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Institute for International Monetary Affairs
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Regional Perspective of Philippine Bond Market

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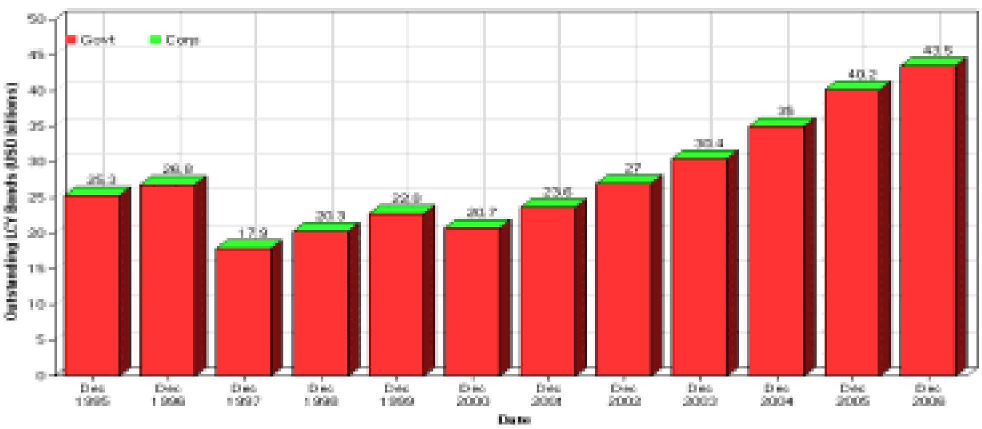
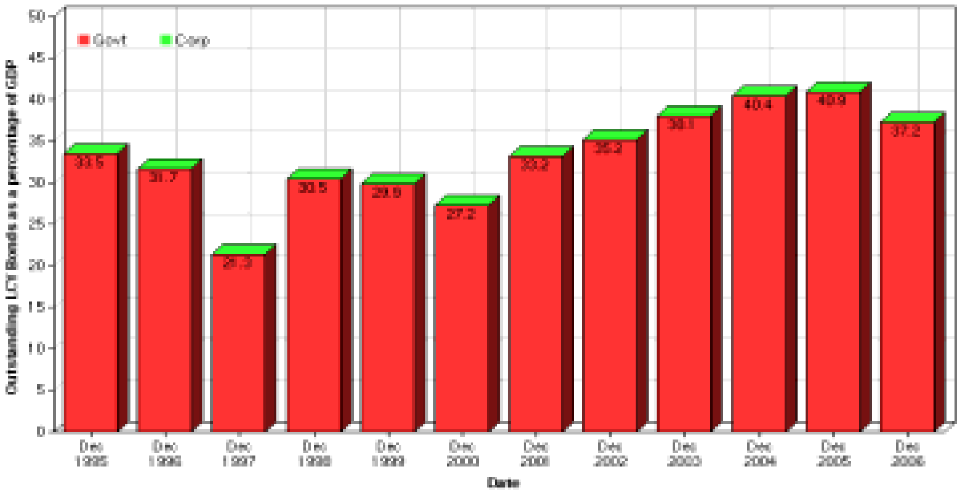
Overview of Philippine Bond market

The Philippine bond market has been growing through the years. From its $17.9 billion level during the Asian Financial Crisis, outstanding local currency bonds now amount to US$ 48.5 billion by end March 2007. The size of the local currency bond market as a percentage of the country's gross domestic product had been declining until recently when the commercial issuances substantially increased in the first quarter of the year. Hopefully this will be the start of a more balanced composition of the Philippine bond market.

