

## PAST PEAK TIGHTENING: BE TACTICAL ON DURATION

- The Bangko Sentral ng Pilipinas (BSP) maintained its benchmark interest rate at 6.25%, calling it a “prudent pause” that took into account the recent downward trajectory of inflation. This increases the chances of a 25-basis-point cut toward year-end.
- Yields of peso government securities (GS) continued to rally throughout the month of May as we expected last March, with Philippine inflation slowing, a lower bond supply, and a new easing cycle on the horizon. Since the BSP Monetary Board meeting last May 18, yields of medium- to long-term bonds retraced from their year-to-date (YTD) lows.
- Given the recent sell-off in the local GS market, we continue to see value in locking in 7- to 20-year government securities as we think that rates will trend lower towards year-end. We also continue to favor buying shorter-tenor securities given the lack of term premium across the curve.

**Financial Markets Sector**  
 Philippine Rates Outlook  
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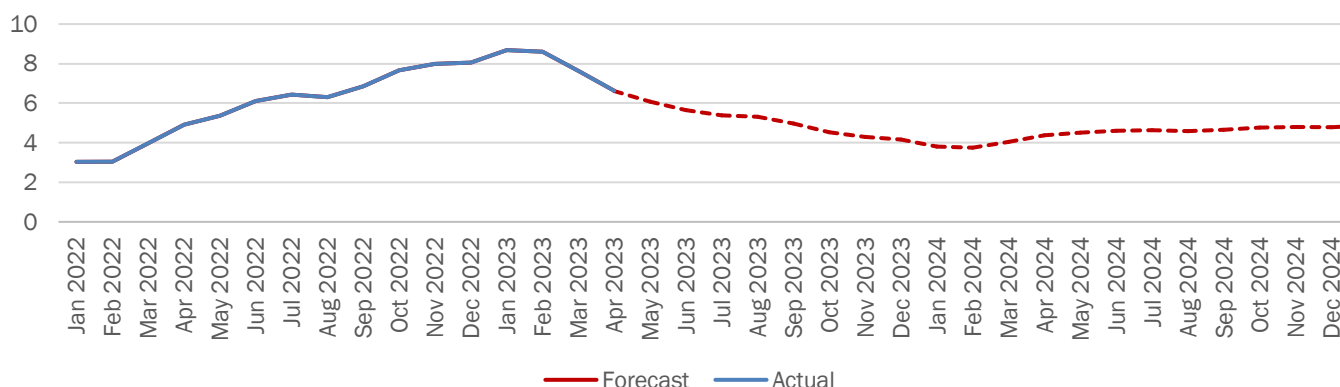
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### A prudent pause

The Bangko Sentral ng Pilipinas (BSP) made a prudent pause in its May 18 Monetary Board meeting. The BSP’s decision came after inflation slowed for the third consecutive month in a row at 6.6% year-on-year and first quarter economic growth showed signs of moderation at 6.4% year-on-year. The central bank also lowered its average inflation forecast for 2023 to 5.5% from 6%, and for 2024 to 2.8% from 2.9%. Risks to the inflation outlook remains largely tilted to the upside, however, due to persistent constraints in the supply of key food items, the impact of El Niño on agricultural commodity prices and utility rates. As the BSP forecasts inflation to fall within the 2-4% target range by September, BSP Governor Felipe Medalla said that another rate hike is unlikely, and signaled a pause for the next two to three policy meetings, barring any supply shocks.

Metrobank forecasts an average inflation rate of 6% for the year, with a gradual decrease to around 4% by the end of 2023. Inflation is expected to sustain its downward trajectory due to the influence of base effects, lower oil prices, and slower economic growth. This supports our view of a 25-bp rate cut by the BSP, bringing the RRR to 6% by end-2023.

Chart 1. Philippine Consumer Price Index (CPI) – Metrobank Research Forecast (%)



We maintain our view of at least a 200-basis point (bp) reduction in banks’ reserve requirement ratio (RRR) this year, likely as early as June. Historically, as every 100-bp cut to the RRR has released PHP 100 billion in excess system liquidity, this will neutralize the liquidity impact from the expiration of the pandemic relief measure that allowed loans to small and medium enterprises (SMEs) as alternative reserve compliance.

