

March 19-23, 2018

## Markets Still Expect BSP 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)	3W Mar '18	52.215	51.930
B. 91-Day Rate (%)	1W Mar '18	1.958	2.032
C. 10-Yr Rate (%)	3W Mar '18	5.949	6.186
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.** We expect bond trading to be sidelined amid the shortened work-week. The Bangko Sentral ng Pilipinas (BSP) decided to stand pat last week, as expected, but programmed borrowing in the second quarter is expected to grow by 35% quarter-on-quarter (QoQ) to Php325bn (\$6.2bn), pressuring up interest rates. The debt auctions will also be more frequent, from fortnightly to weekly. The BSP also revised its inflation outlook this year from 3.8% to 3.9% but sees it slowing to 3.0% in 2019 from 3.1%, using the 2012-based index. Both forecasts are still within the target range of 2%-4%. That being the view, the BSP opted to keep its benchmark steady. Still, the market is skittish, fearing a rate hike catch-up by the BSP going forward.

The BSP's steady hand and the Fed's 25-bp rate hike were widely expected. Analysts still expect the BSP to raise rates this year to narrow the real interest rate gap between a Fed that's way ahead of the policy tightening cycle compared to a still dovish BSP. Higher food prices especially meat and fish (a little uptick in rice prices), higher utility bills, local oil pump prices plus the weaker peso were behind the inflation upticks in the past two months and not necessarily the tax reform law. Sustained credit growth at 19% as of last January was also proving to be a concern as it may add to excess liquidity and fan more inflation pressure leading to increased risk of overheating and further peso weakness.

**Market review.** The benchmark yield curve fell by an average of 15bps week-on-week (WoW) as heightened trade war worries in the US pushed investors to seek safe haven. The spread between the local 10-yr local benchmark and the 10-yr US Treasury (UST) narrowed to 315bps from 334bps, as the former fell by 21bps to 5.97% (done) and 28bps year-to-date (YTD), while the latter shed 3bps to 2.82%. Yields of ROPs rose by an average of 2bps, bucking the movement in USTs, which fell slightly by 3bps.

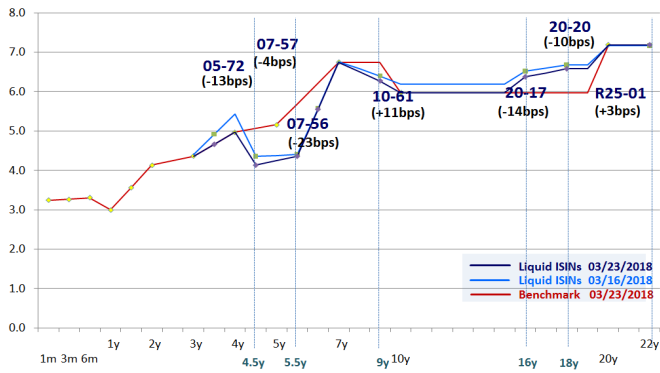
**Market picks up. Total daily traded volume up 35% week-on-week (WoW) to Php10.0bn.** The liquid yield curve fell by an average of 21bps as investors viewed the trade war as undermining the so-called synchronized global growth and a perceived economic weakness favors bonds. Investors sought shelter from safe havens and dumped risky equities exposure, causing the PSEi to scour new multi-year lows. The front-end (FXTN 05-72: 1yr) fell by 13bps to 2.91%, the belly (FXTN 10-61: 9.7yrs) down by 21bps to 5.97%, while the tail (R25-01: 20.5yr) was up by 3bps to 7.19%. Secondary trading volume rose by 35% to Php10.0bn, as T-bond trading increased by 63% to Php9.1bn while T-bill likewise halved to Php885mn. Still these volumes are on the low side. The Bureau of the Treasury (BTr) partially awarded its Php20bn T-bill auction last week. Average rates for the 91-day, 182-day, and 364-day T-bills were 2.995%, 3.206%, and 3.434%, respectively. Only the 91-day T-bill was fully awarded amid strong demand for the bill, while the bid rates for the other two were capped. Only Php16bn out of the Php 20bn was awarded, while bid-to-cover ratio was 1.34x.

