UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

UNCTAD

Ninth UNCTAD Debt Management Conference

Geneva, 11 - 13 November 2013

External Shocks, Financial Stability and Debt

by

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Debt Management Conference:
External Shocks, Financial Stability and Debt

United Nations Conference on Trade and Development
November 2013

Where we used to be…

Back in 2005…

Nominal Debt — *Php 3,888.2 bn / U$73.2 bn*

Risk Indicators		
Nominal Debt-to-GDP	**68.5%**	High indebtedness
FX Risk		
FX Debt as % of Total	**44.3%**	High exposure to adverse currency swings
Refinancing Risk		
ATM External (Yrs)	**10.7**	70% of domestic debt have tenor of <5 yrs
ATM Domestic (Yrs)	**4.6**	
ATM Total (Yrs)	**7.3**	
Liquidity Risk		
ST FX Debt as % of GIR	**18.0%**	Ample FX cover
Interest as % of Revenue	**36.7%**	Large IP posed heavy burden on socio-economic development
Interest as % of Expenditure	**31.1%**	

What we did?

Structrual and Other Developmental Reforms and Programs

Creating a supportive macroeconomic environment

1993 — 1998 — 2003 — 2008

1993: Creation of the Bangko Sentral ng Pilipinas

1994: Liberalization of foreign bank entity

1995: Liberalization of telecommunications industry

1997: Privatization of water services

1998: Deregulation of the oil industry

2000: Passage of General Banking Law and Phil. E-Commerce Act

2001: Liberalization of the power sector (EPIRA)

2002: Adoption of inflation targeting framework

2003: Passage of Special Purpose Vehicle Act

2004: Passage of Government Procurement Reform Act

2004: Adoption of Basel 2

2005: Passage of Securitization Act

2005: Passage of Expanded Value-Added Tax Law (EVAT)

2006: Establishment of the Wholesale Electricity Spot Market (WESM)

2007: Implementation of risk-based bank supervision

2008: Passage of Renewable Energy Act

2009: Passage of Tourism Act

What we did?

Structrual and Other Developmental Reforms and Programs

Creating a supportive macroeconomic environment

2010:
Applied Zero Based Budgeting Approach in preparing the 2011 Budget

2010:
Implementation by the Bureau of Customs (BOC) of Electronic to Mobile System; Enhancement of the agency's post-entry audit capability

2010:
Launched PPP Program

2011:
Passage of the Government-Owned-and-Controlled Corporations (GOCCs) Governance Act of 2011

2011:
Enhanced Business Name Registration System

2012:
Issued EO 79 Institutionalizing and Implementing Reforms in the Philippine Mining Sector Providing Policies and Guidelines to Ensure Environmental Protection and Responsible Mining in the Utilization of Mineral Resources

2012 and beyond
Full implementation of the Government Integrated Financial Management Information Systems (GIFMIS) in 2013

2012 and beyond:
Sin Tax Bill and Rationalization of Fiscal Incentives Bill

2010 - - - **2011** - - - **2012** - - - →

2010:
Reinvigorated implementation of programs against corrupt officials, tax evaders and smugglers

2010:
Simplified and shortened business practices through web-based applications at the BIR

2010:
Set up the Debt Management Office at the Department of Finance

2011:
Issued guidelines on the adoption of Philippine Financial Report Standards (PFRS) 9: Adopted phased-immigration to Basel III

2011:
Issued EO 29 on Open Skies Policy

2011:
BOC National Single Window

2012:
Program Budgeting Approach

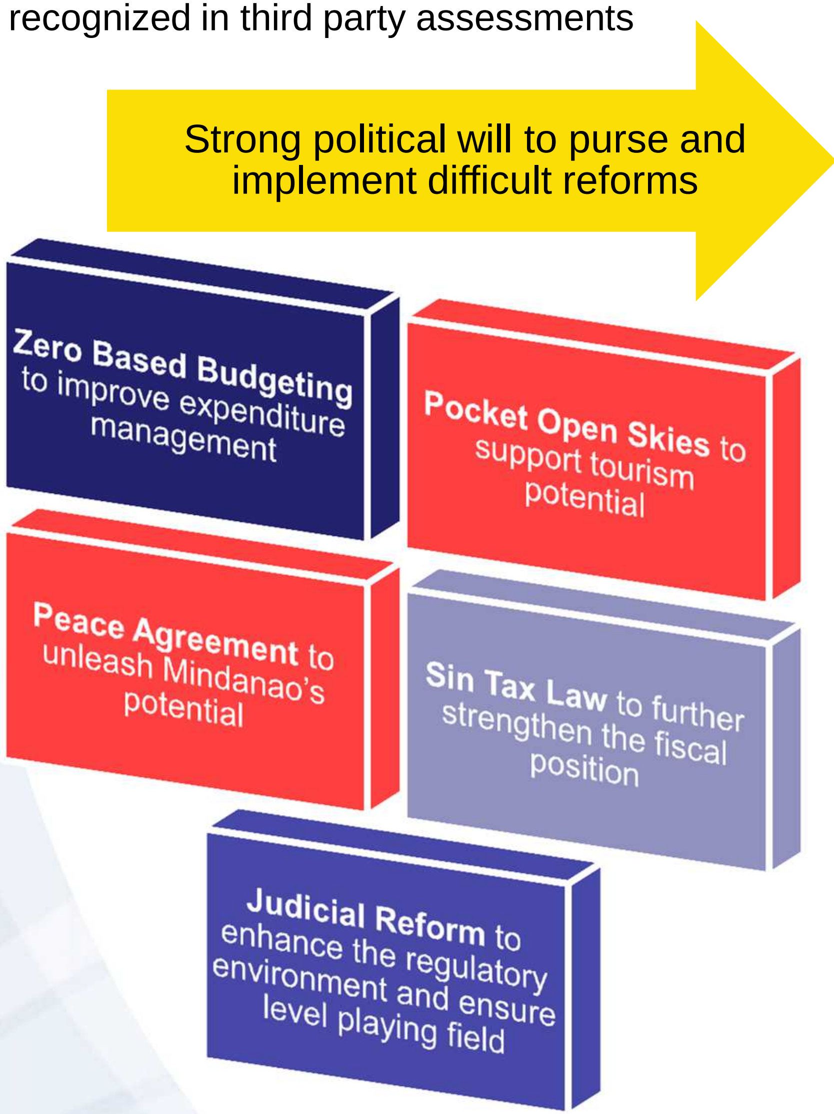
2012:
Nationwide Launch of Philippine Business Registry Facility

2012:
Passage of Amendments to the Anti-Money Laundering Act of 2001

2012:
Launched Food Staples Sufficiency Program

What we did?

