.gov.ph/press-releases/id/162842.

The Philippine peso has shown record strength despite the recession and rising COVID-19 cases. The peso traded at PHP48.76 against the United States (US) dollar on 15 August, marking a 3-year high. The domestic currency owed its strength to the weak demand for US dollars due to the slowdown in global economic activities. The issuance of Retail Treasury Bonds (RTBs) in July also drew in strong demand for pesos. The gradual resumption of domestic economic activities and sound financial buffers, including high gross international reserves, also contributed to the strength of the peso.

Size and Composition

The size of the LCY bond market in the Philippines continued to expand in Q2 2020, reaching PHP7,477 billion (USD150 billion) at the end of June on growth of 5.2% quarter-on-quarter (q-o-q), which was down from 6.9% q-o-q in Q1 2020 (**Table 1**). The expansion was driven by the government segment given the contraction in the corporate segment during the quarter. On an annual basis, the growth of the bond market was faster in Q2 2020 at 11.5% y-o-y compared with the preceding quarter of 7.9% y-o-y. Government bonds comprised 79.0% of the total bond market at the end of June, with corporate bonds accounting for the rest.

Government bonds. Total LCY government bonds outstanding expanded 6.8% q-o-q to PHP5,904 billion in Q2 2020, which was down from the growth in the previous quarter of 7.5% q-o-q. Treasury bills and Treasury bonds drove the increase in market size as the government boosted its borrowing to fund fiscal stimulus measures to support economic recovery amid the continuing COVID-19 pandemic. A substantial increase in outstanding Treasury bills was seen, with nearly 50% q-o-q growth on the back of higher issuance volume during the quarter. Treasury bonds grew 2.8% q-o-q, although slower compared with 6.8% q-o-q in Q1 2020, while outstanding debt from government-related entities marginally decreased due to bond maturities. On an annual basis, the government bond stock grew 11.6% y-o-y.

Total debt raised by the government in the domestic market declined 6.9% q-o-q to PHP668.6 billion in Q2 2020. The quarterly decline was due to a high base in Q1 2020 when PHP310.8 billion in RTBs were issued. Without the RTBs, bond issuance in Q2 2020 was higher than in Q1 2020 as the government increased its borrowing plan to fund efforts to cushion the economy against the negative impact of the COVID-19 pandemic. Moreover, the government wanted to take advantage of the low interest rate due to high liquidity in the domestic market. In Q2 2020, the Bureau of the Treasury's (BTr) issuances were weighted toward short-term instruments as Treasury bill issuance increased 60.9% q-o-q to PHP488.6 billion. The BTr increased the issuance of short-term securities with the addition of 35-day Treasury bills in its weekly auctions. The auctions were met with

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2019		Q1 2020		Q2 2020		Q2 2019		Q2 2020	
	PHP	USD	PHP	USD	PHP	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**6,707**	**131**	**7,106**	**140**	**7,477**	**150**	**1.8**	**16.8**	**5.2**	**11.5**
Government	5,290	103	5,526	109	5,904	119	1.7	15.2	6.8	11.6
Treasury Bills	652	13	557	11	797	16	7.4	71.2	43.1	22.1
Treasury Bonds	4,616	90	4,930	97	5,068	102	1.2	10.7	2.8	9.8
Others	22	0.4	40	0.8	40	0.8	(35.5)	(45.9)	(0.02)	83.3
Corporate	1,417	28	1,579	31	1,573	32	2.3	23.3	(0.4)	11.0

( ) = 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 USD) are not included.
Sources: Bloomberg LP and Bureau of the Treasury.

strong demand, prompting the BTr to open its TAP facility to accommodate the investors. Treasury bonds issuance amounted to PHP180 billion, declining 56.6%q-o-q due to the aforementioned RTB base effect.

Corporate bonds. Debt outstanding in the corporate sector slightly declined by 0.4% q-o-q in Q2 2020 to PHP1,573 billion after registering an increase 5.0% q-o-q in Q1 2020. The decline can be attributed to the maturation of bonds accompanied by just few a corporate issuers during the quarter.