Size and Composition of Local Currency Bonds

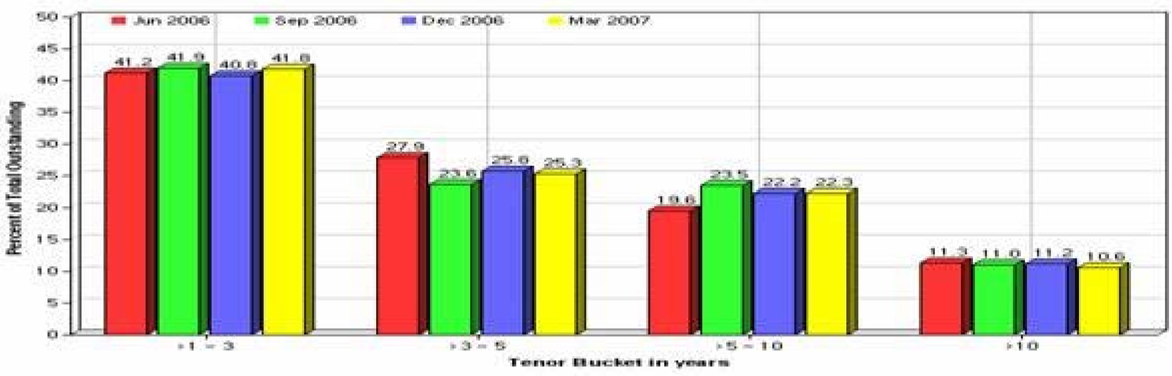


Local Currency Bonds as % of GDP



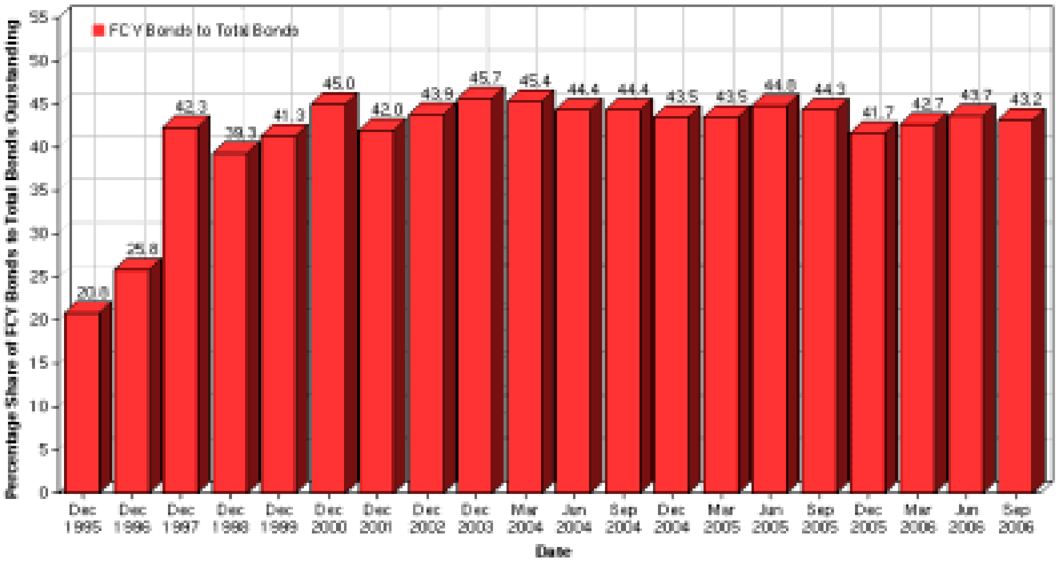
The domestic market offers several short and long-term securities to meet the markets needs. It ranges from as short as a year to as long as twenty-five years. As the graph below shows over 40% of total debt are short-term borrowings (1 to 3 years), about 25. 5% have three to five year maturity; another 25% within 5-10 year maturity and 10% have maturities over ten years.

Maturity Profile



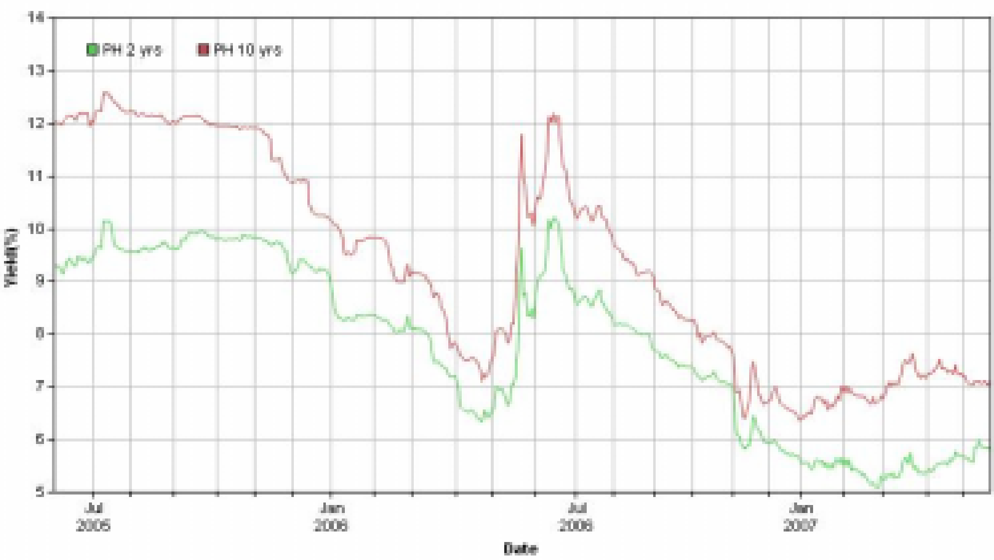
The percentage of government bonds issued in foreign currency (i.e. in US dollars) is declining indicating that the government has not been borrowing as much in the international market and with the restructuring of the domestic maturity profile, further reduction in foreign currency denominated bonds as percentage of GDP in 2007 is foreseen. In the same manner, foreign currency bonds as a percentage of total bonds outstanding are slowly declining.

