

## July Inflation Cements August BSP Hike

### Primary Indicators

|   | Period     | Latest Period | Preceding Period |
|---|------------|---------------|------------------|
| <b>I. Real Economy (Growth, %)</b>              |            |               |                  |
| A. GDP  | 1Q2018     | 6.8           | 6.7              |
| B. Manufacturing (VoPi)                         | Feb '18    | 24.8          | 18.5             |
| <b>II. Monetary and Banking</b>                 |            |               |                  |
| A. Outstanding Loans, net of RRP (Php Bn), UKBs | Feb '18    | 7,806         | 7,827            |
| Y-O-Y Growth (%)                                | Feb '18    | 16.9%         | 18.3%            |
| B. NPL to Total Loans                           | Feb '18    | 1.36          | 1.30             |
| C. M3 Growth (Y-O-Y)                            | Mar '18    | 14.1          | 13.4             |
| <b>III. Prices</b>                              |            |               |                  |
| A. PHP/\$ (PDS data)                            | 4W Jul '18 | 53.000        | 53.100           |
| B. 91-Day Rate (%)                              | 3W Jun '18 | 3.484         | 3.323            |
| C. 10-Yr Rate (%)                               | 4W Jul '18 | 6.450         | 6.650            |
| D. Inflation (%)                                | Jul '18    | 5.6           | 5.2              |
| YTD (%)   |            | 4.7           | 4.6              |
| E. RRP  | May '18    | 3.250         | 3.000            |
| F. SDA Rate                                     | May '18    | 2.750         | 2.500            |
| <b>IV. External Accounts</b>                    |            |               |                  |
| A. Balance of Payments (\$ m)                   | Apr '18    | -270          | -266             |
| YTD (\$ m)                                      |            | -1,497        | -1,227           |
| i. Current Account (\$ b)                       | 4Q17       | -3.3          | 0.55             |
| % of GDP  |            | 3.8%          | 0.7%             |
| ii. Capital Account (\$ m)                      | 4Q17       | 14            | 36               |
| % of GDP  |            | 0.02%         | 0.05%            |
| iii. Financial Account (\$ m)                   | 4Q17       | -2.0          | 135              |
| % of GDP  |            | 1.8%          | 0.1%             |
| B. Net Foreign Portfolio Inv (\$ m)             | Oct '17    | -563          | 112.6            |
| YTD(\$ m)                                       |            | -770          | -206             |
| C. OFW Personal Remittances                     | Mar '18    | 2,627         | 2,528            |
| YTD(\$ b)/YoY(%)                                |            | 7.8/-9.9%     | 5.2/5.4%         |
| D. Gross Intl Reserves (\$ b)                   | Apr '18    | 79.6          | 80.5             |
| YoY Growth                                      |            | (2.9%)        | (0.5%)           |
| 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.** There is strong upward bias on the yield curve as July inflation clocked in at 5.7%, beating consensus expectation of 5.5%, near the top-end of the Bangko Sentral's (BSP) forecast range of 5.1%-5.8%, higher than June's 5.2%, and a five-year high. Food and non-alcoholic beverages led the growth at 7.1%. The high figure has all but cemented a 50-bp hike this August 9, when the BSP's monetary board meets again, a move that is expected to buoy the Philippine peso that dipped by as much as 6% this year and curb inflation from overshooting. The strong hawkish stance by BSP Governor Espenilla helped the peso recover some ground, up 0.43% to Php53.1 against the dollar for the month of July, and spurred slight buying at the tail-end, down by an average of 8bps week-on-week (WoW) as Espenilla's statement relieved investors that have been calling for more hikes. Philippine long-term growth prospects remain dim, especially with charter change noise, reflecting on a flatter tail. Analysts also noted renewed trade war tensions between the US and China and a dovish Bank of Japan (BoJ) contrary to hawkish expectations could have also contributed to the buying.

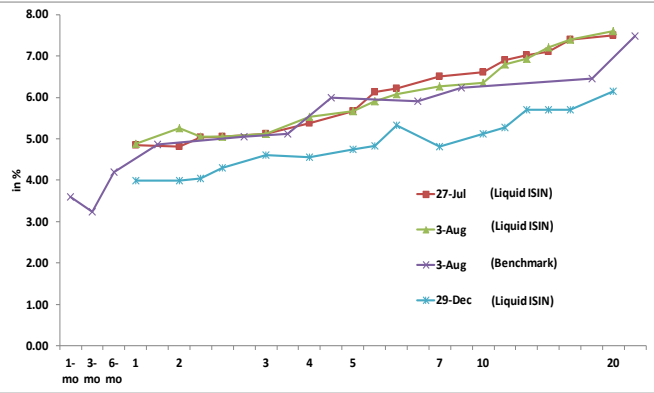
**Market review.** The local benchmark yield curve was unchanged on average week-on-week (WoW) ahead of the BSP monetary board meeting. The spread between the local 10-yr local benchmark and the 10-yr US Treasury (UST) narrowed to 350bps from 362bps in the prior week as the former fell by 20bps to 6.45% (done), while the latter was flat, down by just 1bp WoW to 2.95%. Yields of ROPs also were also flat, just down by 1bp on average, tracking the movement of the UST curve which was also unchanged last week.

