EXTEND DURATION AMID RATE CUT EXPECTATIONS

Financial Markets Sector
Philippine Rates Outlook
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Ruben Zamora
ruben.zamora@metrobank.com.ph

Earl Andrew Aguirre
ea.aguirre@metrobank.com.ph

Marian Florendo
marian.florendo@metrobank.com.ph

Joshua Tatlonghari
joshua.tatlonghari@metrobank.com.ph

- The Philippines remains one of the fastest-growing economies among major Asian countries in 2023, with potential growth areas aligned with the priorities of the current administration, despite elevated inflation and slower growth.
- At the beginning of 2024, the Bangko Sentral ng Pilipinas (BSP) and the US Federal Reserve (Fed) both held their policy rates steady, as expected. We are expecting rate cuts for both the BSP and the Fed by the second half of 2024. The BSP is likely to delay its first cut by up to a full quarter later than that of the Fed.
- Although the markets have started to agree on a view of gradual policy rate cuts, we still prefer to lock in longer duration through 5- to 20-year peso government securities and 5- to 10-year US dollar credits before a further dip in yields. We see stronger-than-expected economic data releases as opportunities to re-enter the fixed income market at potentially higher yields.

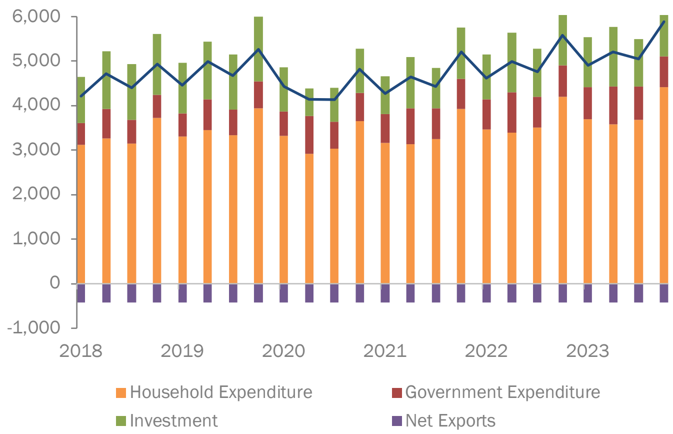
2024 Growth Opportunities

The Philippines is among the best-performing economies in Asia, outpacing China, Vietnam, Indonesia, Malaysia and Singapore. At 5.6% gross domestic product (GDP) growth in 2023, the country exceeded market expectations of 5.2% despite settling below the government target of 6%-7%, for the year.

By 2025, the World Bank expects the Philippines to achieve upper-middle-income status. This means having a gross national income (GNI) per capita income range of USD 4,466 to USD 13,845. In 2023, GNI per capita reached PHP 238,842 which translated to around USD 4,293. GNI has increased 14.26% in 2023 from PHP 209,038 in 2022.

Chart 1. PH Real GDP growth rate

Chart 2. PH Real GDP components



Potential growth industries in 2024 are focused on the priorities of the current administration. They are aligned with 8-Point Socioeconomic Agenda under the medium-term fiscal framework (MTFF) comprised of the following focus areas: (1) food security, (2) improved transportation, (3) affordable and clean energy, (4) health care, (5) social services, (6) education, (7) bureaucratic efficiency, and (8) sound fiscal management.

Private consumption. Consumption remains to be the main driver of the country's GDP. Latest data from the Philippine Statistics Authority (PSA) shows that the percentage share of consumption in GDP remains high at 76.6%, with a 5.6% year-on-year (YoY) growth for the last quarter of 2023. This year, consumer spending is expected to continue to be the main driver. To support consumers, the government is looking at managing elevated prices by improving the resilience of agriculture, using strategic trade policies, and preventing anti-competitive practices in the market. Department of Finance (DOF) Secretary Ralph Recto also committed to ensuring price stability to protect the purchasing power of Filipinos.
Food Security. Food security is a priority of the government, especially with the rice crisis in 2023 brought about by export restrictions imposed by rice-exporting countries, which accounted for 90% of the Philippines' rice imports in 2022. This led the government to directly influence prices to address the problem. Apart from bilateral agreements with other countries to

secure the supply of rice this year, the government continues to seek investments in improving local agricultural production, expanding post-harvest storage facilities, and enhancing supply chains. The National Food Authority (NFA) also launched the Masagana Agri-Food Infrastructure Modernization program for strategies to increase production, modernize production system, and improve post-harvest systems and infrastructure.