At the end of June, the banking sector remained the largest holder in the LCY corporate bond market with outstanding debt comprising 41.2% of the total corporate bond stock, up from 34.7% at the end of June 2019 (**Figure 2**). The banking sector and "other" sectors were the only sectors that saw an increase in their shares of corporate bonds compared to a year earlier. All other sectors saw lower shares at the end of June 2020 compared to June 2019, with holding firms experiencing the largest decrease from 18.2% to 14.2%.

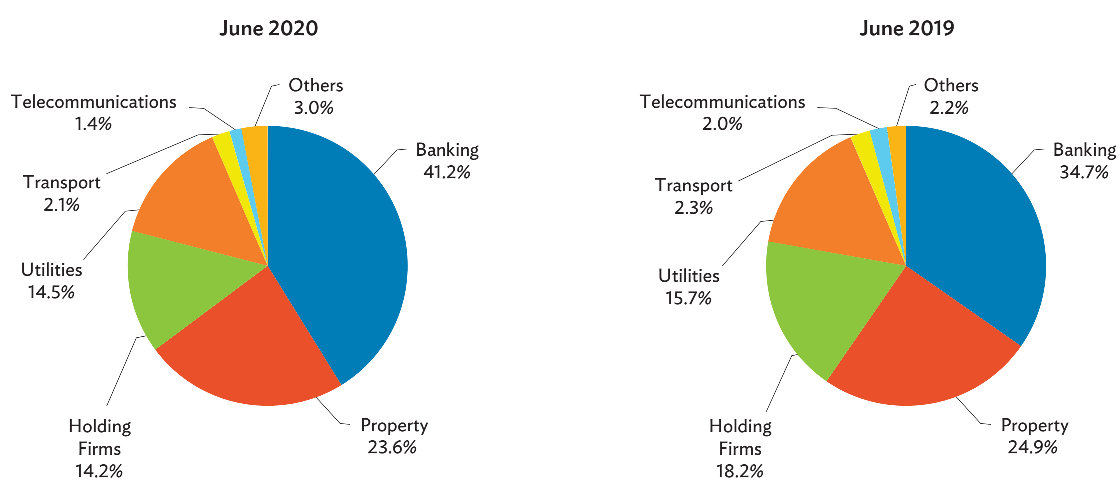
The top 30 corporate issuers had aggregate debt outstanding of PHP1,386.2 billion at the end of June, comprising 88.1% of the total corporate bond market (**Table 2**). The banking sector led the list with outstanding bonds totaling PHP617.3 billion or 44.5% of the total LCY corporate bond market. There were 11 banks on the list, including the two top corporate issuers: Metropolitan Bank and BDO Unibank. Holding firms were the second-largest issuers with PHP298.4 billion of bonds outstanding (21.5% share), led by SM Prime Holdings. Property firms came in third with PHP195.5 billion (14.1% share) led by Ayala Land.

Corporate bond issuance in Q2 2020 declined dramatically, falling 81.3% q-o-q and reversing the double-digit q-o-q growth in Q1 2020. Only three corporates raised funds in Q2 2020, issuing a combined PHP27.6 billion worth of bonds. The weak issuance activity from the corporate sector can be attributed to gloomy economic and business prospects due to the ongoing pandemic. Amid lingering uncertainty and halted economic activities due to the strict quarantine measures in place for the entirety of Q2 2020, firms held off expansion and issuance plans to properly assess the situation, even with low interest rates and the market awash with liquidity. **Table 3** lists all issuances in Q2 2020, which comprised short-tenor securities from the banking and property sectors.