Share of Foreign Currency Denominated Bonds to Total Bonds



The current yield environment is very attractive as interest rates have been declining. The era of high yields experienced in 2005 up to middle of 2006 is over – from a high of over 12% to about 6.5% for the ten-year bonds. The declining Philippine yields are a result of excess global liquidity driving investors to the emerging markets. Although it is still one of the highest in the region, the decline in yields of peso bonds is in tandem with the rest of the ASEAN countries. With yields currently at historically low levels, now is the right time for businesses to issue bonds.

Philippine LCY Bonds
Benchmark Yield Curves

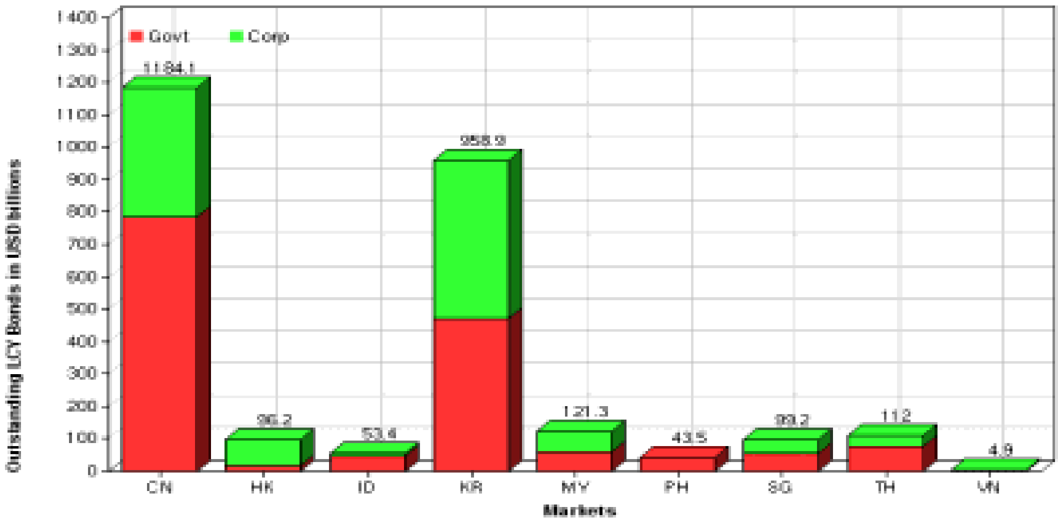


Regional Perspective

In the region, bond markets have grown rapidly in the past few years. Excluding Japan, local currency bonds amounts outstanding have increased almost 7-fold from US $400 billion in 1997 to over US$2.8 trillion in 2006. China has the highest volume reaching US $1,184.1 billion. It is followed by Korea at US$ 958.9 billion. The Philippines, as of December 2006, has US $43.5 billion worth of local currency bonds outstanding.

