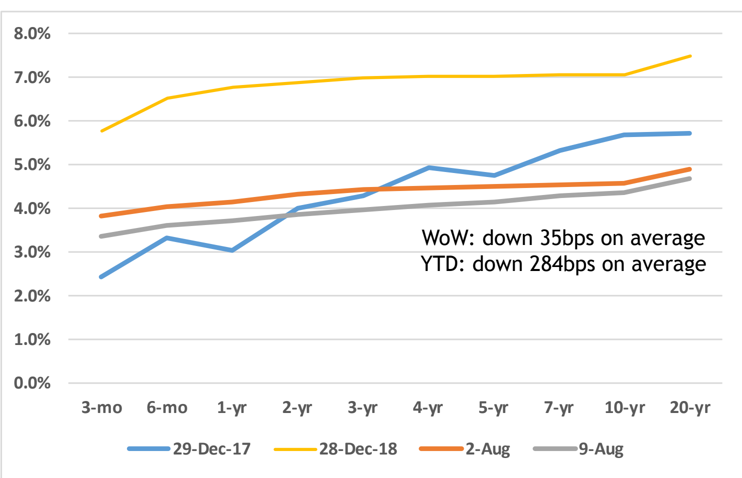
Weekly Fixed Income Summary and Outlook

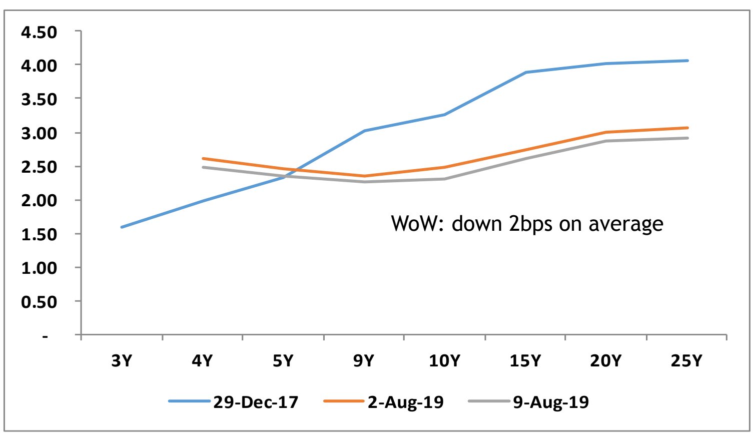
August 5-9, 2019

Liquidity Easing

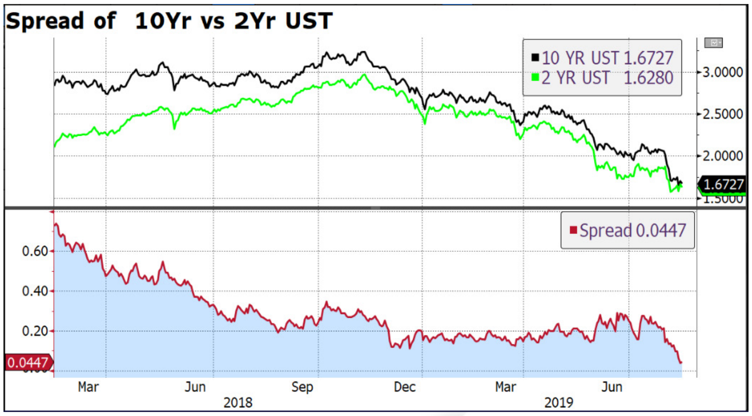
Average YTD and WoW changes of the Philippine PhP Yield Curve, BVAL



Average YTD and WoW changes of the Philippine $ Sovereign Curve



10-Yr and 2Yr Treasury Spread



Outlook. Interest rates are moving lower on liquidity easing by the BSP, a trend likely to be sustained, also on the back of lack of news about an aggressive return by the government back to the bond market. Foreign borrowing was just concluded with the Samurai bond float this month worth Php44bn, which raised the foreign reserves buffer of the BSP to $85b, equal to 7.4 months' worth of imports and 5.2x cover for short-term liabilities.

