

World Bank Treasury Webinar on Debt Management Amidst Large Capital Flows The Case of the Philippines

26 February 2014

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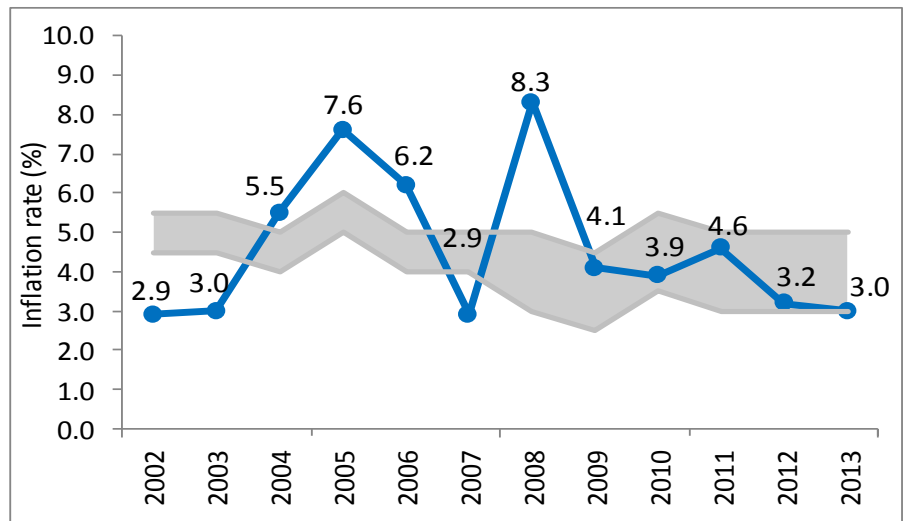
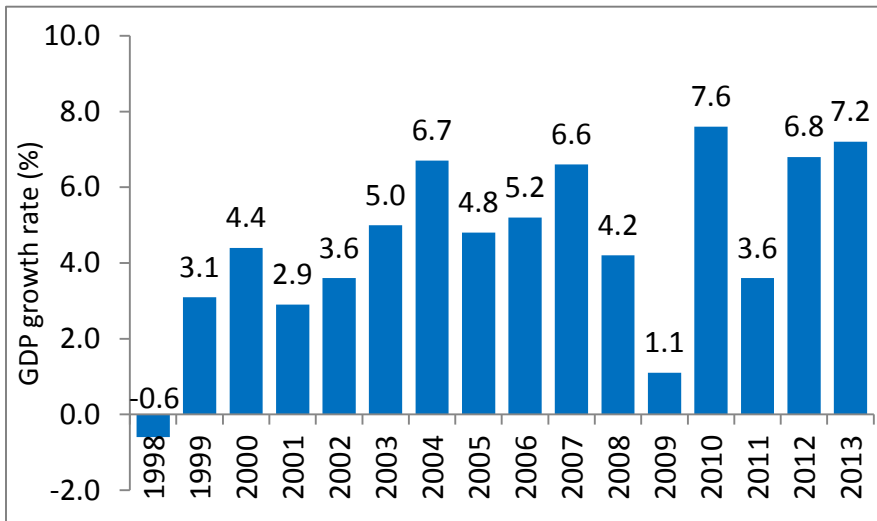


Agenda

1. Background on evolution of key macroeconomic variables
2. FX flows and effects on the economy
3. Impact on monetary policy objectives
4. Debt management under FX flows
5. Challenges in achieving debt management and monetary policy objectives
6. Strategies to overcome these challenges
7. Lessons learned and recommendations