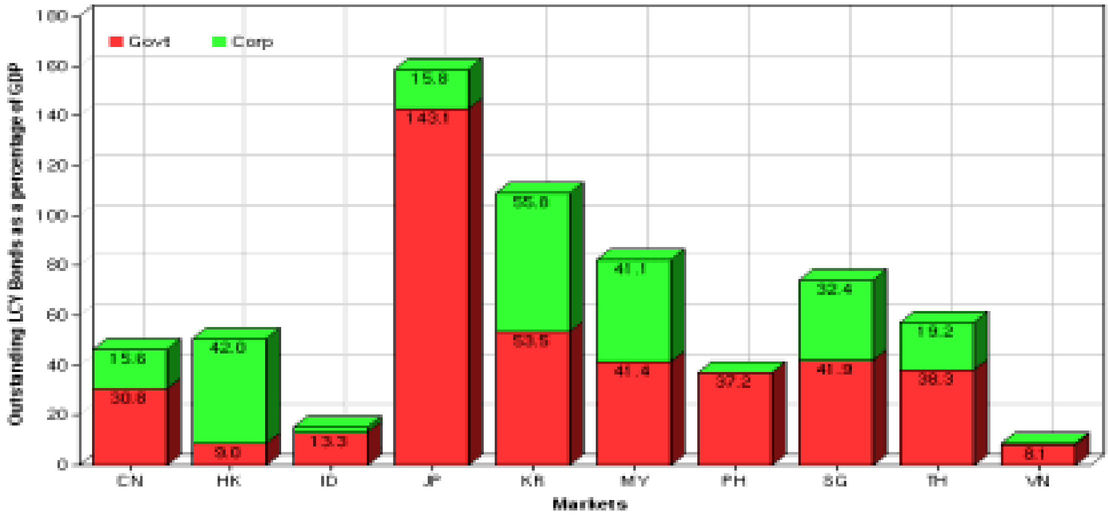
Asia's bond markets continued to grow at rates above GDP growth thus local currency bond to GDP ratio continued to rise from average of 53% at end 2005 to 61.5% by end 2006. Japan has a local currency bond market that exceeds levels of its own economy while Korea has volume that is almost as big as its economy.