Tourism. By end of 2023, the country recorded a staggering 5.1 million international visitor arrivals for the year. To enhance the tourism sector in the Philippines, the country is undergoing significant transformation, including the enhancement of infrastructure, streamlining of processes, and ensuring ease of travel for both domestic and international tourists. Among these is a public-private-partnership (PPP) project (15-year PPP concession agreement) to enhance the Ninoy Aquino International Airport (NAIA). This covers the rehabilitation of NAIA's passenger terminals and airside facilities, development of commercial assets and utility systems, and provision of surface access facilities that enable intermodal transfer at the airport and inter-terminal passenger transfer facilities and services.

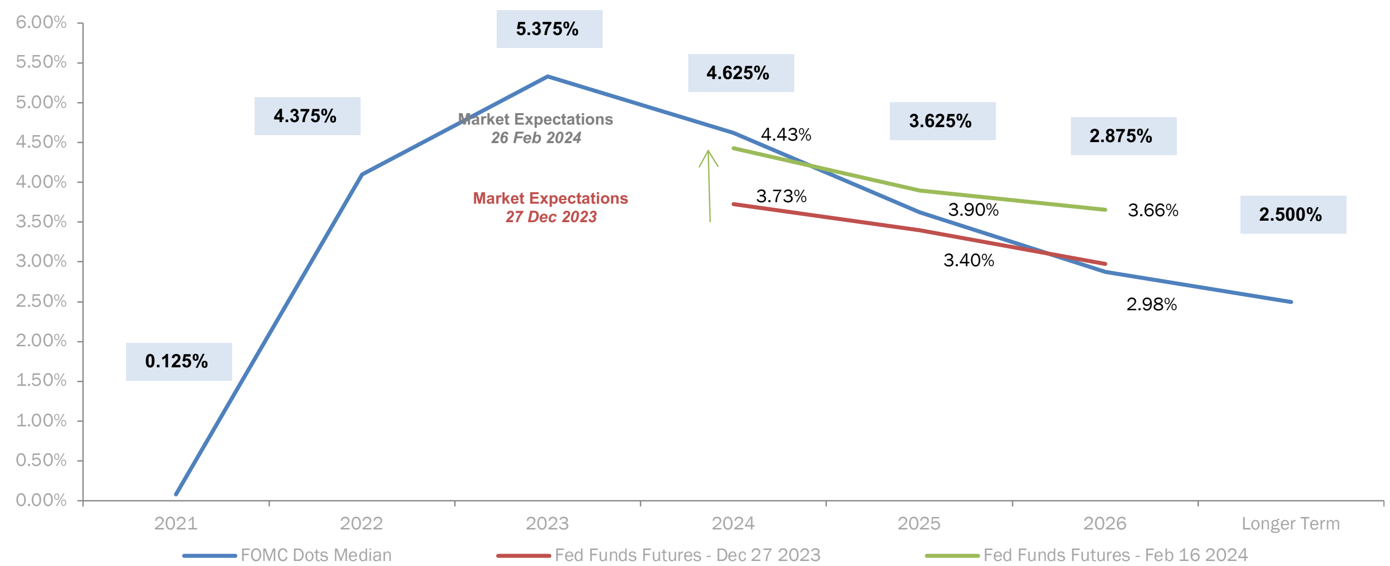
Digitalization. The President, through an executive order, implemented the streamlining of the permitting process for the construction of telecommunications and internet infrastructure, which is a welcome development for potential investments in the improvement of internet connectivity especially in geographically isolated and disadvantaged areas. Apart from infrastructure, the pandemic has also opened opportunities for e-commerce. With the issues on online safety, the government continues to set up mechanisms to protect online transactions, merchants, and costumers alike, through policies and laws such as the Internet Transactions Act and the Sim Card Registration Act. These developments provide a safer and more inclusive space that attracts more businesss activities.

Public Infrastructures. The government is enhancing public-private partnerships (PPPs) to pave the way for the construction of big ticket infrastructure projects. To support this, the government is implementing the Public Services Act which opened up public services to 100% foreign ownership (previously 40%). Current PPPs include airports, ports, railways, and highways. Early this year, newly appointed Finance Secretary Ralph Recto reaffirmed his goal to boost economic growth and enhance the quality of life for Filipinos. Recto said, instead of imposing new consumer taxes, he prefers to strictly implement current taxes and improve tax collection efficiency. His leadership, with the help of other members of the economic team, aims to increase government revenue, implement fair taxes for all, and lower debt through increased economic activity.