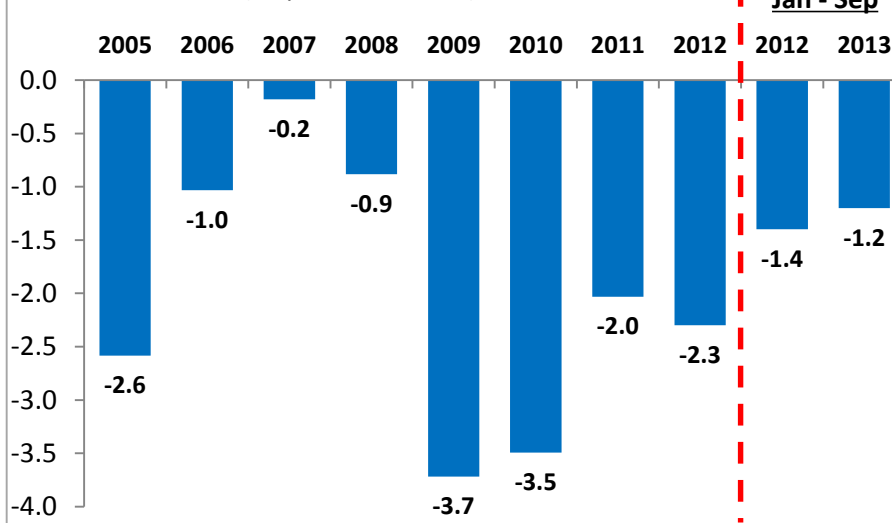
Favorable alignment of solid growth and low inflation

15 consecutive years of positive GDP growth since 1999
while inflation within target for 5 consecutive years since 2009

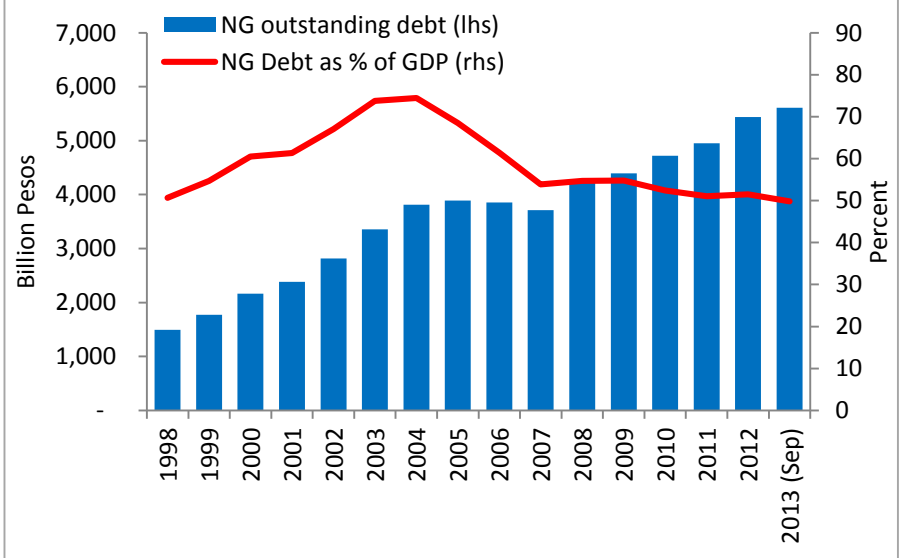


Sufficient fiscal space behind sustainable revenue and expenditure path

FISCAL BALANCE (As percent of GDP)