- The passage of landmark reform measures demonstrate improved governance, which has been recognized in third party assessments



Third Party Report	Latest	Previous	Change
World Bank Ease of Doing Business Assessment	108/189	133/189	Up 25
Transparency International 2012 Corruption Perception Index	105/179	129/183	Up 24
World Bank 2012 Worldwide Governance Indicators Government Effectiveness*	55.9	51.2	Up 4
IMD 2013 World Competitiveness Report	38/60	43/59	Up 5
Heritage Foundation 2012 Economic Freedom Index	97/177	107/179	Up 10
Thomson Reuters/INSEAD Asia Business Sentiment Survey** (Q3 2013 vs Q2 2013)	100/100	94/100	Up 6
Grant Thornton 2013 Global Dynamism Index	21/60	46/50	Up 25

*Percentile ranking

** % of respondents with positive outlook on the Philippines

What we did?

Improving the Government Debt Portfolio through Prudent Issuance Policy

Ensuring debt sustainability requires long-term commitment to improving the government's debt portfolio. To this end, the formulation of the National Government's debt strategy is guided by the following objectives:

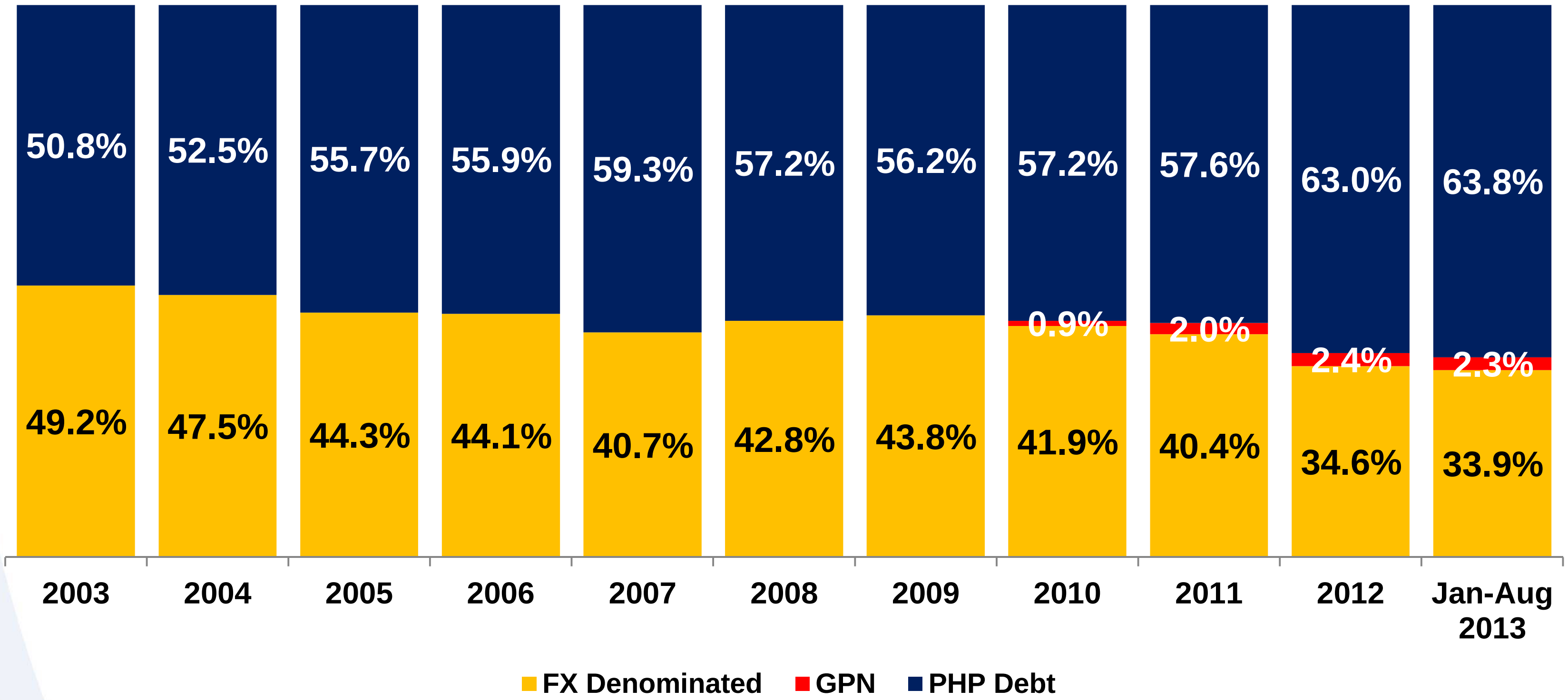
❖to meet the government's financing requirement at minimal cost consistent with an acceptable level of risk;

❖to reduce National Government (NG) foreign currency denominated debt;

❖to further support the deepening and development of the domestic capital market.

Issuance Policy | Borrowing Mix

Heavy Bias Towards Domestic Sources of Financing



- To minimize *FX risk* and help develop the domestic capital market, the borrowing program has been designed to take advantage of ample onshore liquidity.
- Further, with the introduction of the GPN format, the Republic was able to gain access to foreign funds without compromising its debt portfolio's FX position.

The Innovative Global Peso Note (GPN)

the first ever local-currency-linked bond in Asia

- The GPN enhances the government's debt investor profile while paving the way for greater participation by offshore investors in the local capital markets.

2011

receives U$ 1.0 B

converts U$ 1.0 B proceed to P44.109 B debt at USDPHP = 44.109

REPUBLIC OF THE PHILIPPINES

2021

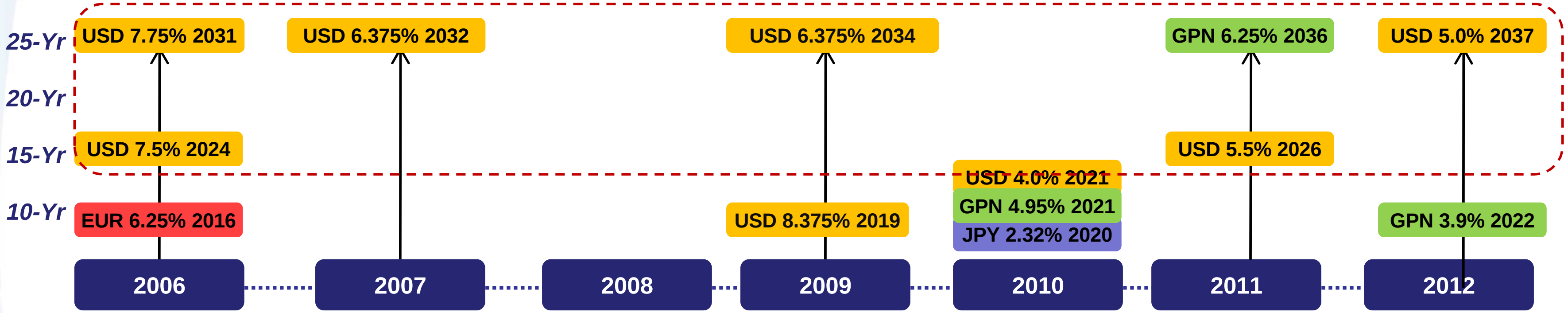
pays back U$ equiv of P44.109 B using USDPHP rate on redemption date