The peso yield curve went down by 45 bps on the average for the entire month of Aug. to date and was lower at 2.93% from the year's start (tenor above 1 yr) and 270 bps lower on the average from the October peak for tenors above 1 yr.

Recent government bond auctions showed sustained drops in the domestic interest rates. Yesterday, government's Auction Committee fully awarded bids for the Treasury Bills amid strong market demand. The 91-, 182-, and 364-day T-bills fetched averages of 3.398%, 3.677%, and 3.898%, respectively -- lower than previous auction's results of 3.769%, 4.100%, and 4.519%, respectively. The auction was oversubscribed with total bids reaching P87.1 billion, almost six times the P15.0 billion offering which showed increased system liquidity, as it was also higher than the previous Php74.3 billion, almost five times the P15.0 billion offering. This prompted the BSP's plan of boosting the term offer to Php100bn for short-term deposits today from the previous Php80bn, part of its liquidity management.

In its last auction this week, (Tuesday), the Philippine Bureau of the Treasury in Manila said the average yield on its 10-year bond at auction was 4.196 percent with a coupon of 6.875 percent, lower by 4.5basis points from the secondary market rate for the equivalent tenor. Total sold 20b pesos ($383.5m); total bids 65.22b pesos. Accepted competitive tenders 12b pesos ($230.1m). Accepted non-competitive tenders 8b pesos ($153.4m). Bid/cover ratio at 3.261, lower than 3.292 previously. Auction was oversubscribed; 65.2b pesos bids vs 20b offered.

The biggest influence reinforcing the sustained interest rate decline is the sharp slowdown of the 2nd quarter Philippine GDP growth which was even worse than the first quarter's negative surprise of 5.6%, now at 5.5% and representing a worrisome characteristic of a broad deceleration in almost all industry sectors except Services and big parts of the so-called economy's Aggregate Demand such as consumption expenditures of both the government (10% of GDP) and households (66% of GDP), both of which were initially expected to recover and bring the economy to a faster growth track in the second quarter. But these didn't happen and instead raised questions about whether there is ample time for government to do a really meaningful spend catch-up in the second half, thus creating a robust fiscal stimulus.

If this is so, then government's budget deficit target of 3.2% of GDP and the aggressive infrastructure that underpins it are both at risk. It is notable that government spending (initially expected to be 11-12% growth in an election year based on historical patterns) was way below these growth levels at 7.4% in the first quarter and even slower to 6.9% in the second quarter.

Market review. The local benchmark yield curve and US Treasuries both fell 35bps and 9.1bps on average week-on-week (WoW), respectively. Year-to-date, the former was down by 284bps following the central bank's decision to cut benchmark interest rates and has further eased due to another possible 25bps cut and 1 percentage point cut in RRR. The front-end (364-day T-bill) dropped 43bps to 3.72%, the belly (FXTN 10-63:9.5yrs) down 21bps to 4.37%, while the tail (R25-01:20.5yr) shed 21bps to 4.70%, all WoW.

The spread between the 10-year local benchmark and 10-year US Treasury slightly narrowed to 263bps from 272bps in the week prior. The former was down by 21bps to 4.37%, while the latter also down by 12bps to 1.74%.

Secondary trading average volume was up 31.4% to Php52.9bn, while T-bill volume rose 66.7% to Php8.5bn.

Liquidity Indicators. Gross international reserves (GIR) rose to $85.18bn in July from $84.93bn in June. BSP reported that the increase in GIR was due to inflows arising from the BSP's foreign exchange operations and income from investments abroad and the National Government's net foreign currency deposits.

For the week July 25-31, 2019 (latest week), time deposits for below 1 year, 1-2 years, and over 2 years were at 3.7%, 3.5%, and 4.3%, respectively. It dropped by 0.2%, 0.2%, and 0.3%, respectively from the previous week. Meanwhile, for the week July 29-August 2, 2019 (lastest week), Interbank Call Loan Rate was at 4.65% from 4.72% of the previous week.