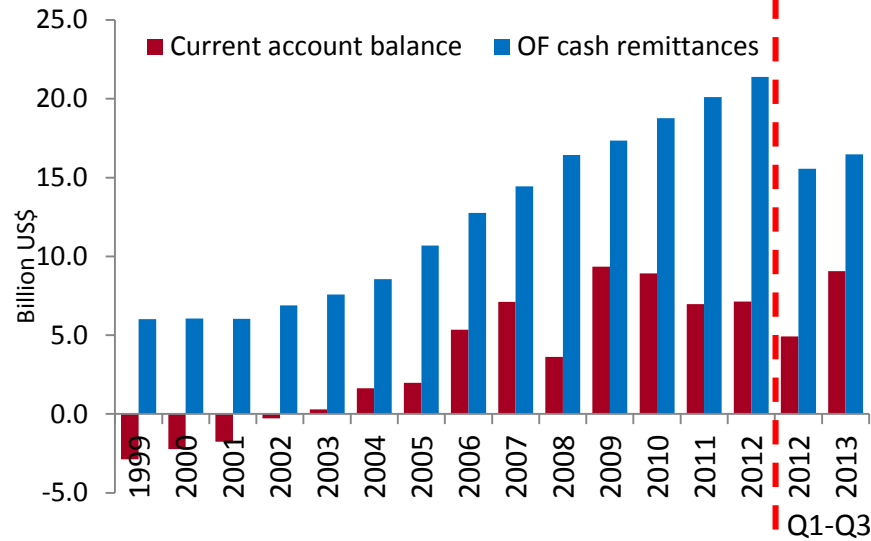


NG debt ratios have declined significantly over the last 8 years

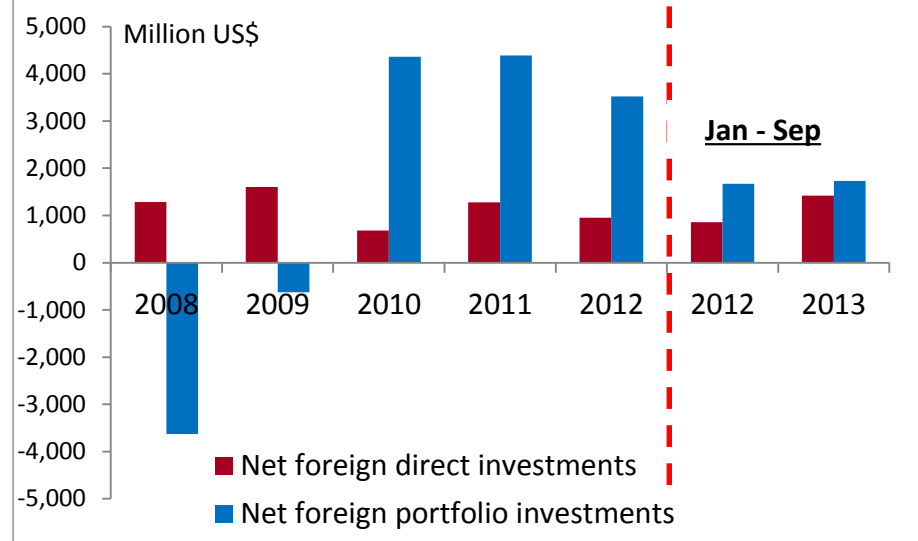


PHL economy on the receiving end of foreign exchange inflows

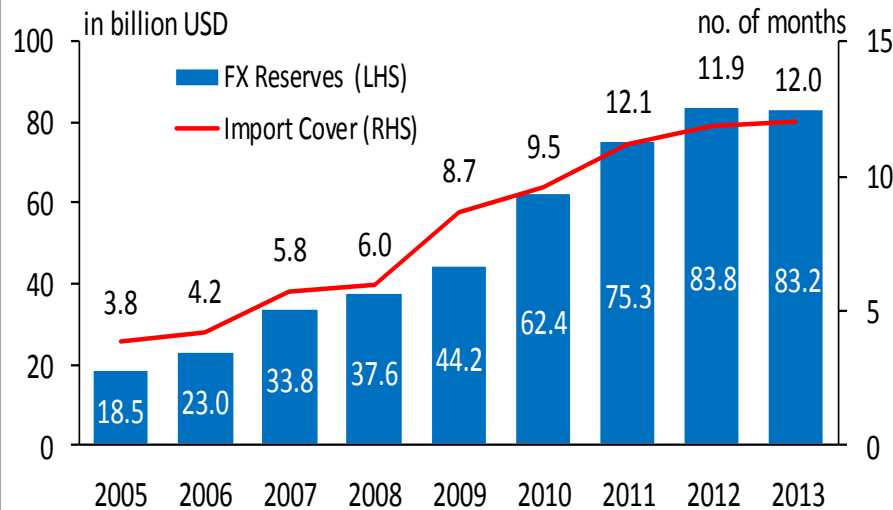
Current account in structural surplus position for 10 years