Investor Profile

The investor landscape for LCY government bonds in June was changed from a year earlier. Contractual savings and tax-exempt institutions were the largest investors in LCY government bonds at the end of Q2 2020, with their market share rising to 39.0% from 23.2% in June 2019 (**Figure 3**). This investor group overtook banks and

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.	Metropolitan Bank	130.8	2.6	No	Yes	Banking
2.	BDO Unibank	121.4	2.4	No	Yes	Banking
3.	Ayala Land	115.0	2.3	No	Yes	Property
4.	SM Prime Holdings	103.6	2.1	No	Yes	Holding Firms
5.	SMC Global Power	80.0	1.6	No	No	Electricity, Energy, and Power
6.	Bank of the Philippine Islands	64.6	1.3	No	Yes	Banking
7.	San Miguel	60.0	1.2	No	Yes	Holding Firms
8.	China Bank	56.2	1.1	No	Yes	Banking
9.	Rizal Commercial Banking Corporation	53.6	1.1	No	Yes	Banking
10.	Security Bank	52.8	1.1	No	Yes	Banking
11.	Philippine National Bank	52.2	1.0	No	Yes	Banking
12.	Vista Land	43.6	0.9	No	Yes	Property
13.	Petron	42.9	0.9	No	Yes	Electricity, Energy, and Power
14.	SM Investments	42.7	0.9	No	Yes	Holding Firms
15.	Ayala Corporation	40.0	0.8	No	Yes	Holding Firms
16.	Aboitiz Equity Ventures	37.0	0.7	No	Yes	Holding Firms
17.	Maynilad	32.8	0.7	No	No	Water
18.	Aboitiz Power	30.5	0.6	No	Yes	Electricity, Energy, and Power
19.	Union Bank of the Philippines	26.6	0.5	No	Yes	Banking
20.	Philippine Savings Bank	25.4	0.5	No	Yes	Banking
21.	Manila Electric Company	23.0	0.5	No	Yes	Electricity, Energy, and Power
22.	Filinvest Land	22.0	0.4	No	Yes	Property
23.	San Miguel Brewery	22.0	0.4	No	No	Brewery
24.	East West Banking	17.7	0.4	No	Yes	Banking
25.	Robinsons Bank	16.0	0.3	No	No	Banking
26.	GT Capital	15.1	0.3	No	Yes	Holding Firms
27.	Doubledragon	15.0	0.3	No	Yes	Property
28.	PLDT	15.0	0.3	No	Yes	Telecommunications
29.	San Miguel Food and Beverage	15.0	0.3	No	Yes	Food and Beverage
30.	NLEX Corporation	13.9	0.3	No	No	Transport
Total Top 30 LCY Corporate Issuers		**1,386.2**	**27.8**			
Total LCY Corporate Bonds		**1,573.4**	**31.6**			
Top 30 as % of Total LCY Corporate Bonds		**88.1%**	**88.1%**			

LCY = local currency, PHP = Philippine peso, USD = United States dollar.
Notes:
1. Data as of 30 June 2020.
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 2020

Corporate Issuers	Coupon Rate (%)	Issued Amount (PHP billion)
Metropolitan Bank		
1-year bond	3.00	10.50
Ayala Land		
2-year bond	3.00	10.00
Rizal Commercial Banking Corporation		
2-year bond	4.85	7.05

PHP = Philippine peso.
Source: Bloomberg LP.

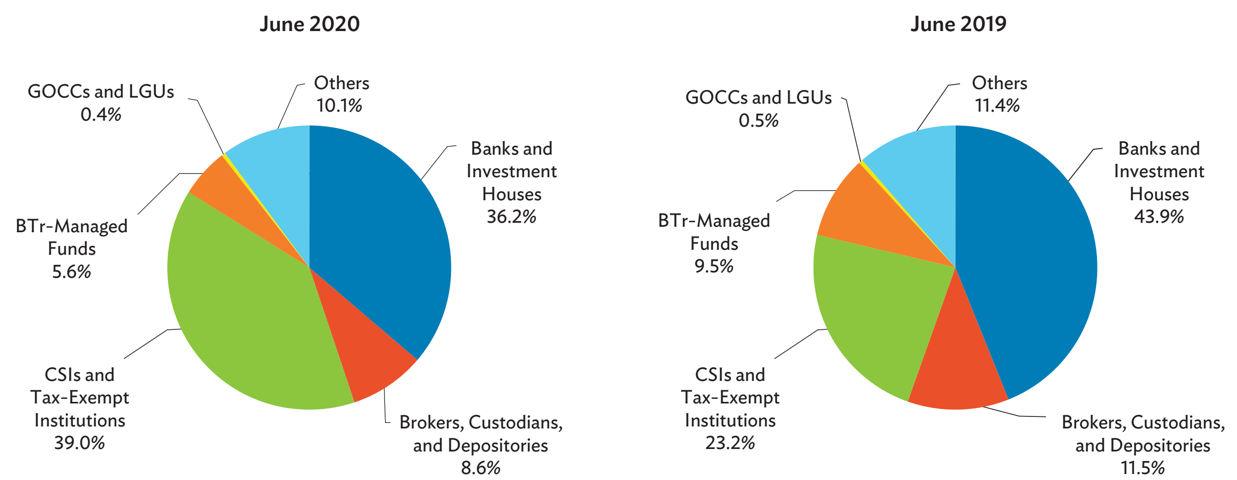
investment houses as the largest investor group, whose market share declined to 36.2% from 43.9% during the review period. Other investor group also outpaced brokers, custodians, and depositories to assume the third-largest market share by the end of Q2 2020. BTr-managed funds and government-owned or -controlled corporations and local government units maintained their respective rankings, albeit with declining holding shares. Only contractual savings and tax-exempt institutions showed an increase between June 2019 and June 2020 in both absolute government bond holdings and the share of total government bonds outstanding.

