

March 12-16, 2018

## Firm US CPI Abate Fears of Aggressive Fed Hike

### Primary Indicators

|                                                 | Period     | Latest Period | Preceding Period |
|-------------------------------------------------|------------|---------------|------------------|
| <b>I. Real Economy (Growth, %)</b>              |            |               |                  |
| A. GDP                                          | 4Q2017     | 6.7           | 6.9              |
| B. Manufacturing (VoPi)                         | Nov '17    | -8.1          | 15.1             |
| <b>II. Monetary and Banking</b>                 |            |               |                  |
| A. Outstanding Loans, net of RRP (Php Bn), UKBs | Oct '17    | 7,363         | 7,436            |
| Y-O-Y Growth (%)                                | Oct '17    | 17.0%         | 21.0%            |
| B. NPL to Total Loans                           | Oct '17    | 1.46          | 1.42             |
| C. M3 Growth (Y-O-Y)                            | Jan '18    | 12.8          | 11.9             |
| <b>III. Prices</b>                              |            |               |                  |
| A. PHP/\$ (PDS data)                            | 2W Mar '18 | 51.930        | 52.040           |
| B. 91-Day Rate (%)                              | 1W Mar '18 | 1.958         | 2.032            |
| C. 10-Yr Rate (%)                               | 2W Mar '18 | 6.186         | 5.987            |
| D. Inflation (%)                                | Feb '18    | 4.5           | 4.0              |
| YTD (%)                                         |            | 4.3           | 4.0              |
| E. RRP                                          | May '16    | 3.000         | 4.000            |
| F. SDA Rate                                     | Sept '14   | 2.500         | 2.250            |
| <b>IV. External Accounts</b>                    |            |               |                  |
| A. Balance of Payments (\$ m)                   | Oct '17    | -368          | -678             |
| YTD (\$ m)                                      |            | -1,735        | -1,384           |
| i. Current Account (\$ b)                       | 3Q17       | 0.55          | -0.06            |
| % of GDP                                        |            | 0.7%          | -0.1%            |
| ii. Capital Account (\$ m)                      | 3Q17       | 36            | 37               |
| % of GDP                                        |            | 0.05%         | 0.05%            |
| iii. Financial Account (\$ m)                   | 3Q17       | 135           | 823              |
| % of GDP                                        |            | 0.1%          | 0.1%             |
| B. Net Foreign Portfolio Inv (\$ m)             | Oct '17    | -563          | 112.6            |
| YTD(\$ m)                                       |            | -770          | -206             |
| C. OFW Personal Remittances                     | Nov '17    | 2,526         | 2,552            |
| YTD(\$ b)/YoY(%)                                |            | 28.2/5.1%     | 25.7/5.2%        |
| D. Gross Intl Reserves (\$ b)                   | Feb '17    | 80.6          | 81.2             |
| YoY Growth                                      |            | (4.6%)        | (4.6%)           |
| E. Import Cover (x)                             | Oct '17    | 8.4           | 8.7              |
| F. ST External Debt cover (x)                   | Oct '17    | 3.6           | 3.7              |
| G. Exports Growth (% YoY)                       | June'17    | 0.8%          | 13.7%            |
| YTD(\$ b)/YoY growth                            |            | 31.0/13.6%    | 26.1/16.3%       |
| H. Trade Surplus (Deficit) (\$ b)               | July '17   | (1.65)        | (2.15)           |
| <b>V. NG Cash Operations</b>                    |            |               |                  |
| A. Surplus (Deficit) (Php b)                    | June '17   | (90.87)       | (33.42)          |

**Outlook.** The bond market will keep its eyes on the Bangko Sentral's monetary board meeting this Thursday (March 22) and the Fed's meeting this Wednesday-Thursday. While while several officials from the BSP have insisted that inflation is still manageable and the policy rate is still appropriate, there are some analysts who expect a preemptive hike from the bank. Thus, we expect bond trading to be sidelined, although there is downward pressure stemming from the recent weaker-than-expected retail sales and modest February inflation of 2.2%.

On the other hand, the Fed is widely expected to hike rates, with odds currently at 94.4%. Despite the modest inflation reading, current Fed fund futures pricing imply a 35% chance of four rate hikes, up from just 10% at the start of the year.

The Philippines is also set to offer its maiden 3-yr panda bond offering on Tuesday (March 20). Proceeds of the auction, worth \$230mn or RMB1.46bn, will be converted to peso and will be part of the BSP's international reserves and will be used to finance the government's infrastructure projects. Recall that the government has a planned gross borrowing of Php890bn this year (from Php728bn last year) with an 80-20 local-foreign split.

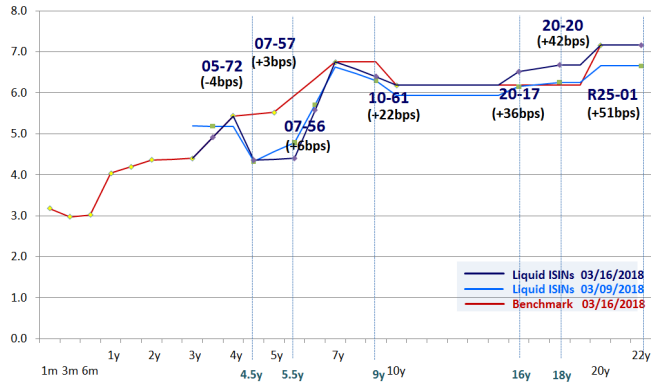
**Market review.** The benchmark yield curve fell by an average of 5bps week-on-week (WoW) as the yield curve slightly steepened again, with the short-end falling by an average of 19bps and the belly and tail rising by an average of 7bps. The spread between the local 10-yr local benchmark and the 10-yr US Treasury (UST) widened to 334bps from 304bps, as the former rose by 25bps to 6.19% (interpolated) and 50bps year-to-date (YTD). There is still upward pressure on yields as the market prices in both Fed and BSP hikes this week, evident in the higher rates that bidders demand with the recent BTr auction of 10-yr bonds. The latter shed 5bps to 2.85% on weaker-than-expected retail sales data and modest February CPI reading. Yields of ROPs fell by an average of 5bps, bucking the movement in USTs, which rose slightly by 2bps, as trade war noise is more pronounced in the US while Asian and European markets are more in a wait-and-see mode.