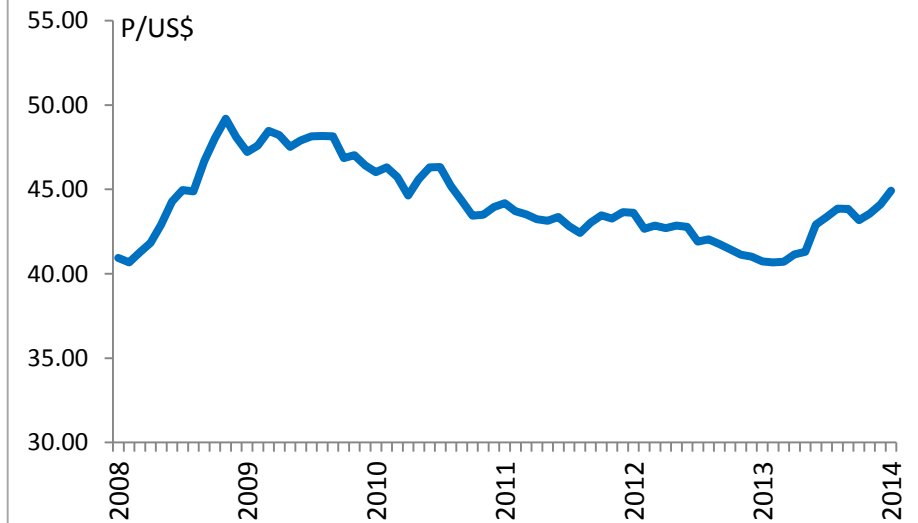
Foreign investments continue to post net inflow