Size and Composition of LCY Bonds
By Country as of December 2006



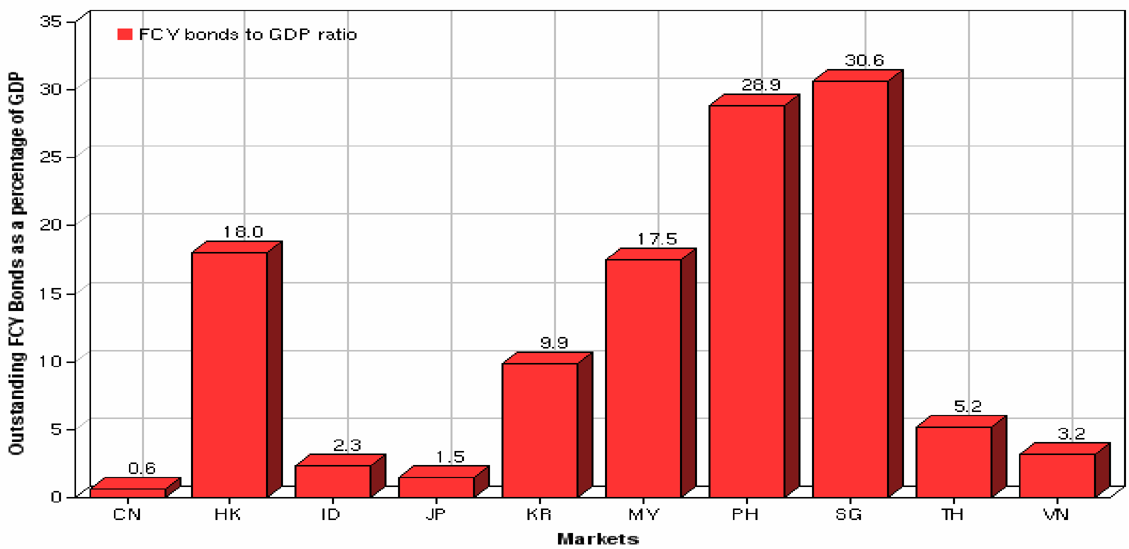
Local Currency Bonds as% of GDP

December 2006

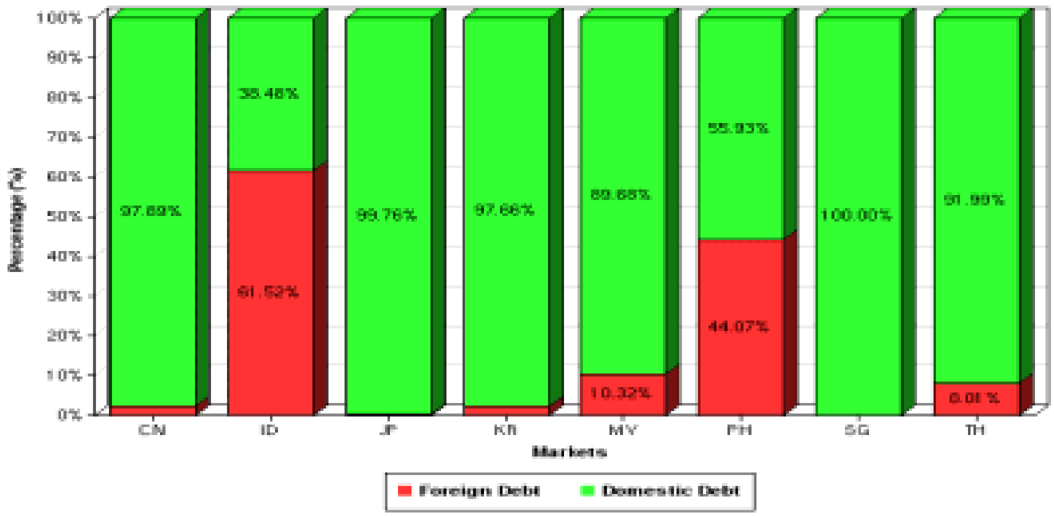


Foreign currency bonds continue to dominate bond markets in the Philippines, Hong Kong and Singapore. Foreign currency bonds for Asia usually means US$ denominated bonds. For the Philippines, foreign currency bonds are mostly issued by the government whereas in Hong Kong foreign currency issuances are mostly done by private corporations. The 1997 Asian crisis was partly triggered by currency (and maturity) mismatches thus most counties are trying to avoid a repeat of such mismatch.

Foreign Currency Bonds as % of GDP

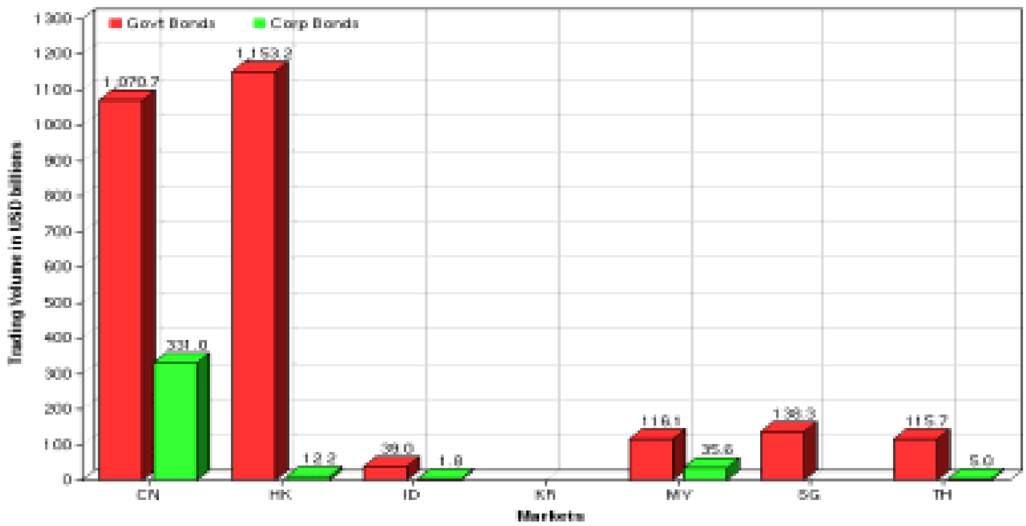


Foreign Currency Bonds to Bonds Outstanding



Market Liquidity as measured by trading volume and turnover ratios, has increased significantly but remains low in comparison with developed markets.

Trading Volume in Asia



Issues and Challenges

There are a number of issues and challenges facing the region that constrain their efforts, individually and as a group, in pushing forward the development of their local bond markets.

These issues are correlated. For example the lack of diversity of investor base is related to the lack of liquidity, which in turn is related to the lack of transparency and availability of timely information.

In the US, dealers have been required beginning 2002 to report OTC trades to the Trade Reporting and Compliance Engine (TRACE) of the National Association of Securities Dealers (NASD). Study showed that this has reduced bid ask spreads by 5 bps.

Similarly efforts are starting in Asia to increase post-trade transparency:

- Thai Bond Market Association (THAIBMA) requires traders to report OTC trade within 30 minutes and distributes information to association members 4x/day
- Bond Information Dissemination System (BIDS) in Malaysia require dealers to enter both price and volume information of trades within 10 minutes of trade and becomes available on screen to subscribers of BIDS
- Korea Security Dealers Association (KSDA) requires dealers to report their transactions within 15 minutes via its information system which then becomes available in its website on the same day
- Philippines - the Fixed Income Exchange has been established. It makes available to its subscribers on line information on price of recent market trades within a few minutes. SEC has issued a new rule on OTC trading requiring OTC trades to be reported to a central reporting system

Other issues constraining bond market development in the region are more related to the maturity and sophistication of the bond markets – lack of hedging instruments and reliability of benchmark yields. Also noted are the lack of regularity in bond issuances plus the practice of rejecting bids to keep rates of government bonds low. These practices do not contribute to the reliability of the benchmark yield.