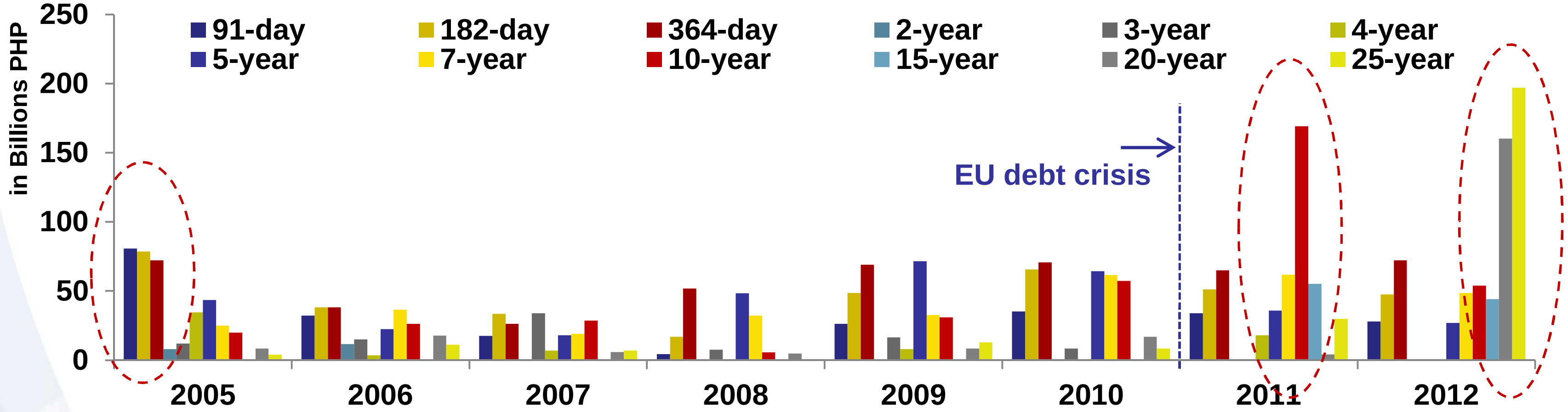
pays 4.95% interest on P44.109 B nominal, but settles in U$ using prevailing USDPHP rates at coupon dates

- Because the instrument is denominated in PHP, the government has no exposure to exchange rate fluctuations.
- Since the instrument is priced to mirror the net-of-tax yield of similar domestic benchmark bonds, it gives offshore investors a corridor to hold-on to peso debt w/o the frictional costs associated with participating in the domestic market .

Issuance Policy | Global Bond Issuances

Extending the Average Maturity of External and Domestic Debt





- Global bond issuances have been concentrated on the long- to the very long-end of the yield curve to maintain comfortable level of average maturity.
- On the domestic side, the decline in borrowing costs across all points in the yield curve provided the perfect backdrop to stretch out portfolio maturities without raising average interest.

What we did?

Debt Portfolio Optimization through Proactive Liability Management

To complement the prudent issuance policy, the Republic also delved actively in **liability management transactions** to minimize portfolio risks and/ cut down costs. These include exercises like:

- switching high coupon bonds with low coupon new issuances;
- redeeming foreign currency debt with peso debt;
- bond exchanges that aim to extend maturities; and
- consolidation of benchmark bonds

Proactive Liability Management

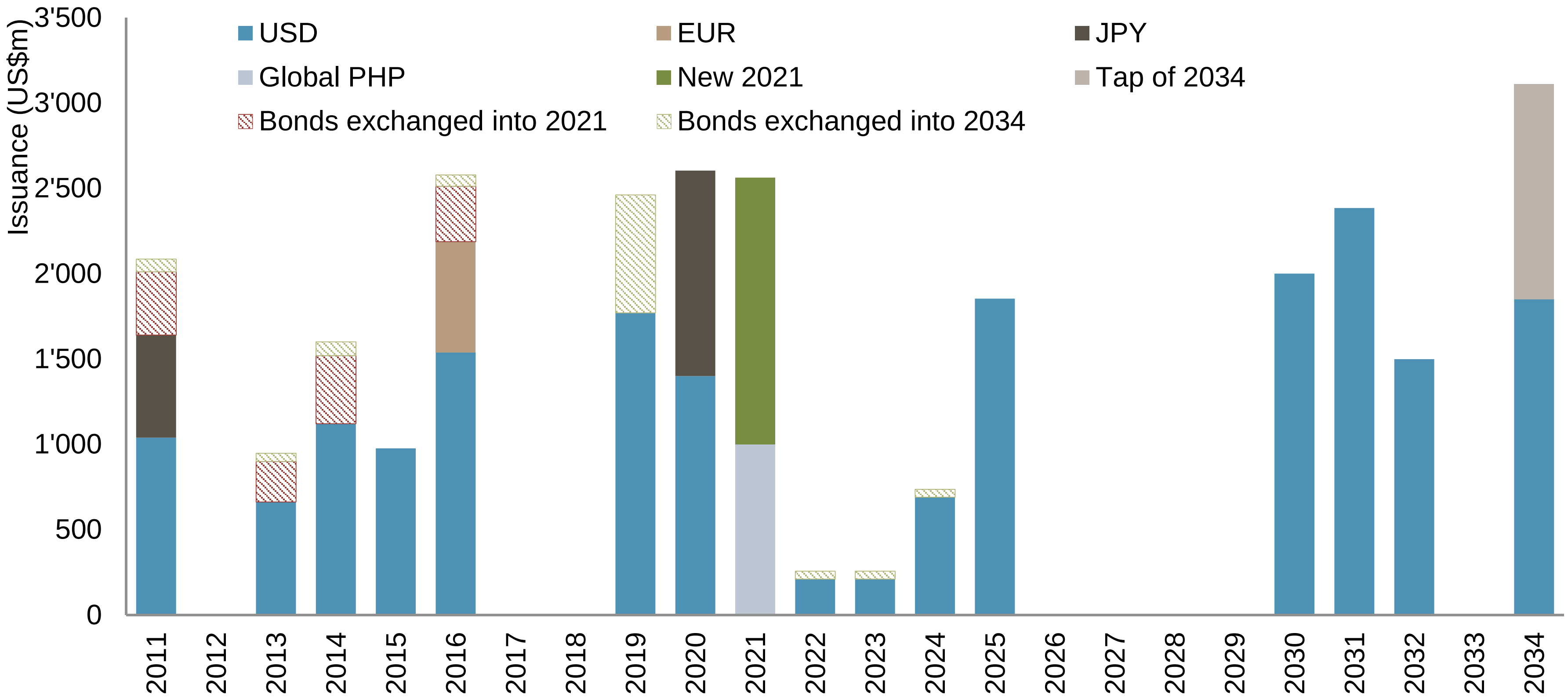
2010	2011	2012
Quantitative Easing (QE2)	*EU Debt Crisis, "flight to safety"*	*Deleveraging in Europe – leveraging in EM Asia, Fiscal Cliff*
U$3.02 billion Global Bond Exchange Offer	**U$1.3 billion Global Bond Tender Offer**	**Redenomination via U$1.5 billion tender offer and P30.8 billion 10-year GPN issuance**
Declining interest rates	*Declining interest rates*	*Declining interest rates, Surge in capital inflows*
P199.5 billion Domestic Bond Exchange, Cash Tender and New 25-year Issue	**P323.5 billion Domestic Bond Swap, New Long 10-year and 20-year Benchmark Bonds**	**Landmark issuance of U$500 million 10.5-year Onshore Dollar Bond**

- The Republic has continuously sought out opportunities to advance its portfolio profile even amidst challenging external environment.