Sustained build-up of foreign exchange reserves

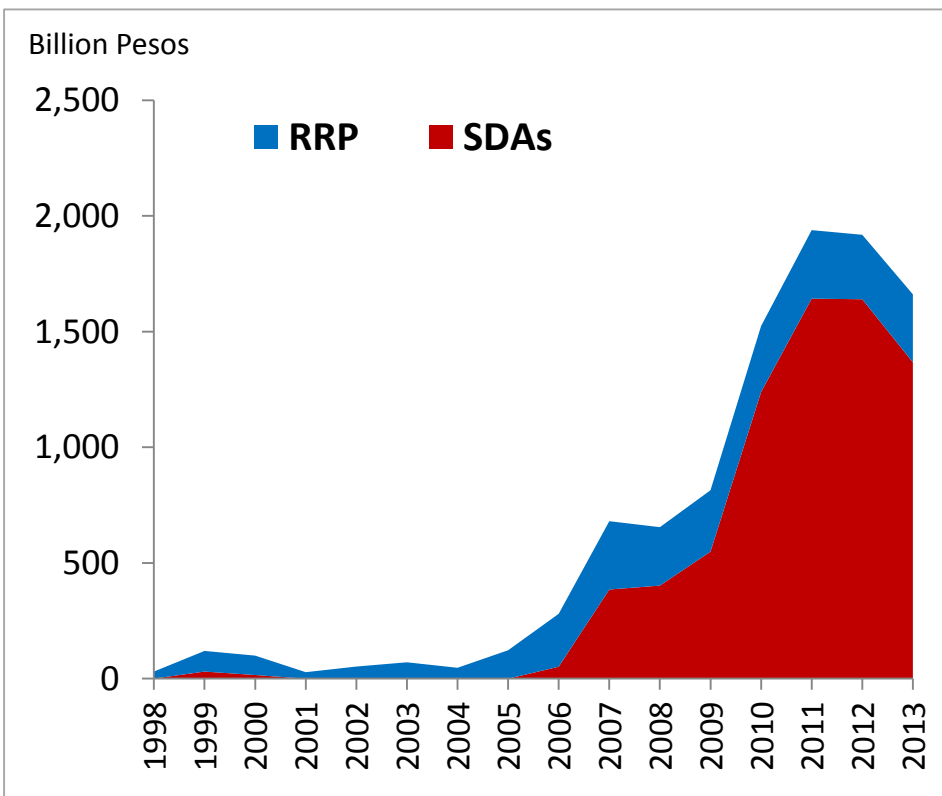


Surge in capital inflows resulted in strengthening of the peso

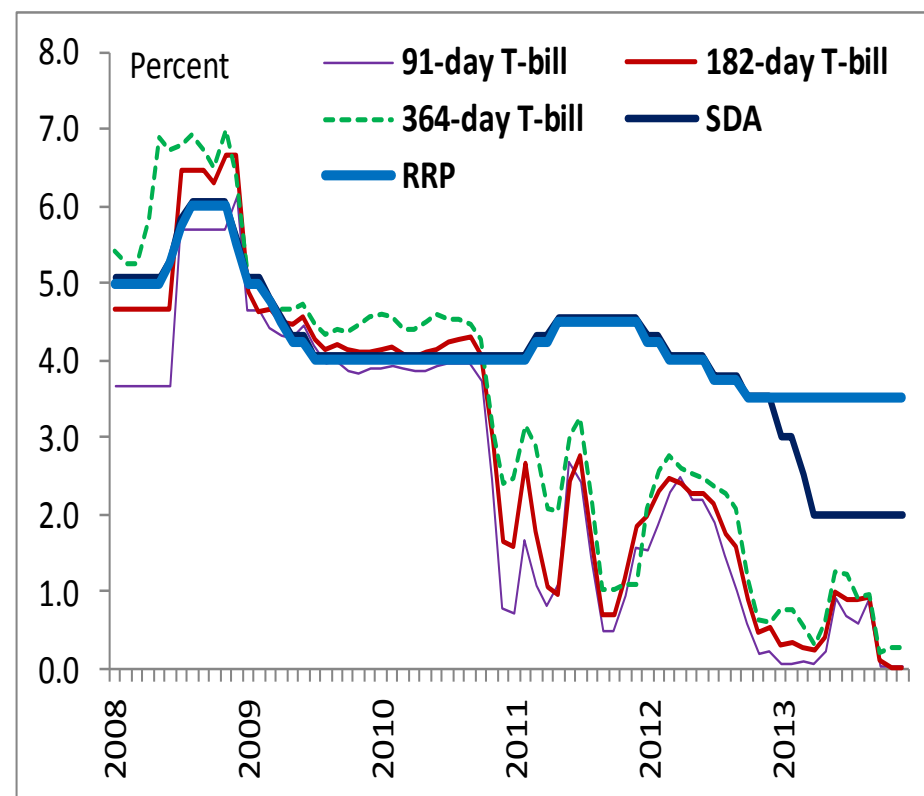


Surge in capital flows complicates the conduct of monetary policy...