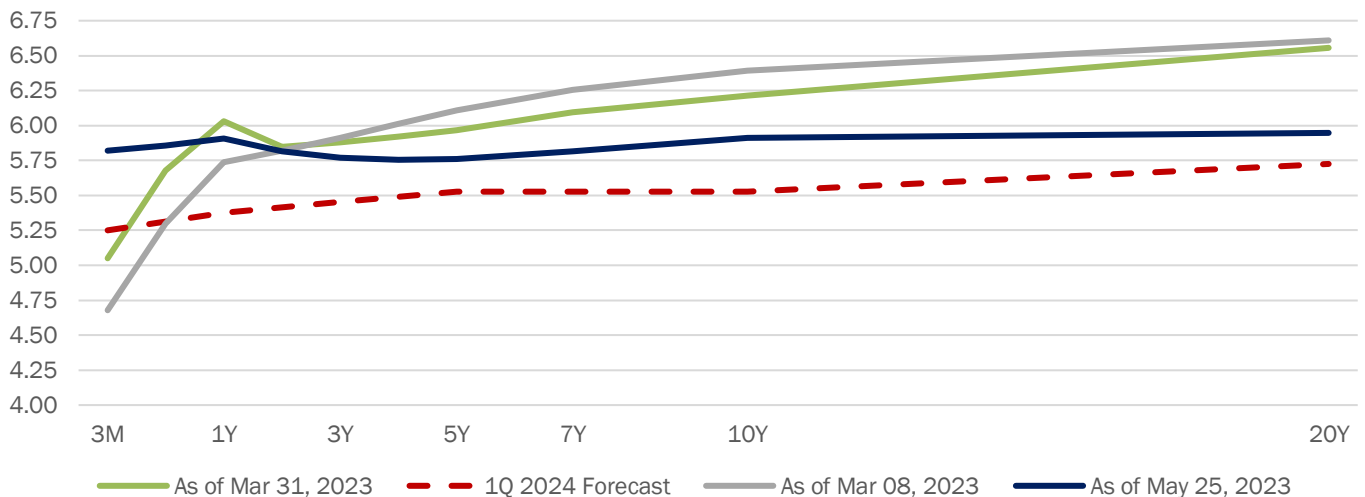
Last March, we saw value in locking in 10- to 20-year government securities, with Philippine inflation slowing and the BSP likely pausing its monetary tightening cycle. We expected the local yield curve to continue its descent due to a lower bond supply in the second half of the year and increasing demand for long-term bonds before the start of the BSP’s next easing cycle. Assuming PHP 10 million was invested in each of the following bonds last March 31 (Table 1), investors should see the following unrealized gains on their bond valuations.

Table 1. Indicative PnL for recommended GS as of May 24 2023

Bond	Maturity Date	31 Mar 2023 Indicative Offer Yield to Maturity (YTM)	24 May 2023 Indicative Bid Yield To Maturity (YTM)	Unrealized Gain/(Loss)
FXTN 10-68	23-Jun-32	6.15%	5.82%	PHP 251,692.96
FXTN 10-69	15-Sep-32	6.15%	5.85%	PHP 230,913.99
FXTN 25-7	30-Sep-35	6.28%	5.97%	PHP 302,723.40
FXTN 20-25	24-Nov-42	6.58%	5.92%	PHP 471,736.03

Looking at peso government securities, local yields then continued to rally throughout the month of May as we expected after the slower inflation print for April at 6.6% vs. 7% consensus estimates. Yields across the curve were lower by around 30 basis points (bps) as market participants priced in a pause and eventual cut from the BSP. Since the BSP’s Monetary Board meeting, profit-taking ensued in the local GS market which led yields of medium- to long-term bonds to retrace higher from their year-to-date lows.

Chart 2. PHP Government Securities / Bloomberg Valuation Service (BVAL) Yield Curve (%)



The Bureau of the Treasury (BTr) also excluded a 20-year issuance in their borrowing program for the third straight month in a row which further flattened the yield curve. The BTr has outlined a PHP 185-billion borrowing plan for June, with two 9-year auctions and bond issuances in the 5-, 6- and 15-year tenor buckets.

**Trade ideas for investors**

**Invest in 7-20Y Government Securities at 5.850-6.100%**

With the further flattening of the peso yield curve, we still see value in the front-end, given that these bonds continue to trade higher compared to longer-dated bonds. Trading investors may also find the recent retracement in yields as good opportunity to tactically load up on duration and to reinstate positions in the 7- to 20-year space at our target entry levels, with the upcoming auctions in June, on the back of falling peso interest rates.

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Top picks indicative pricing as of 30 May 2023. Subject to client suitability and available volume.

Category	Bond	Target Entry Levels	Indicative Yield-To-Maturity (YTM)	Tenor (Years)	Maturity Date
Peso Government Security	FXTN 7-68	5.850-5.900%	5.780%	6.4	13 Oct 2029
Peso Government Security	FXTN 7-69	5.850-5.900%	5.780%	7.0	27 Apr 2030
Peso Government Security	FXTN 10-68	5.900-5.950%	5.905%	9.1	23 Jun 2032
Peso Government Security	FXTN 10-69	5.900-5.950%	5.905%	9.3	15 Sep 2032
Peso Government Security	FXTN 25-7	5.950-6.000%	5.910%	12.4	30 Sep 2035
Peso Government Security	FXTN 13-1	5.950-6.000%	5.930%	12.9	20 Apr 2036
Peso Government Security	FXTN 20-25	6.000-6.100%	5.930%	19.5	24 Nov 2042

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