**Emerging Markets' (EM) 10-year yields up 4bps week-on-week (WoW).** Yields of EM bonds we follow were up by 4bps WoW on average amid heightened trade war fears. Mexico (10-year yield 0bp), the Philippines (+3bps), and Chile (+3bps) relatively outperformed last week, while Brazil (10-year yield +9bps), Indonesia (+7bps), and Turkey (+4bps) underperformed.

**USTs down by 3bps WoW.** US Treasuries fell by an average of 3bps WoW, while the 10-yr UST shed 3bps to 2.82% following Trump's \$60bn tariff deal versus China exports to the US, along with new restrictions on technology transfers and acquisitions of U.S. firms by Chinese competitors. In retaliation, China declared that they would target \$3bn in U.S. goods with import duties of their own in response to previously announced U.S. steel and aluminum tariffs. The amount is smaller and shows a conciliatory and highly measured move by China, giving hopes that Trump's tough talking is really a trade tactic that aims to get an upperhand in the forthcoming US China trade negotiations.

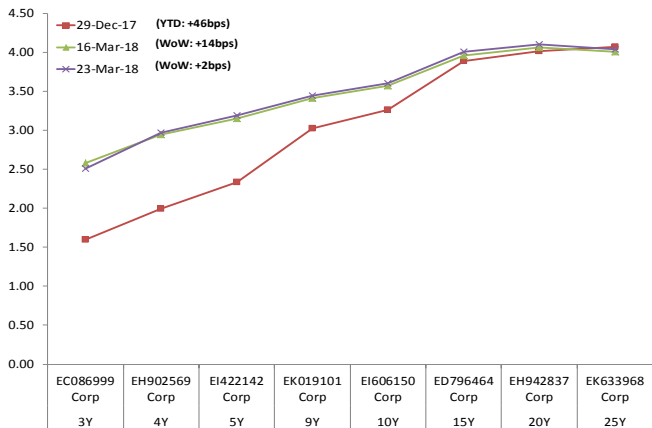
The Fed, as expected, raised its rates by 25bps. Policymakers also shifted their expectations for future rate increases slightly higher and also lowered their expectations for the unemployment rate to 3.8% by the end of the year (from 4.1% currently), suggesting that the Fed will allow the economy to grow faster than its long-term potential for a time and push inflation a bit above the central bank's 2% target rate.

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



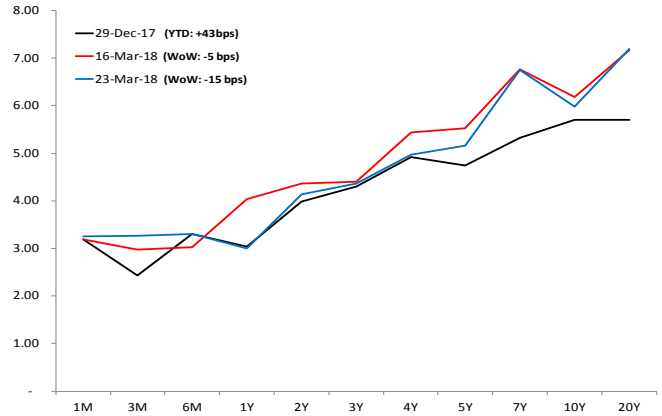
Source: PDS

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



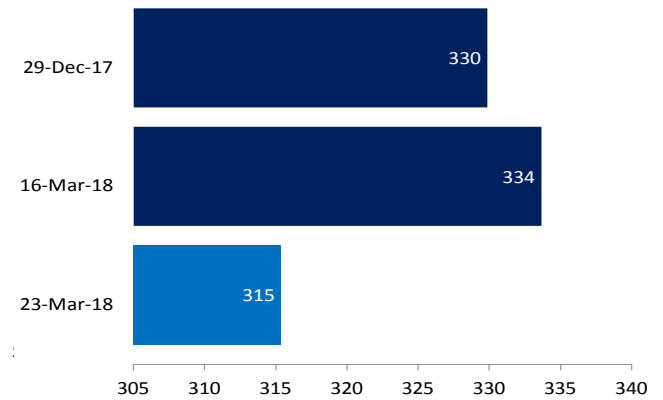
Source: Bloomberg

**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