Sterilization volume increased remarkably in 2010 - 2012

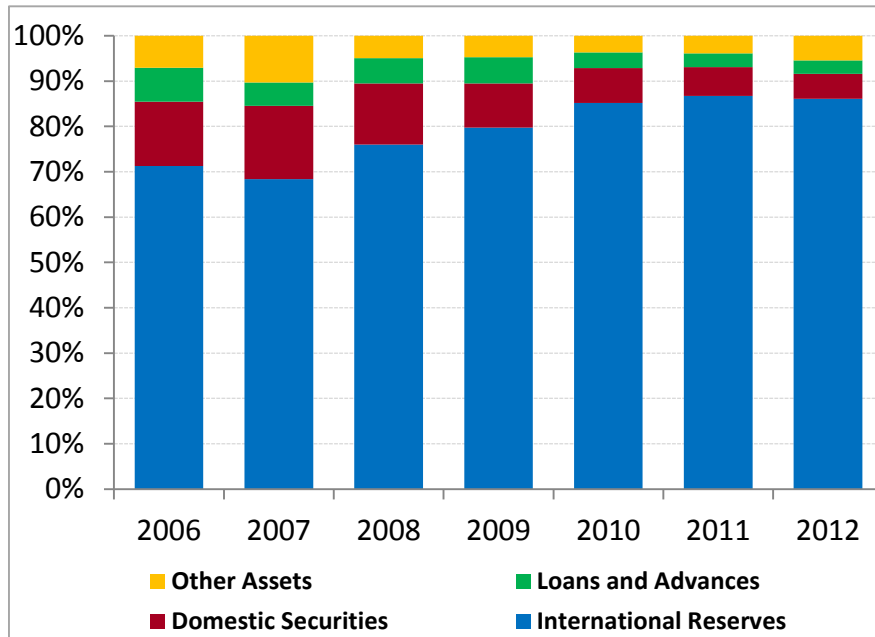


Market interest rates have diverged from BSP's policy interest rates

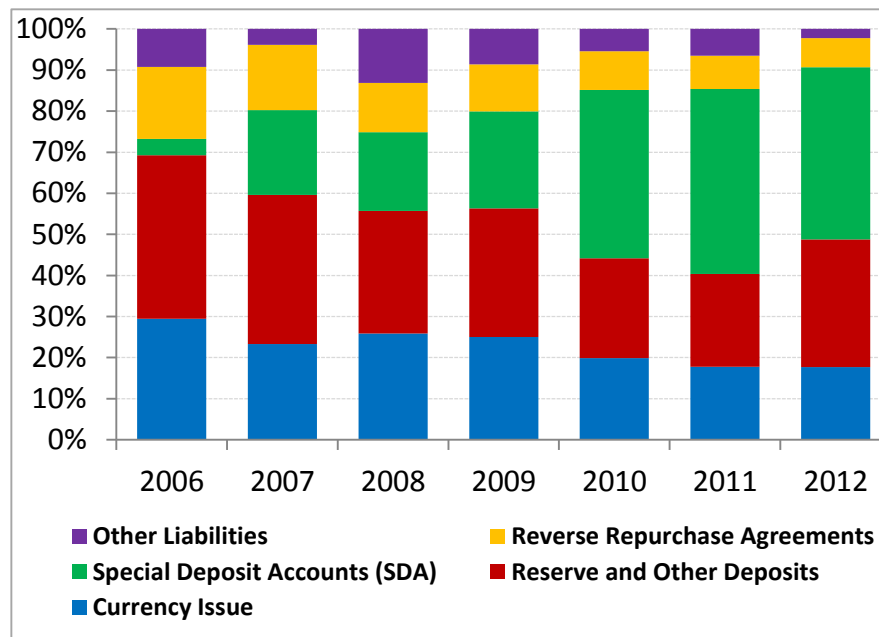


... and shifts the structure of BSP balance sheet

BSP Assets: Significant shift in the composition from domestic securities to international reserves



BSP Liabilities: Deposits account for a substantial portion of BSP liabilities



BSP has incurred losses due to foreign exchange rate fluctuations

Income Position of the BSP

For the periods indicated, in billion pesos

	2007	2008	2009	2010	2011	2012	Jan - Nov	
							2012	2013
Revenue	93.8	95.0	104.4	113.6	118.7	65.7	61.0	53.0
Less: Expense	67.1	86.3	81.4	82.5	116.0	110.7	101.0	77.0
Equals: Net Operating Income/Loss (-)	26.8	8.8	23.0	31.1	2.8	-45.0	-40.0	-23.9
Add/Less: Gains/losses on FX Rate Fluctuations	-113.7	0.5	-9.7	-90.1	-36.2	-50.4	-46.3	2.7
Equals: Net Income/Loss (-)	-86.9	8.9	13.1	-59.0	-33.7	-95.4	-86.3	-23.5

Debt Management Strategic Guidelines

In achieving the ideal debt portfolio NG follows a medium-term strategic guideline in the conduct of its debt structuring and borrowing operations

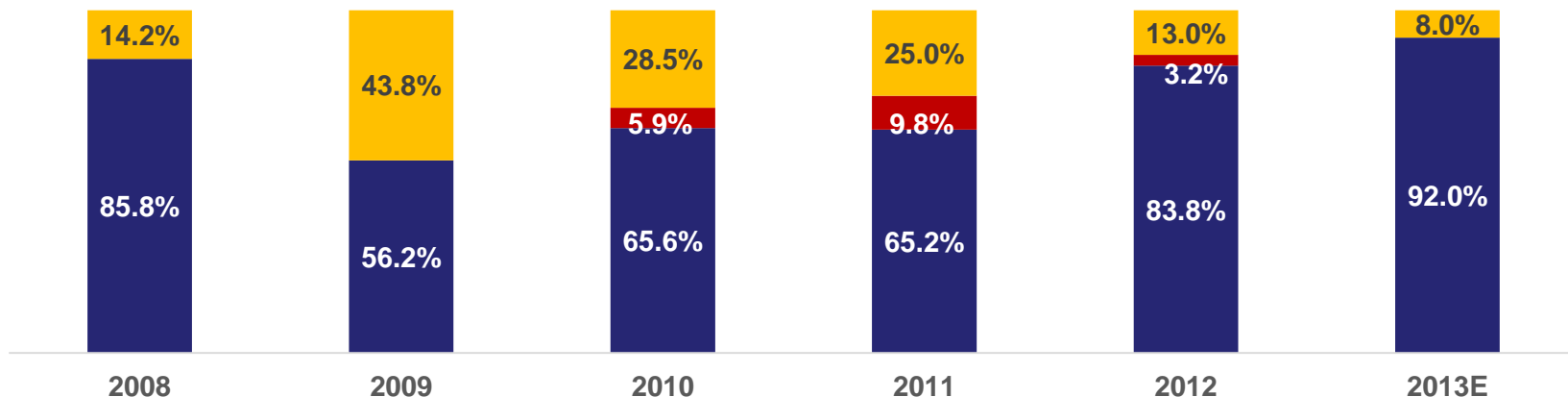
ACTION Required	2013	2014	2015
a. Reduce debt service payments (interest payments to revenue)	18.5%- 20.1%	17.0%- 19.5%	15.5%- 18.5%
b. Minimize foreign exchange risk by reducing foreign currency denominated debt (as % of total debt)	32.5% - 35%	29% - 33.5%	26.5% - 32.5%
c. Minimize financing risks by:			
Minimizing debt maturing in one year (% of total)		9%-15%	
Maintaining average maturity of debt portfolio		7-10 yrs	