Policy Rate and Inflation

The US Federal Reserve (Fed) maintained the Federal Funds Target Rate (FFR) at 5.25% - 5.50% during the first Federal Open Market Committee (FOMC) meeting on January 31. Shortly thereafter, the Bangko Sentral ng Pilipinas (BSP) also maintained the Overnight Reserve Repurchase (RRP) rate at 6.50%. The results of both meetings have met market expectations on the policy rates. Investors and analysts believe that the US and the Philippines are at the peak of their hiking cycles and may soon start cutting rates by the second semester of the year. Moreover, the market is cutting back their expectations of aggressive rate cuts from the initial 175-basis-point rate cut by December to a rate cut similar to the Fed expectation, which is 75 basis points, as a result of stronger-than-expected non-farm payrolls.

Chart 3. Fed Dot Plot



While the Monetary Board recognizes improvements in inflation, prevailing upside risks to prices remain, specifically higher transport charges, increased electricity rates, higher oil and domestic food prices, and the impact of the El Niño. During the meeting, BSP's latest risk-adjusted inflation forecast for this year eased to 3.9% from 4.2%, while the outlook for 2025 remained relatively steady at 3.5% from 3.4%, both within the 2-4% target range of the central bank. Meanwhile, inflation expectations also remain within the target range of BSP. The lower inflation outlook takes into consideration government measures to mitigate the risks of the El Niño phenomenon.

Chart 4. PH Inflation Rate

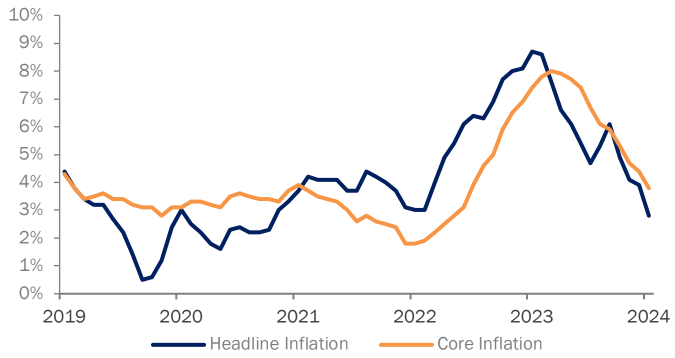
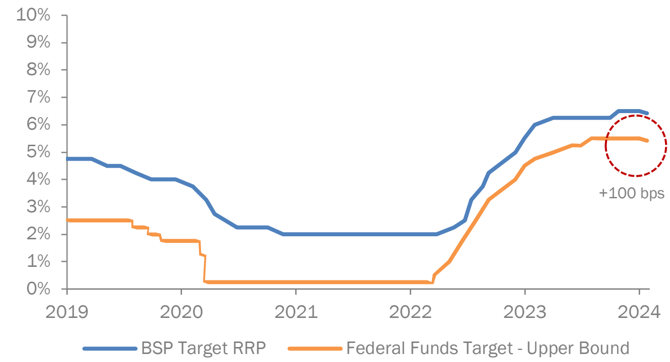


Chart 5. BSP Target RRP & Fed Funds Rate



Under Finance Secretary Ralph Recto, the DOF is initating the Reduce Emerging Inflation Now (REIN) program to ensure the price stability of goods and services and protect the purchasing power of Filipinos.

The REIN program includes the following strategies:

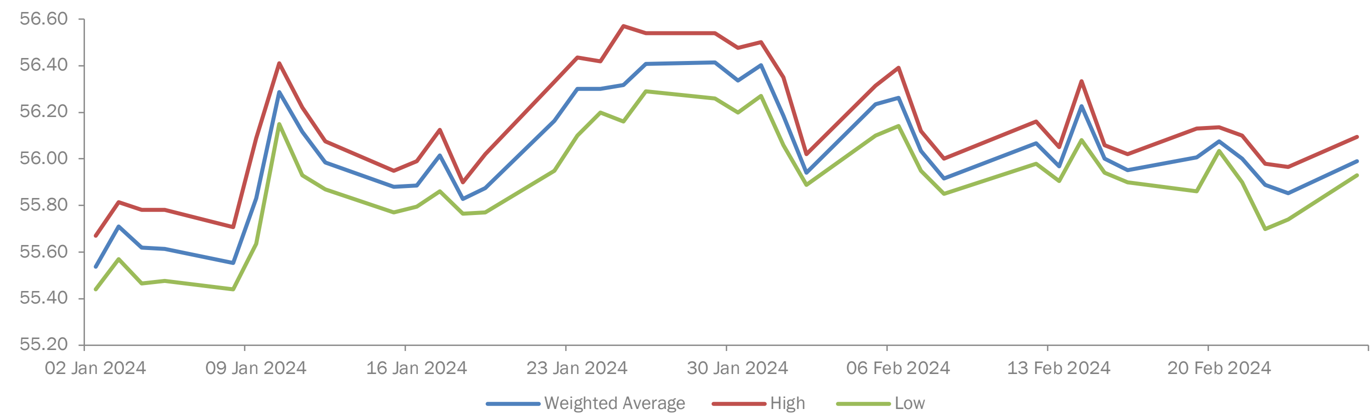
1. Efficiency in the implementation the government's conditional cash transfers programs;
2. Fast-track the implementation of the El Niño Mitigation and Adaptation Plan to mitigate the risk of the El Niño phenomenon, which is expected to peak in March;
3. Fast-track the implementation of the Philippine Crop Insurance Corporation (PCIC)'s indemnification program;
4. Modify rates for rice imports and other goods until the end of 2024 through Executive Order No. 50; and
5. Ensure the timely releases of fuel subsidies.

Update: Metrobank Research is retaining its 2024 yearend average inflation forecast at 4.3%, albeit with a downward bias as estimates show above-target inflation for most of the year due to the impending effects of El Niño on food items, emerging geopolitical risks, and rising rice prices in the world market. Meanwhile, the real GDP growth forecast for 2024 remains at 6.0%.

Foreign Exchange

The USD/PHP exchange rate saw a strong rally at the beginning of the year as it reached an intraday high of PHP 56.57 to the dollar on January 25. The price action was likely a result of strong economic data from the US along with increased market expectations of a higher interest rate policy rate by the Fed for a longer period of time. The local currency pair traded around the 56 level throughout the month of February as corporate demand for the dollar strengthened along with fewer OFW remittances following the previous holiday season.

Chart 6. USD/PHP January to February 2024



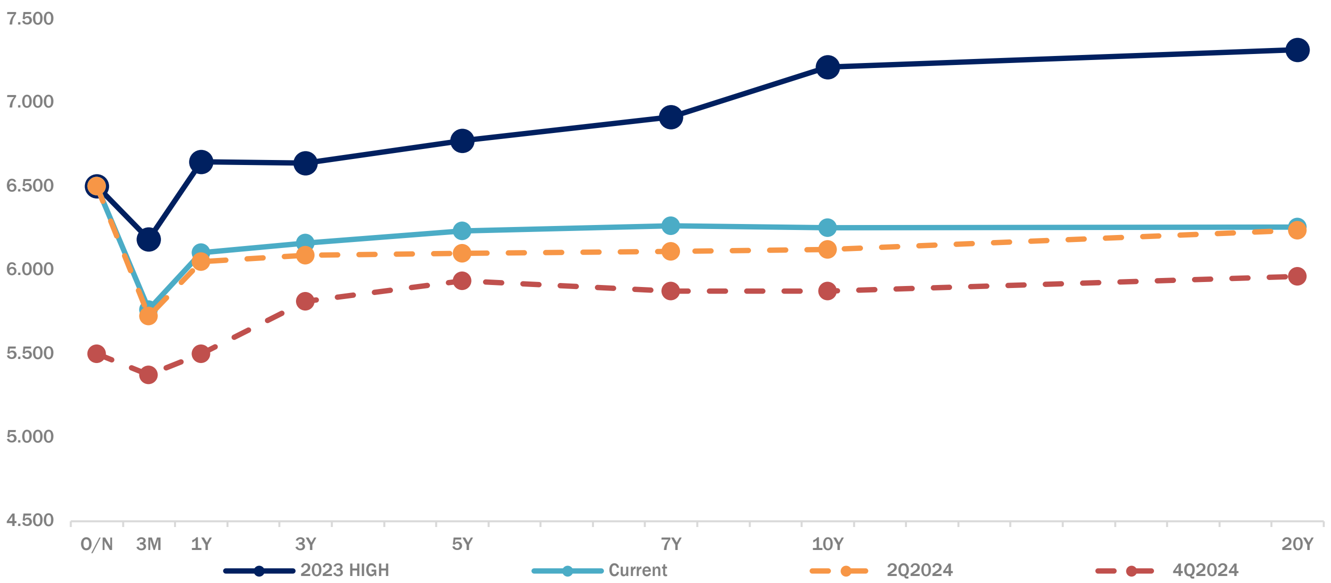
Moreover, USD/PHP remained supported at 55.77 throughout mid-January until the end of February. The depreciation of the peso from around the 55 level in the month of December occurred with a significant decline in the country's Balance of Payments (BoP) position that resulted in a USD 740-million deficit, which is a reversal from the USD 3.1-billion surplus from the same month of the last year. Moving forward, the BoP position could still improve in Q1, considering the proceeds of the government's planned global bond issuance and other official development assistance.

