

October 8-12, 2018

Road to 9.0% and 4.0%?

Primary Indicators

	Period	Latest Period	Preceding Period
I. Real Economy (Growth, %)			
A. GDP	2Q2018	6.0	6.6
B. Manufacturing (VoPi)	Feb '18	24.8	18.5
II. Monetary and Banking			
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)	July '18	11.0	11.8
III. Prices			
A. PHP/\$ (PDS data)	3W Oct '18	53.700	54.130
B. 91-Day Rate (%)	3W Oct '18	4.950	4.404
C. 10-Yr Rate (%)	3W Oct '18	8.050	7.650
D. Inflation (%)	Sept '18	6.7	6.4
YTD (%)		5.0	4.8
E. RRP	Sept '18	4.500	4.000
F. 7-/14-/21-day TDF	Sept'18	4.727%/4.773%/4.855%	
IV. External Accounts			
A. Balance of Payments (\$ m)	June '18	-2,931	157
YTD (\$ m)		-3,087	-133
i. Current Account (\$ b)	1H18	-3,087	-133
% of GDP		-1.9%	-0.1%
ii. Capital Account (\$ m)	1H18	-1	24
% of GDP		-0.00%	0.02%
iii. Financial Account (\$ m)	1H18	-720	-252
% of GDP		-0.44%	-0.2%
B. Net Foreign Portfolio Inv (\$ m)	June '18	-225	1,093
YTD(\$ m)		-2,867	3,094
C. OFW Personal Remittances	July ' 18	2,401	2,357
YTD(\$ b)/YoY(%)		16.6/3.0%	14.2/2.7%
D. Gross Intl Reserves (\$ b)	Aug '18	77.8	76.7
YoY Growth		(4.8%)	(5.4%)
E. Import Cover (x)	Aug '18	7.5	7.4
F. ST External Debt cover (x)	Aug '18	619.9	611.1
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	-14.7%	-12.9%
V. NG Cash Operations			
A. Surplus (Deficit) (Php b)	June '17	(90.87)	(33.42)

Outlook. Markets continued to be defensive amid inflation concerns and geopolitical noise abroad. In its biannual report, the US formally declined to label China a currency manipulator, something that could have given Trump ammunition to renegotiate trade terms with China. Although, the report did highlight that the US' disappointment with China's non-disclosure of its currency interventions. The Chinese government has long been viewed as a currency manipulator to gain international trade advantage especially now with the brewing trade war.

Although local government has taken action to address food shortages which has elevated prices, the market remains cautious as risks are still tilted towards the upside. Inflation in the last quarter averaged 6.2%, higher than the second quarter's 4.8% and 2.7% in the same period last year. Year-to-date, inflation is at 5.0%, just a tad lower than the BSP's forecast of 5.2% for the year. The average bid rate for the 7-yr T-bond auction was 8.28%, already higher than the 10-yr's interpolated rate of 8.05%. The 7-yr and 10-yr historically had a spread of 25-35bps, so if we take the previous 7-yr auction as any indication of the market's interest rate expectations, this places the 10-yr rate expectation at 8.5-8.6%, slowly inching closer to 9.0%. Expect market sentiment to be the same and keep bond yields elevated.

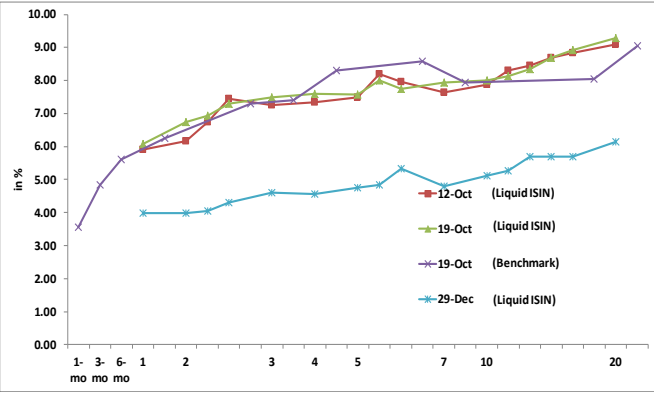
Market review. The local benchmark yield curve rose by 7bps on average week-on-week (WoW) as the market remained cautious. The spread between the local 10-yr local benchmark and the 10-yr US Treasury (UST) slightly narrowed to 485bps from 491bps in the prior week as the former was relatively flat at 8.05% (interpolated) while the latter rose by 5bps to 3.20%. Yields of ROPs rose by 4bps on average, tracking the movement in US treasuries which rose by 5bps on average.