Managing the Debt Portfolio

The Global Bond Exchange of 2010

lengthening the maturity of the external debt portfolio



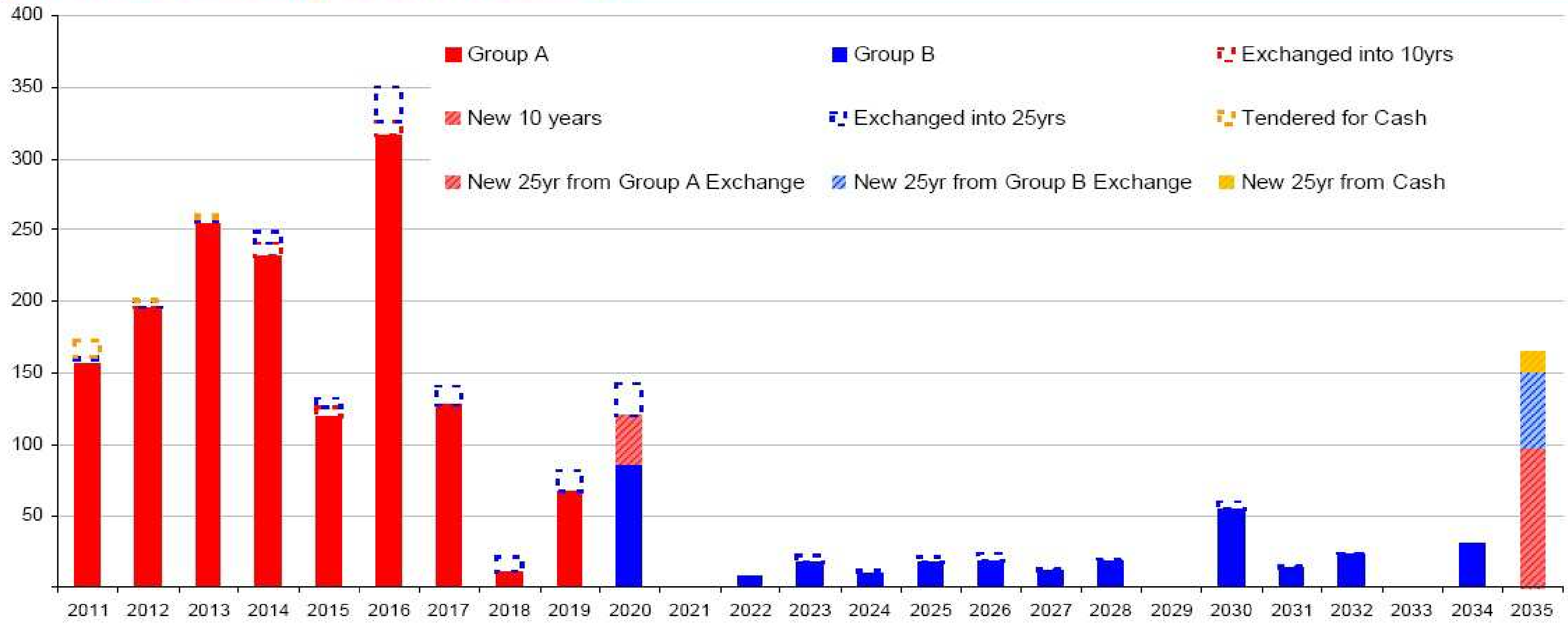
- In September 2010, the Republic got back some of its high coupon old debt in exchange for U$1.5 bn of new ROP 2021 and U$767 mn of the re-opened ROP 2034.
- The transaction helped mitigate refinancing risk by extending the maturity of the global bond portfolio by 9 years. It also reduced annual debt service cost by about US$69.6 million.

Managing the Debt Portfolio

Domestic Bond Exchange Program

Taking advantage of declining interest rate environment to manage refinancing risk

ROP PHP Debt Maturity Profile Post Exchange



- Similarly, the republic has also executed bond exchanges in the domestic market in 2006, 2007, 2009, 2010, and 2011 to smoothen its debt maturity profile, extend the maturity of existing Peso liabilities, and establish liquid benchmarks at the long end of the yield curve.
- The transactions also achieved cashflow and debt service relief, allowing the government to channel more resources to its infrastructure and socio-economic projects.

Synthetic Buyback | Tender Offering of 2011

Riding market jitters to buyback expensive dollar debt

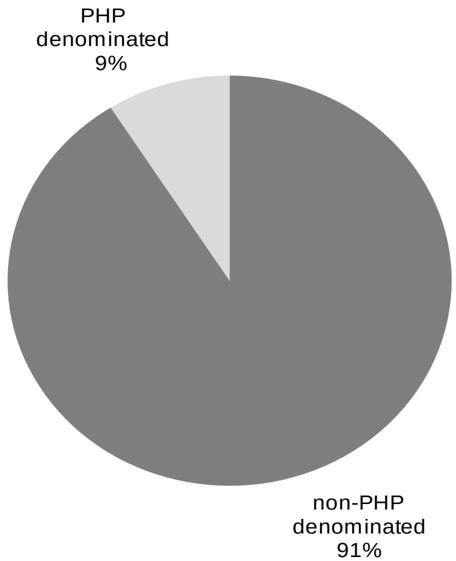
- Riding the wave of global risk aversion, the Philippines executed a *Global Cash Tender Offer* targeting a significant portion of its high coupon foreign debt.
- Approximately U$1.3 bn of ROP and EUR bonds were bought back using investible funds from the Bureau of the Treasury’s managed fund and proceeds of a U$50 mn tap of the ROP 2034, thereby transferring the ownership of these bonds to government and hence effectively retiring them.

Redenomination of 2012

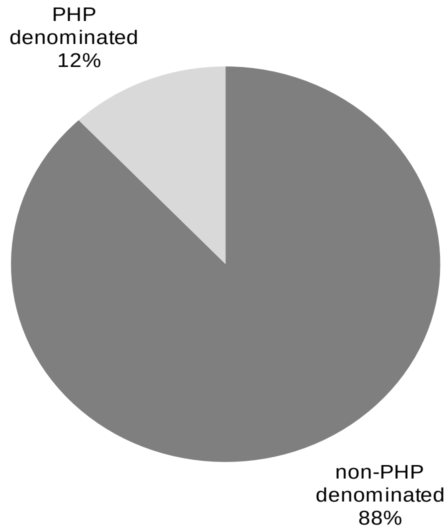
Issuance of cheaper PHP debt to buyback expensive FX debt

In Nov 2012, the Republic executed a series of transactions that bought back U$1.168 bn of high coupon foreign currency bonds using a mix of proceeds from the issuance of a 10 Yr GPN (72%) and assets from the Government's investible funds(28%).