**Average total daily traded volume up 79% week-on-week (WoW) to Php8.9bn.** The liquid yield curve fell by an average of 1bp WoW as trading volume recovered. The front-end (364-day T-bill) rose by 4bps to 4.87%, the belly (FXTN 10-61: 9.7yrs) fell by 24bps to 6.36%, while the tail (R25-01: 20.5yr) was flat at 7.39%, as a strong BSP policy response has already been priced in. Secondary trading average volume rose by 79% to Php4.5bn as T-bond volume more than doubled (up 116%) to Php4.5bn while T-bill volume likewise rose by 53% to Php4.4bn. Last week, the Bureau of the Treasury's (BTr) rejected all bids for the reissued 20-yr bond with bid rates reaching an average of 7.390%, higher than the previous auction. The auction was 1.3x oversubscribed for the Php15bn offered. Lastly, the latest Php15bn auction of 91-day, 182-day and 364-day T-bill was fully awarded at average bid rates of 3.290%, 4.186%, and 4.899%, respectively, more or less the same level as the previous auction. The auction was three times oversubscribed.

**Emerging Markets' (EM) 10-year up 7bps (WoW).** Yields of EM bonds we follow were up by 7bps WoW on average amid renewed trade tensions between the US and China. The Philippines (10-year yield -20bps), China (-5bps), and Poland (-5bps) outperformed last week, while Turkey (10-year yield +101bps), Argentina (+28bps), and Brazil (+27bps) underperformed.

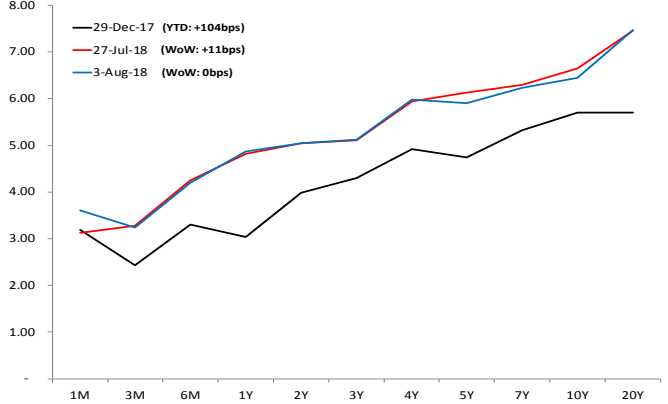
**USTs flat WoW.** US Treasuries were unchanged WoW on average, while the 10-yr UST was likewise flat, just down by 1bp WoW to 2.95%, as the Fed kept rates steady as expected during its meeting last week. The Fed changed its description of the US economy from 'solid' to 'strong', raising the odds for a Fed hike this September to 94% and another hike in December to 66% from 88% and 51%, respectively. News of increased borrowing in the second half also spooked investors -- second half borrowing is now expected to total \$769bn, \$56bn higher than April's estimate, 63% higher during the same period last year, and the most since July-December 2008's \$1.1tn. This will also bring 2018's total borrowings to \$800bn, 14% higher YoY, and puts the US on track to touch \$1tn in 2019 and past that in 2020. The Treasury is boosting sales of US debt to help finance a widening budget gap after Trump signed \$1.5tn in tax cuts last year and after Congress approved a \$300bn spending increase. In the data front, new jobs added last July fell short of expectations, clocking in at 157,000 vs 190,000 expected, but employment fell back to 3.9%. Average hourly wage grew by 2.7%, the same pace as last June.

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



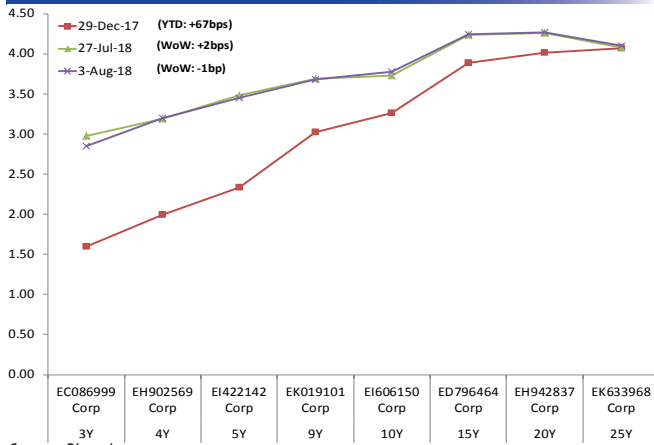
Source: PDS

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



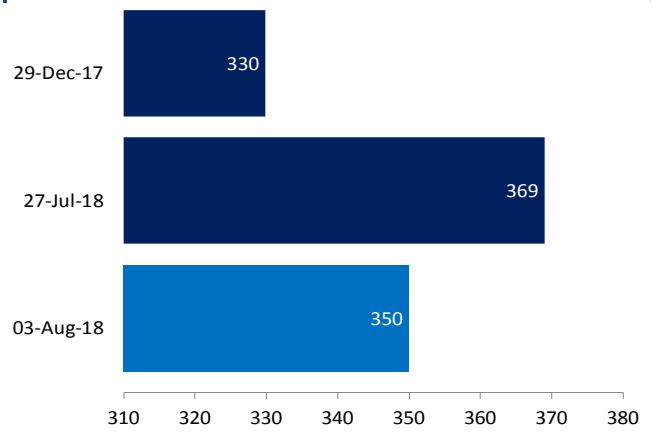
Source: Bloomberg

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



Source: Bloomberg

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



Source: Bloomberg