Average total daily traded up 125% week-on-week (WoW) to Php7.9bn. The liquid yield curve rose by an average of 9bps WoW as the front-end (364-day T-bill) rose by 50bps to 6.49%, the belly (FXTN 10-63: 9.5yrs) up by 17bps to 8.05%, while the tail (R25-01: 20.5yr) spiked to 8.93%, up 8bps WoW. Secondary trading average volume recovered by 125% to Php7.9bn, still very thin, as average T-bond volume increased by eight times to Php4.2bn. On the other hand, T-bill volume rose by 23% to Php3.6bn. The latest Php15bn auction of 91-day, 182-day, and 364-day T-bills was fully awarded with average rates of 4.952%, 6.059%, and 6.489% for the 91-day, 182-day and 364-day T-bill, respectively. All were higher than the previous auction and secondary market rates. The auction was 1.6x oversubscribed. Lastly, the Bureau of the Treasury (BTr) fully rejected all tenders for the reissued 7-yr bond as bid rates averaged 8.284%, higher than the previous auction's rate of 7.085%. The auction was also 1.6x oversubscribed.

Emerging Markets' (EM) 10-year up 6bps (WoW). Yields of EM bonds we follow were up by 6bps WoW amid markets that were nervous about Chinese action with the yuan. Argentina (10-year yield -172bps), Brazil (-38bps), and Turkey (-29bps), while Pakistan (10-year yield +29bps), Mexico (+9bps), and Chile (+6bps) underperformed.

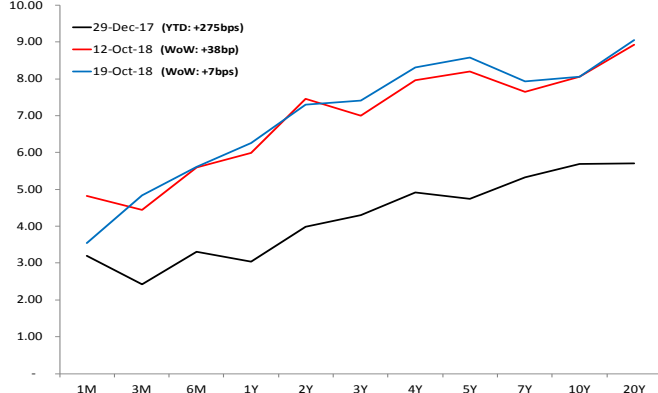
USTs up 5bps WoW. US Treasuries were up by 5bps WoW on average as the 10-yr UST likewise rose by the same amount to 3.20%, on global markets' concerns about the Chinese yuan, which fell to its lowest level (CHY/USD of 6.94) since January. Markets became nervous that it would cross the psychological barrier of 7 later this year. Markets were also on edge over the ongoing dispute between the US and Saudi Arabia over the disappearance of journalist Jamal Khashoggi. The Fed also released its minutes from its last meeting which had a hawkish tone. Officials generally agreed to stay the course of gradual increases to preserve a steady economy. Notably, there were members who said that the Fed might even need to go beyond normalization of rates into a more restrictive stance to prevent inflation from overshooting and to address "the risk posed by significant financial imbalances". Recall that the Fed previously indicated four more hikes after their last hike in September and then one in 2020. Odds for a hike in December was steady at 80%, which implies three more in 2019.

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



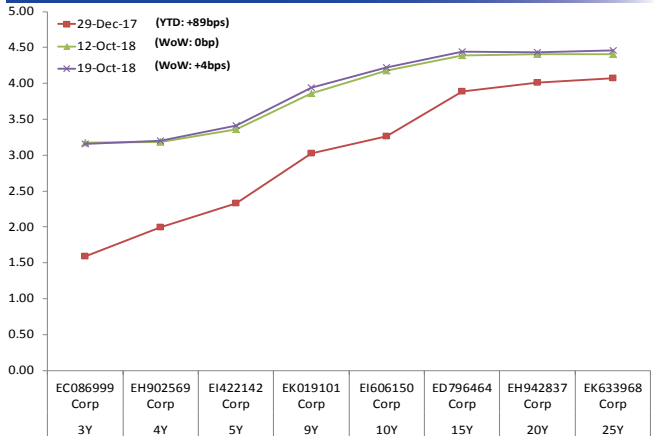
Source: PDS

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



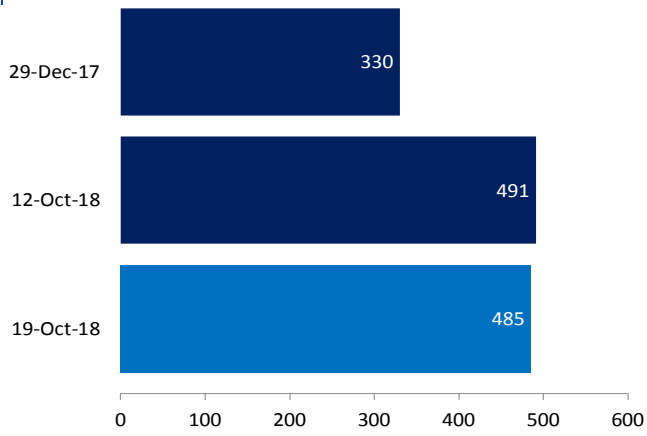
Source: Bloomberg

Average YTD and WoW changes of the USD Philippine Sovereign Curve



Source: Bloomberg

PH and US Treasury 10-Yr Spread (bps)



Source: Bloomberg