Prior to the transaction



After the transaction



- The transaction was able to achieve: **1)** interest savings of U$73.9 mn per annum; **2)** maturity extension through the GPN leg; and **3)** redenomination of about 3% of the external debt portfolio to PHP.

Liquidity Management | Onshore Dollar Bond (ODB)

comprehensive balance sheet approach to managing the country's risk exposure

The landmark issuance of the 10.5-Year Fixed Rate Onshore Dollar Bonds (ODB) was envisioned to:

(i)take advantage of the excess liquidity of US$ in the local banking system;

(ii)increase domestic borrowing vs. external to balance international markets in period of volatility; and

(iii)develop a new, alternative and domestic U$ Fund source, proceeds of which can be used to pay off high coupon dollar debt.

Where we are now . . .

Macroeconomic Indicators

Sustained improvement across credit metrics

	2005 vs. 2011		2013
	2005	2011	Latest
GDP Per Capita[1] (US$)	1,209	2,386	1,317[2]
Real GDP growth (%)	4.8	3.9	7.8[3]
National Government Interest (% of Revenue)	36.7	20.5	20.1[5]
Fiscal Deficit (% of GDP)	2.6	2.0	0.9[3]
National Government Debt (% of GDP)	68.5	50.9	47.5[3]
Import Cover (x)	3.8	11.3	16.3[6]
Current Account (% of GDP)	1.9	3.1	4.2[3]
OFW remittances (US$ billions)	10.7	20.1	14.5[5]
Gross International Reserves (US$ billions)	18.5	75.3	83.5[6]

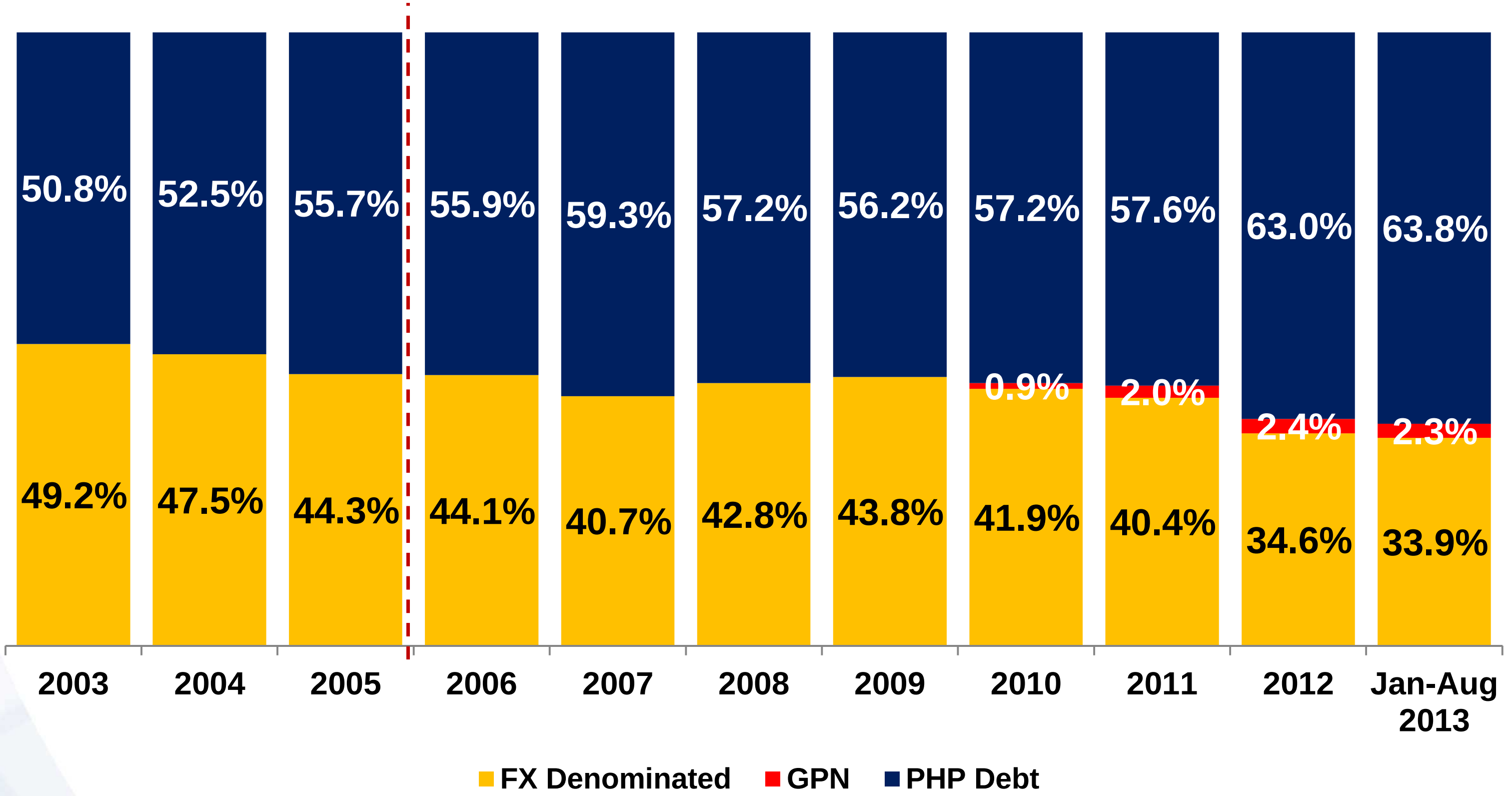
Source: Bangko Sentral ng Pilipinas (BSP), National Economic and Development Authority (NEDA), Department of Finance (DOF) and Bureau of the Treasury (BTr").
(1) At current prices
(2) GDP per capita (US$ current) as of 1H 2013;
(3) As of 1H 2013
(4) As of Jan-Sep 2012
(5) As of Jan-Aug 2013
(6) Based on September 2013 data

Where we are now . . .

Reduced External Debt Component

Exposure to adverse foreign exchange movements has been mitigated

The share of *foreign currency denominated* debt to total National Government debt has been gradually declining over the years.