Gross borrowing mix as a policy tool

Government Financing is shifting towards being more domestically funded (flow)

Gross Borrowing Mix

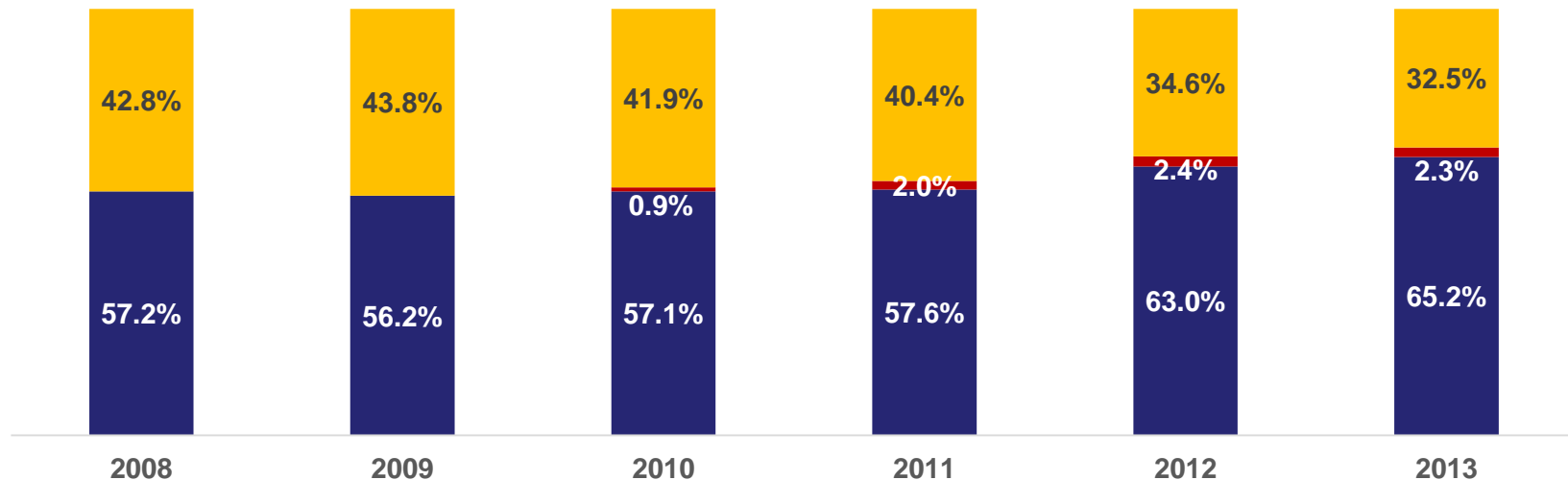
■ Domestic ■ GPN ■ Foreign



Debt dynamics have improved as share of FX denominated debt is on decline (stock)