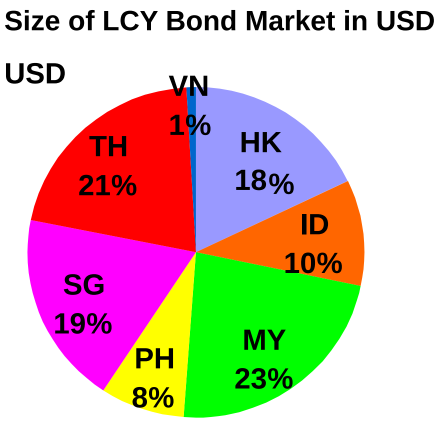
Although there are now more electronic trading floors in Asia for bonds, government and corporate bonds are being traded over the counter in most countries and secondary trading of domestic bonds is still low. Electronic trading floors include Surabaya SE electronic trading platform in Indonesia, Korean SE internet based trading system and OTC trading floor, Labuan International Financial Exchange in Malaysia which is active in trading of Islamic bond and the Philippine Dealing and Exchange Corp.

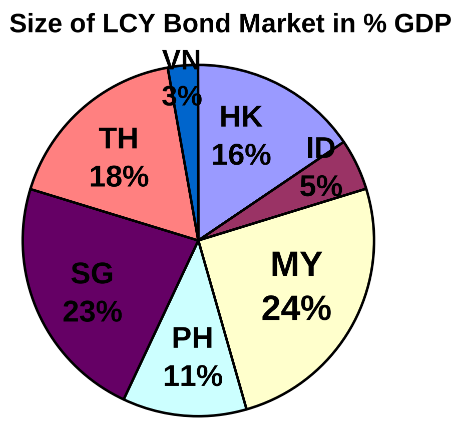
The infrastructure for clearing and settlement of bonds particularly for cross-border trades remains weak. This impedes the efficient transfer of securities and exposes investors to counter-party and settlement risks.

Malaysian Experience

The case of Malaysia is an example of an effective strategy to develop their local currency bond market. Malaysia accounts for about 23 % of the active emerging bond markets in the region and has the biggest bond market relative to GDP.

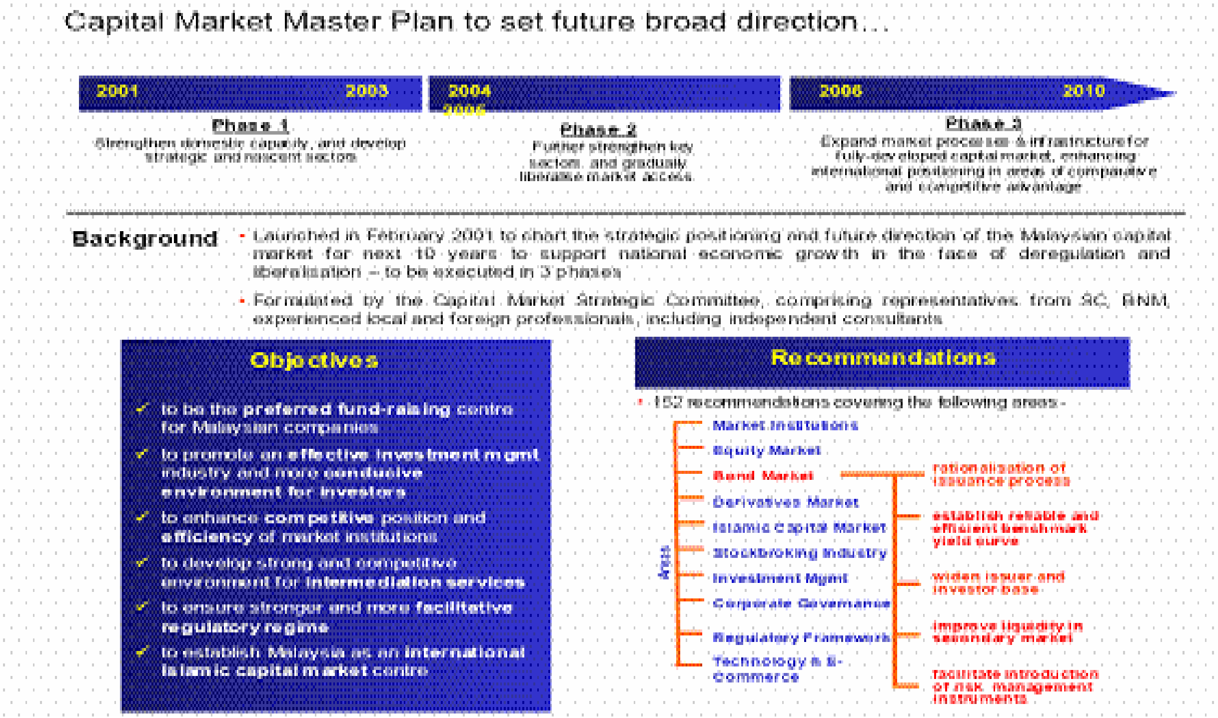
The Malaysian Corporate Bond Market is now open to foreign investors. Both domestic and foreign investors can buy and sell conventional and Islamic corporate debt instruments through the exchange and over-the-counter markets.