****includes MRTBs and ODB***

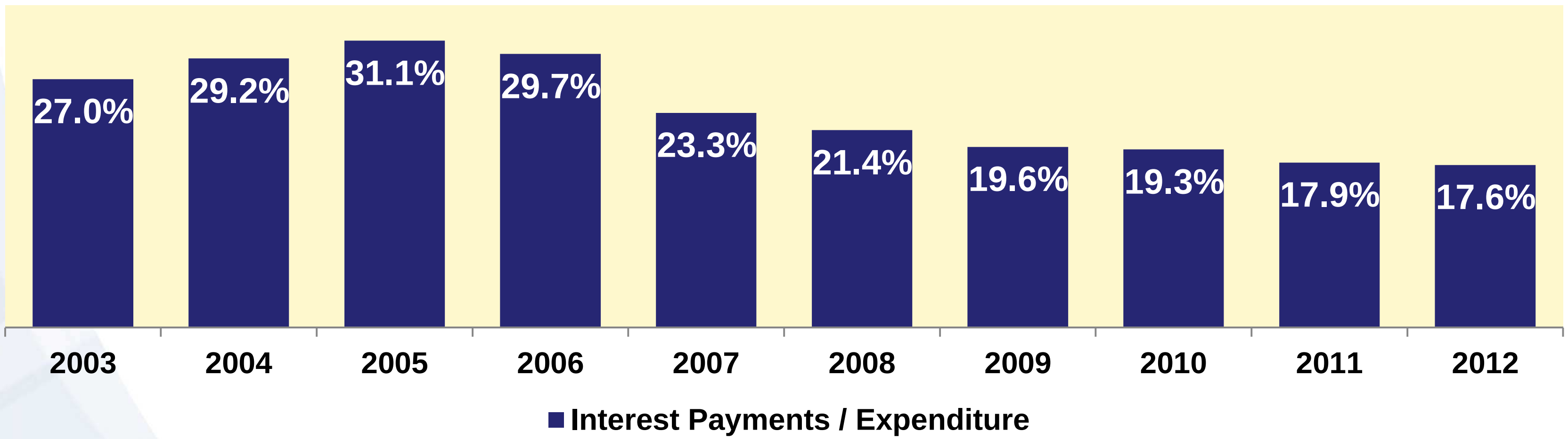
Where we are now . . .

Lengthened Debt Maturities and Reduced Burden of Debt

Reduced rollover risk and increased debt carrying capacity

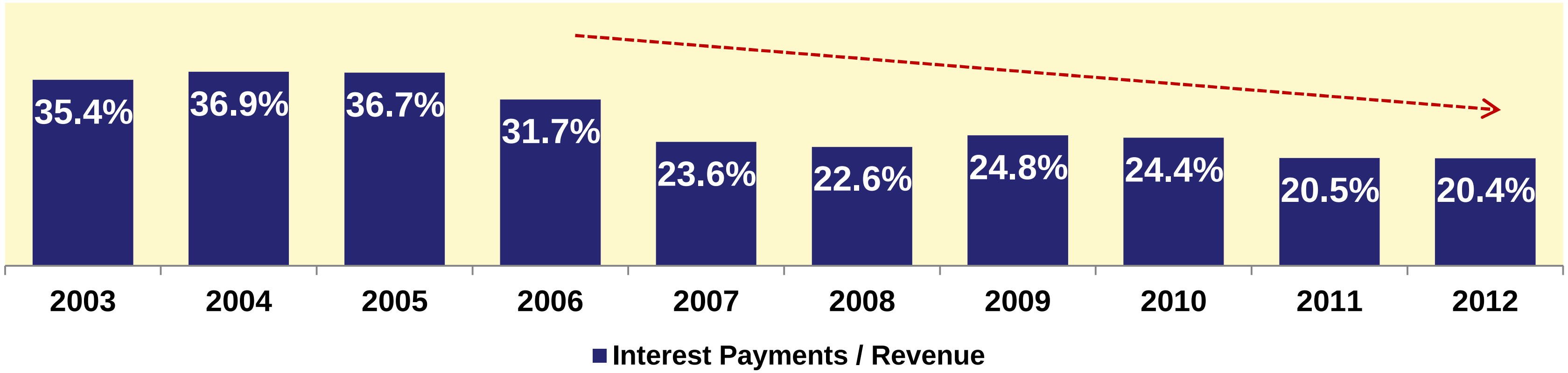
Average maturity of both domestic and external liabilities have been stretched- out enabling the government to channel more funds to finance more programs supportive of sustainable economic growth

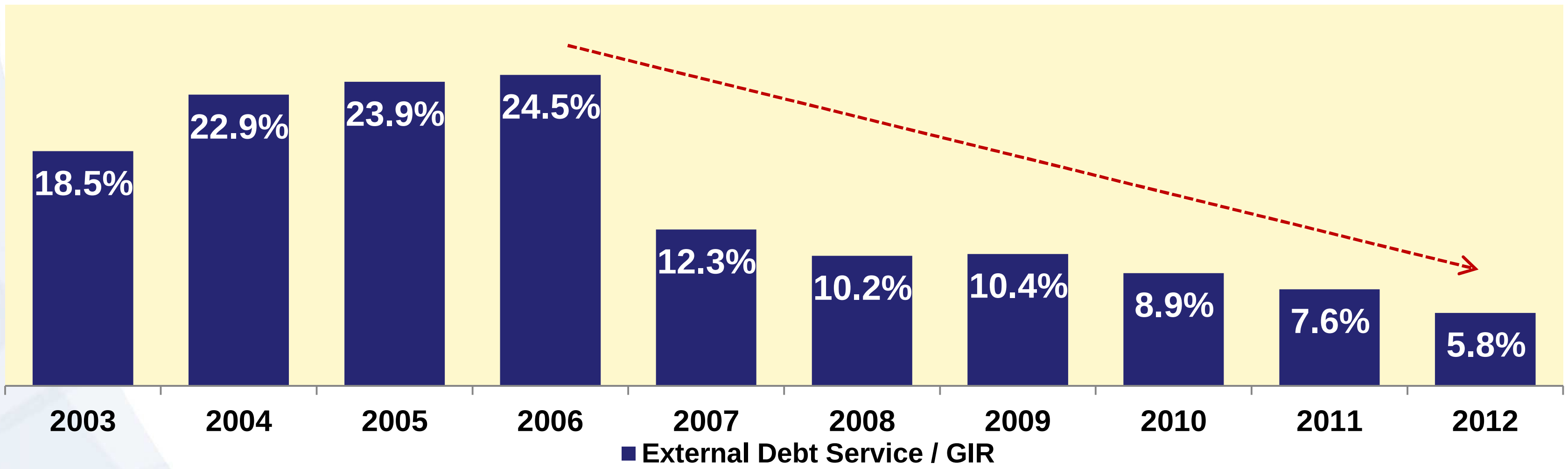
	2006	2007	2008	2009	2010	2011	2012
NG Portfolio	**7.6**	**7.9**	**7.7**	**8.0**	**8.8**	**10.2**	**10.9**
Domestic	5.2	5.2	5.2	6.0	6.7	9.2	10.4
External	10.6	11.8	11.0	10.6	11.3	11.4	11.5



Where we are now . . .