Evolution of NG Debt

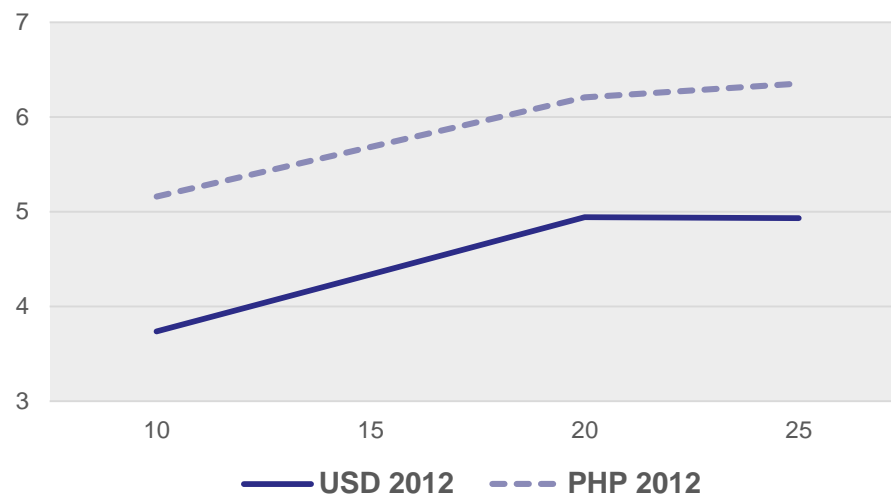
■ PHP Debt ■ GPN** ■ FXC Denominated*



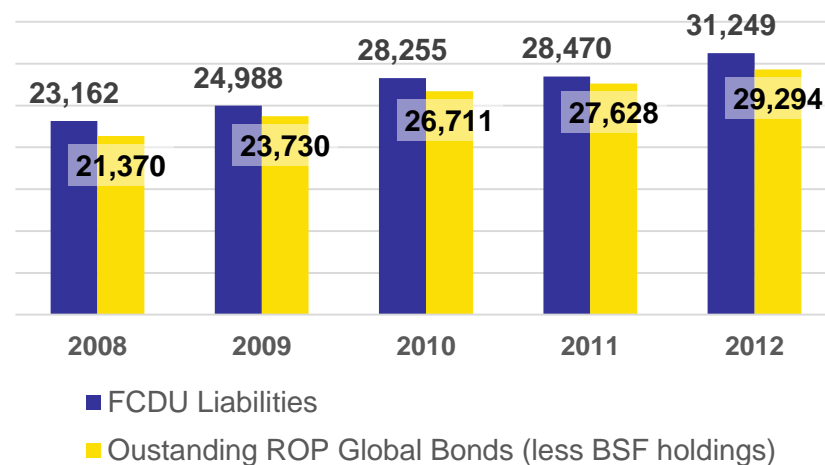
However, foreign currency funding is still needed

- From cost perspective, issuance of dollar bond (in 2012-2013) makes sense: US Treasury rates were near zero and the ROP sovereign spread was at its tightest
- Regular dollar bond issuance helps preserve healthy access to external market in case domestic funding conditions deteriorate.
- Need to re-price sovereign USD YC: more tightly priced USD YC will benefit local corporations in need of dollar funding.
- NG needs to provide quality investment vehicle* for dollar holdings of local banks (FCDU's).
- Bond issuance is an effective tool for maintaining long average maturity (11 years) of external debt portfolio.
- Local investors have stiff preference for shorter term investments (i.e. SDA), thus compromising NG's duration target.

USD vs PHP YC, 2012



FCDU Liabilities vs Available ROP's
(in USD Millions)



Working towards a solution to the challenges

- In 2012 NG trimmed down its global bond issuance, and bought back about USD500 Mn of high coupon ROP's using internal funds.
- At end 2012 NG debuted a 10-year onshore Dollar Bond targeted at USD of local banks: low-cost dollar funding without additional inflows.
- In 2013, the NG held back a USD3 Bn global bond opting instead for jumbo issuance of peso denominated Retail Treasury Bonds (PHP150 Bn).
- The NG also accelerated the repayment of expensive direct and guaranteed loans to multi-lateral partners (about USD540 Mn)

Particulars	2013 Program	2013 Actual
Gross Foreign Borrowing	189.8 bPHP	45.54 bPHP
Gross Domestic Borrowing	568.0 bPHP	401.138 bPHP
Financing Mix		
Foreign	25%	8%
Domestic	75%	92%

Lessons Learned

- Increased coordination between government debt management and monetary policy is paramount
- Any medium-term borrowing strategy should incorporate other public sector policy objectives (e.g. Monetary Policy, Financial Stability) and the limitations arising therefrom.
- Publication of a formal MTDS provide valuable platform to argue debt management decisions, in the face of multiple objectives, including those of other policy institutions.
- Having a deep and relatively developed domestic capital market is crucial as it affords flexibility to switch funding sources in case access to other markets become unavailable

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