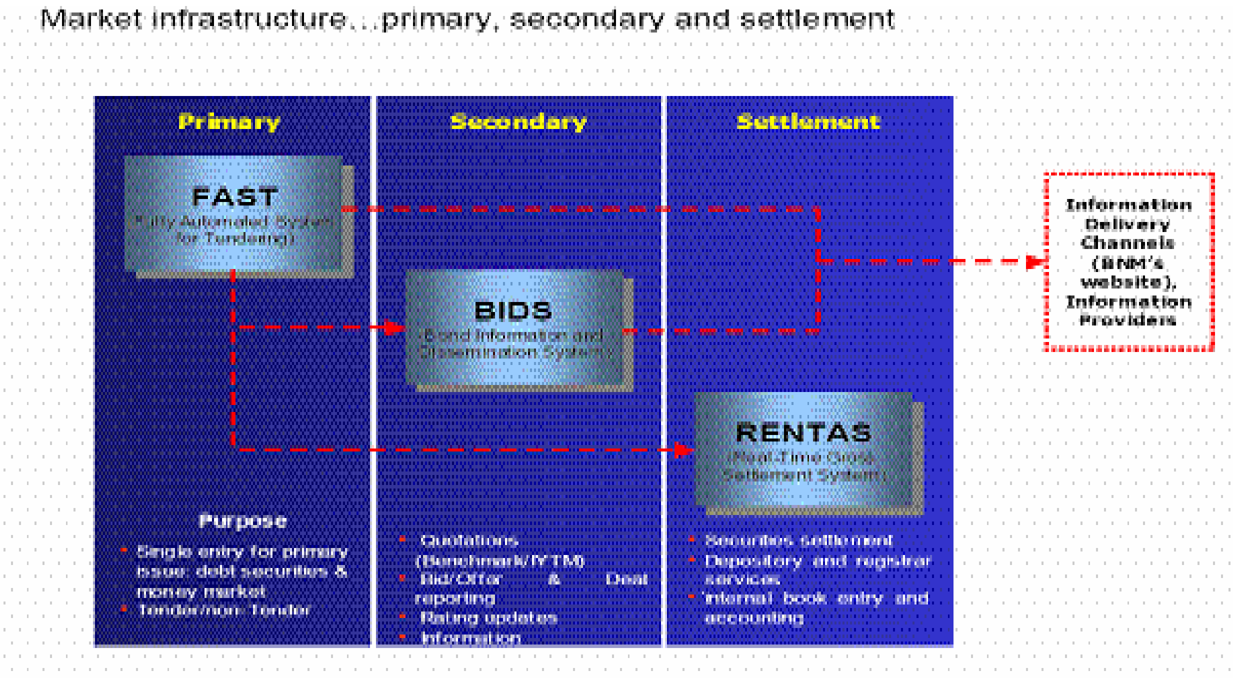


One of the most significant steps taken by Malaysia was the preparation of a Capital Market Blueprint in 2001 that clearly defined the course of actions to take to develop their bond market. A monitoring mechanism was put in place to ensure that the articulated objectives and targets are met according to plan.

The Philippines has also recently adopted a Capital Market Development Blueprint and it will be up to the major players – both regulators and private sector- to ensure that the plan is turned into action.



Malaysia also made sure that the market infrastructure is in place. Over a defined period of time, in accordance with the Blueprint, a modern and responsive market infrastructure was developed and the mechanisms put in place.



The Malaysian Securities and Exchange Commission also established the rules and regulations and ensured compliance with such rules.