Ratings Update

On 30 May, Standard and Poor's Global (S&P) maintained the Philippines' sovereign credit rating at BBB+ with a stable outlook. The rating affirmation reflected expectations that the economy would continue to achieve above-average growth over the medium term, supported by sound external settings. S&P expects the economy to bounce back strongly in 2021 following a contraction in 2020. S&P also stated that the government's long track record of fiscal prudence would provide a buffer against the deterioration of its fiscal standing, assuming an economic recovery begins in 2021.

On 11 June, Japan Credit Rating Agency upgraded the Philippines' sovereign credit rating by a notch to A– from BBB+ but also adjusted the outlook to stable from positive. The rating agency cited the Philippines' high and sustainable economic growth performance as the basis for the upgrade. While the COVID-19 pandemic impaired the economy with the imposition of lockdown measures, Japan Credit Rating Agency views that the downturn will be limited given strong economic fundamentals, a resilient external position, and the government's massive stimulus package.

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

Bangko Sentral ng Pilipinas Cuts Reserve Requirements for Thrift Banks and Rural and Cooperative Banks

In July, the BSP reduced the reserve requirements for thrift banks, and rural and cooperative banks by 100 bps each to 3.0% and 2.0%, respectively. The central bank stated that the move is a part of its omnibus package of reforms to assist the banking public with their liquidity requirements during the ongoing COVID-19 pandemic and to support the transition toward a sustainable recovery after the crisis. The reserve requirement cuts are expected to increase the lending capacity of the banks and release approximately PHP10 billion in cash into the economy, which will support small businesses and rural community-based clients. The reduction is effective 31 July.

Bureau of the Treasury Launches Bonds.PH

In July, the BTr launched Bonds.PH, the first mobile application in Asia for the distribution of government bonds enabled by distributed ledger technology. The system, which utilizes blockchain technology, allows tamper-proof record keeping and can facilitate complex transactions. Such technology supports financial inclusion in the economy as it makes investing, especially to the unbanked, easier and more secure. The BTr's issuance of RTBs in July utilized this technology.

Bangko Sentral ng Pilipinas Approves the Exclusion of Debt Held by Market-Makers from Single Borrower's Limit

In July, the BSP approved a new policy that excludes debt securities acquired from market-making activities of BSP-supervised financial institutions from the single borrower's limit (SBL) as part of initiatives to develop the capital market. According to the BSP's new policy, market-making activities from 1 August 2020 to 31 July 2021 will be excluded from the SBL computation for 90 calendar days from the time of acquisition of the securities. Beginning 1 August 2021, the debt securities will only be excluded from the SBL computation for a period of up to 60 calendar days. The BSP stated that this policy will promote liquidity and transparency in the market by giving market-makers latitude to continue providing prices for debt securities in the secondary market and to make available an exit mechanism for investors to liquidate their holdings.