Although the USD/PHP has moved above 56.00, Metrobank Research still reiterates its view that the USD/PHP will trade within the lower range of 53.00-56.50. The yearend forecast remains at 54.00 on the expectation of further dollar weakness as global markets price in Fed rate cuts by the first half of the year. While the BSP is also expected to start easing its monetary policy after a Fed rate cut, high borrowing costs may still keep investment spending and imports relatively tempered.

Chart 7. USD/PHP Weighted Average

Trade Ideas for Investors

With the recent issuance of the new RTB 5-18 and the stronger-than-expected local CPI for January, the yields on peso government securities (GS) have returned to around the 6.25% area, albeit on a very flat curve. Despite this selloff, GS yields have dropped significantly from their 2023 highs following the BSP's off-cycle hike.



Even as markets revert to views of more gradual policy rate cuts, our fixed income traders still expect the GS yield curve to end the year within the range of 5.25%-5.75%. For this reason, we reiterate our recommendation to be overweight on duration ahead of the anticipated policy rate cuts. We prefer 5- to 20-year GS bonds, with coupon rates of at least 6%, in order for investors to benefit from above-average regular cash flows.

Indicative pricing as of 11 March 2024. Subject to client suitability and available volume.

Government Securities	Indicative Yield-To-Maturity (YTM)	Suggested Entry Level	Tenor (Years)	Maturity
RTB 5-18	6.225%	6.200% - 6.300%	5.0	28 Feb 2029
FXTN 7-71	6.220%	6.250%-6.325%	6.9	18 Jan 2031
FXTN 10-72	6.210%	6.200%-6.400%	9.9	25 Jan 2034
FXTN 25-6	6.210%	6.300%-6.400%	10.7	05 Nov 2034
FXTN 25-7	6.230%	6.300%-6.400%	11.6	30 Sep 2035
FXTN 20-23	6.220%	6.300%-6.450%	14.9	24 Jan 2039

With the Fed expected to cut rates first, we also emphasize our preference for 5- to 10-year US dollar sovereign and corporate bonds. For sovereigns, we like Indonesia, Saudi Arabia, and Oman, which, compared to the Philippines, are able to export oil, metals, and other vital industrial commodities. Meanwhile, for corporates, we like various US and Asia investment grade (IG) names with resilient business models and diverse global revenue streams that are expected to weather through a global slowdown, sticky inflation, and elevated borrowing costs.

Indicative pricing as of 11 March 2024. Subject to client suitability and available volume.

Category	Issuer	Bond	Indicative Yield-To-Maturity (YTM)	Tenor (Years)	Maturity / Next Call Date
Sovereigns	Republic of the Philippines	RDB 29	4.769%	5.2	11 Apr 2029
Sovereigns	Sultanate of Oman	OMAN 29	5.483%	5.4	1 Aug 2029
Sovereigns	Kingdom of Saudi Arabia	KSA 34	4.951%	9.9	16 Jan 2034
US IG	Citibank NA	C 5.803 28	4.766%	4.5	29 Aug 2028
Asia IG	Indonesia Asahan Aluminum	IDASAL 5.45 30	5.618%	6.2	15 May 2030
Asia IG	Bangkok Bank PCL	BBLTB 5.5 33	5.258%	9.3	21 Jun 2033

Although both the US and Philippines recently released stronger-than-expected inflation figures which could potentially delay the policy rate cuts, we see opportunities to re-enter the fixed income market as bond yields tend to move higher on the news.

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