Establishing rules and regulations for market players…

Market Ethics and Code of Conduct	• To ensure smooth functioning of both the primary and the secondary market • Issued Malaysian Code of Conduct for Principals and Brokers in the Wholesale Money and Foreign Exchange Markets in 1995 • The Model Code issued by ACI – The Financial Market Association with local addendum was adopted in May 2002.
Rules and Regulations	• Rules on FAST, BIDS and RENTAS • Guidance Notes on Repurchase Agreements (repo) • Guidelines on Securities Borrowing and Lending • Guidelines on Asset-Backed Securities

All of these deliberate and planned efforts to develop the government and commercial bond market led to the flourishing of Malaysia's bond market.

A Case for Integration and Cooperation

The governments of the ASEAN+3 region all acknowledge the need to develop their local currency bond markets and steps have been taken to push such development. However, development of the bond market in the ASEAN+3 region has been at different paces and on different tracks. There is clearly a need for regional cooperation in pursuing further these efforts. The finance ministers had earlier discussed measures to deepen the financial markets and in August 2003 the Asian Bond Market Initiative (ABMI) was launched.

The ABMI is an organized response by the ASEAN+3 governments to the Asian crisis. The ABMI is geared towards creating the necessary environment that will stimulate the growth of Asian bond markets and thus encourage investment of the considerable Asian savings into the region.

ABMI also acts as a catalyst to further enhance cooperation in the financial sector across the member countries. All 10 members of ASEAN are also members of ABMI including the plus 3 countries – China, Japan and Korea. The ABMI implements its policies through four voluntary working groups plus an AdHoc Support team for the Focal working group and Technical Assistance Coordination team.

A quick update of the status of the working groups:

- WG 1 Phase 1 study completed "ASEAN+3 Regional Multi-Currency Bond" & Phase 2 study "ASEAN+3 Regional Basket Currency Bonds" being finalized
- WG 2 Study on "ASEAN+3 Guarantee & Investment Mechanisms" completed and new study to examine options to be started 2007
- WG 3 Phase 1 study on **"**Bond Market Settlement and Emerging Linkages in Selected ASEAN+3 Countries" June 2005 and Phase 2 Study on "Minimizing Foreign Exchange Settlement Risk in the ASEAN+3 Region" is being finalized and expected to be completed in 2nd quarter 2007.WG 4 Technical expertise provided to enhance credibility and visibility of domestic rating agencies.

Role of ADB in Regional Bond Market Development

Under the ABMI, ADB has provided support through technical assistance to all 4 working groups and also to the Focal group including conduct of regional joint studies by examining the feasibility of establishing a regional guarantee mechanism, a regional clearing and settlement system, harmonized credit and trading standards, introducing new securitized debt instruments, and improved local credit rating systems.

ADB also acts as catalyst for bringing the public and private sectors together to discuss issues that constrain bond market development and to agree on measures to take, in partnership with each other, to address such issues.

ADB has also been issuing prime name credit paper in Asian local currency debt markets in the region including Korea Malaysia (2006), Thailand (2005), and PRC (2005). ADB and other multilateral and bilateral institutions issue such bonds to create a pricing benchmark for triple-A debt in the local markets, and to stimulate local and international investor interest. In May 2007, the ADB issued a Philippines peso bond with a principal amount of P5 billion maturing in five years and a day. It has a fixed rate of 5.23% per annum and its price is equivalent to 85% of five-year Philippine Government Security. The bookrunners were First Metro Investment Corporation and Standard Chartered Bank, Philippines.

ADB also developed and maintains the Asian bonds online website that makes available for free to the public essential data on current market activities, the legal and regulatory framework of each market, and monitors government policies and initiatives affecting the ASEAN+3 bond markets.

In addition ADB publishes twice a year the Asian Bond Monitor which reviews recent developments in East Asian local currency bond markets. The latest issue April 2007 will be published tomorrow and it will downloadable from Asian bonds online. This website and the publication help to narrow the information gap on Asian bond markets and contribute to greater market transparency. The ADB has been supporting capital market development of the Philippines for over a decade. The bank has extended to the country program loans aimed at broadening and deepening the capital markets by diversifying the investment channels, enhancing transparency, and improving market efficiency. The loans were accompanied by technical assistance grants that supported the key regulators of the capital market by enhancing their capabilities and improving skills

- $150 million Capital Market Development Program (CMDP) Loan 1363-PHI August 1995
- $75,000,000 Nonbank Financial Governance Program (NFGP) Loan 1858-PHI November 15, 2001
- $150 million Second Non-bank Financial Governance Program (SNFGP) Loan 2003 PHI September 2, 2003
- $200 million Financial Market Regulation and Intermediation Program (FMRIP) Loan 2278 PHI December 2006

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