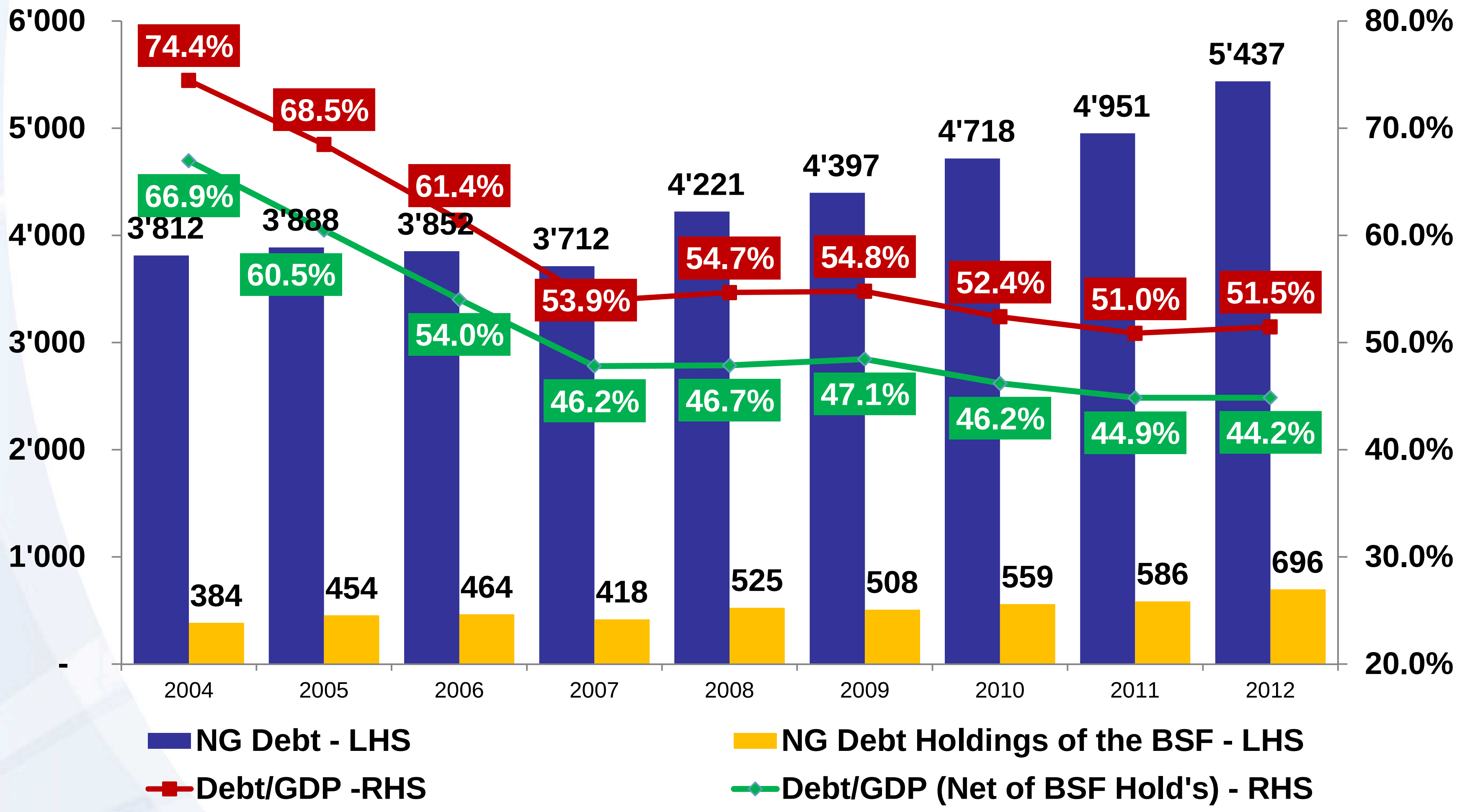
Ability to Service Debt





Where we are now . . .

Debt Sustainability has Improved Significantly



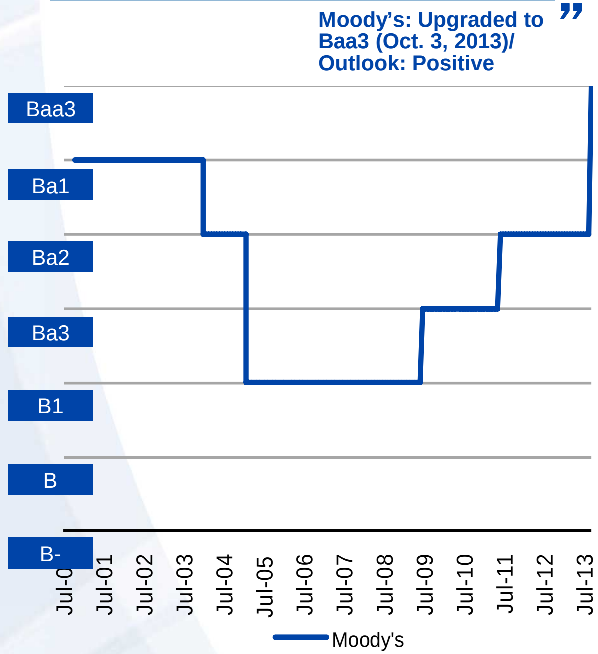
Where we are now . . .

	2005	2012
Nominal Debt-to-GDP	68.5%	51.5% ✓
FX Risk		
FX Debt as % of Total	44.3%	34.6% ✓
Refinancing Risk		
ATM External (Yrs)	10.7	11.5 ✓
ATM Domestic (Yrs)	4.6	10.4 ✓
ATM Total (Yrs)	7.3	10.9 ✓
Liquidity Risk		
ST FX Debt as % of GIR	18.0%	3.1% ✓
Interest as % of Revenue	36.7%	20.4% ✓
Interest as % of Expenditure	31.1%	17.6% ✓

Investment-grade approval from the three largest CRAs

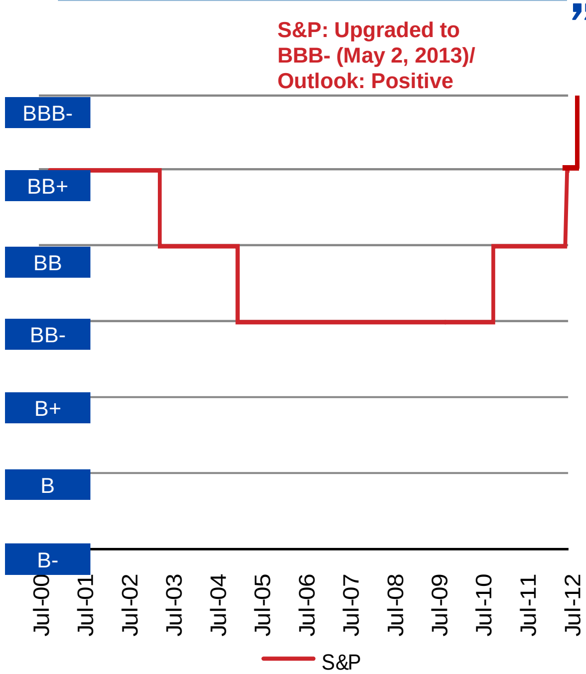
MOODY'S

"The **stability of the Philippines' funding conditions** – during the recent bout of market volatility in emerging markets – points to the **country's relative lack of vulnerability to external financial shocks**"