**Market picks up. Total daily traded volume up 42% week-on-week (WoW) to Php7.4bn.** The liquid yield curve rose by an average of 14bps as the tail-end increased by 33bps on average ahead of the panda bond offering. The front-end (FXTN 05-72: 1yr) fell by 4bps to 3.04%, the belly (FXTN 10-61: 9.7yrs) up 22bps to 6.10%, while the tail (R25-01: 20.5yr) was up by 51bps to 7.16%. Secondary trading volume picked up, rising by 42% to Php7.4bn, as T-bond trading increased by 32% to Php5.6bn while T-bill likewise rose by 89% to Php1.8bn. The Bureau of the Treasury (BTr) only partially awarded its latest Php20bn T-bond offering amid higher-than-expected bid rates. Average accepted rate was 6.18% and only Php7bn of the offered volume was accepted. Bids totaled Php22.8bn (1.14x).

**Emerging Markets' (EM) 10-year yields flat week-on-week (WoW).** Yields of EM bonds we follow were flat WoW on average amid ongoing trade war fears. Colombia (10-year yield -18bps), Hong Kong (-14bps), and Brazil (-12bps) have outperformed last week, while Turkey (10-year yield +38bps), the Philippines (+34bps), and Russia (+8bps) underperformed.

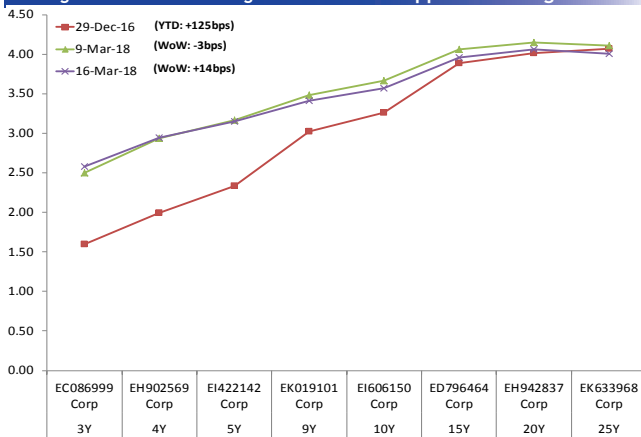
**USTs up by 2bps WoW ahead of FOMC meeting.** US Treasuries rose by an average of 2bps WoW, while the 10-yr UST shed 5bps to 2.85% on the release of weaker-than-expected retail sales data, which showed a decline in February of 0.1% versus an expected rise of 0.3%. US consumer price index (CPI) last February also showed a 2.2% increase in the year through February, in line with expectations and up from 2.1% in January. The data indicated inflation is gradually picking up without any big acceleration as policy makers expected, thus no reason for a faster pace of rate hikes. The lack of an upside surprise on the CPI figures helped calm investors who remain on edge after data released in February showed wages and prices rising faster than anticipated.

**PDST-R2 Rates of Liquid Government Securities, week-on-week change**



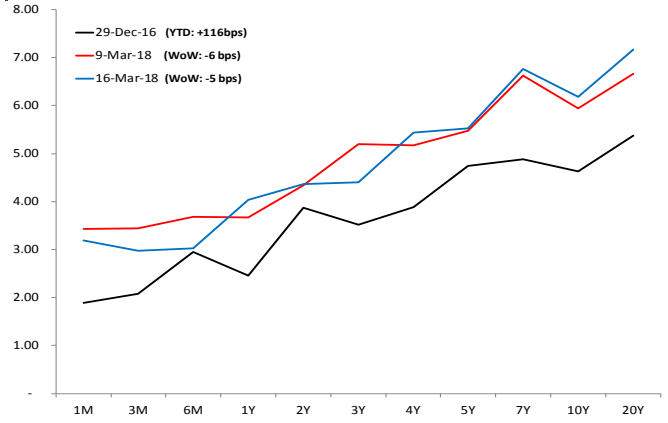
Source: PDS

**Average YTD and WoW changes of the USD Philippine Sovereign Curve**



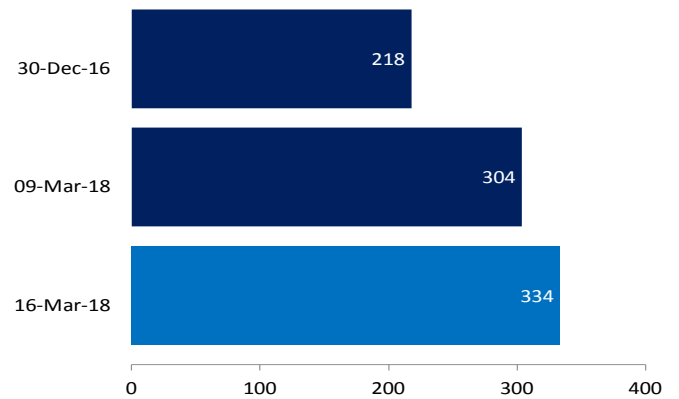
Source: Bloomberg

**Average YTD and WoW changes of the Philippine PhP Yield Curve, PDST-R2**



Source: Bloomberg

**PH and US Treasury 10-Yr Spread (bps)**



Source: Bloomberg