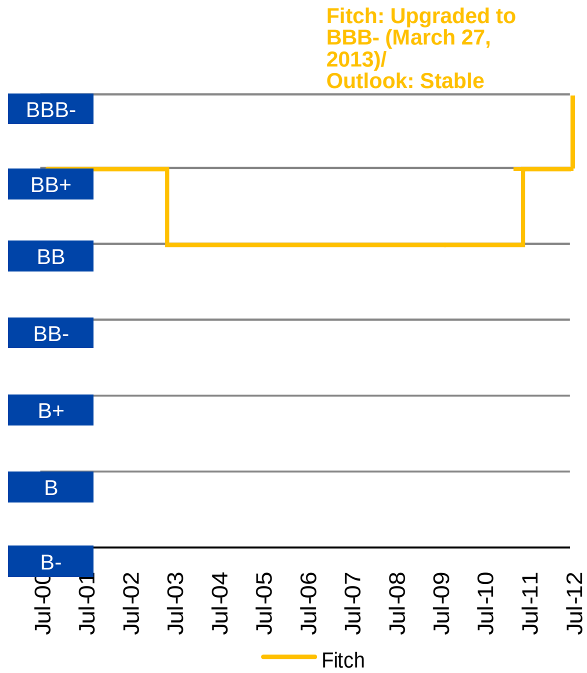
STANDARD & POOR'S

"The upgrade on the Philippines reflects a strengthening external profile, moderating inflation, and the government's **declining reliance on foreign currency debt**"



FitchRatings KNOW YOUR RISK

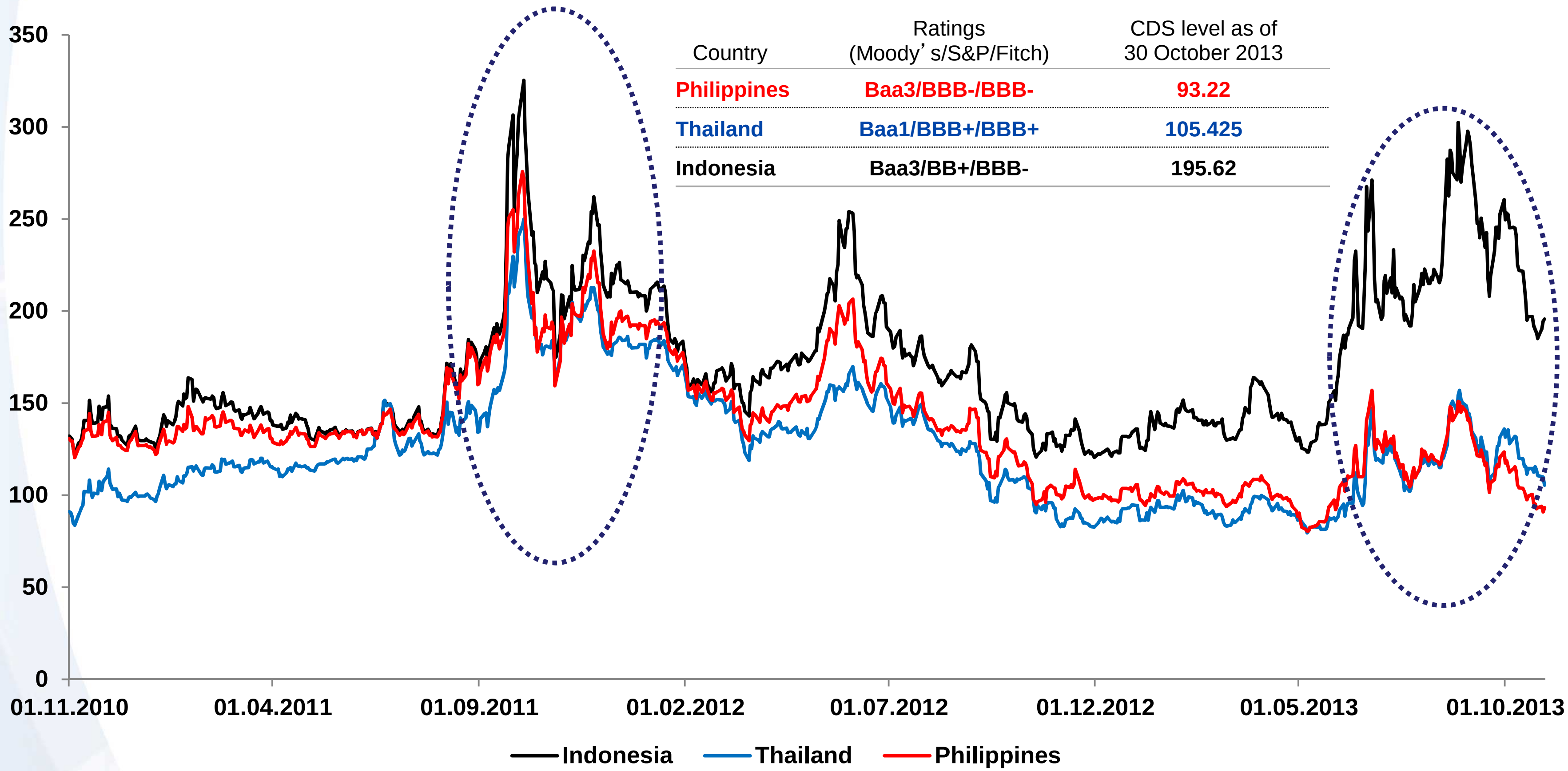
"The sovereign has taken advantage of generally favourable funding conditions to **lengthen the average maturity** of GG debt to 10.7 years by end-2012 from 6.6 years at end-2008. The **foreign currency share of GG debt has fallen** to 47% from 53% over the same period"



Source: Moody's, S&P and Fitch.

High market confidence in Philippine debt

Philippines' CDS levels are performing better than some higher rated peers



Country	Ratings (Moody's/S&P/Fitch)	CDS level as of 30 October 2013
Philippines	Baa3/BBB-/BBB-	93.22
Thailand	Baa1/BBB+/BBB+	105.425
Indonesia	Baa3/BB+/BBB-	195.62

Source: Bloomberg.
(1) Long-term issuer default rating.

Moving Forward: Capital Market Development

Ongoing Efforts and Initiatives

Comprehensive program for deepening of domestic capital markets

- The republic has continuously implemented reform programs to develop and deepen the domestic capital market to become the sustainable source of financing.

- Primary Dealer and Market Maker
- Market Unification
- Inflation-linked Bonds
- Repurchase Agreements
- Strips
- Bellwether Securities

Medium term debt targets

ACTION REQUIRED	2013	2014	2015
Reduce debt service payments (interest payments to revenue)	18.5% to 20.1 %	17.0% to 19.5%	15.5% to 18.5%
Minimize foreign exchange risk by reducing foreign currency denominated debt (as % of total debt)	32.5% to 35.0%	29% to 33.5%	26.5% to 32.5%
Minimize financing risks through:			
a) Minimizing debt maturing in one year (as a % of total)		9% to 15%	
b) Maintaining average maturity of debt portfolio		7 to 10 yrs	

- The government has committed itself to a sustainable debt portfolio through institutionalizing a medium-term debt strategy.

Thank You!