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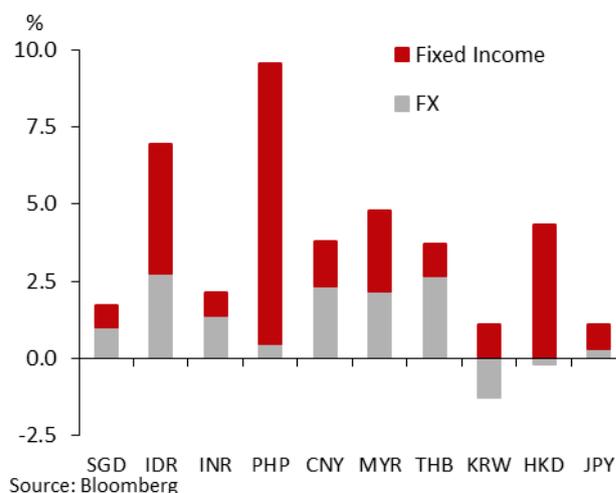
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- Amongst Asian 10Y local government bonds, RPGBs have garnered the highest total return of 9.6%.
- RPGBs could continue to outperform though expected drivers of outperformance have likely shifted (we expect fixed income component to dominate fx component).
- If inflation falls further and as a result, prospects for easing increase, RPGBs should see a decent-sized rally.
- PHP can hold up relatively well in EM-negative scenarios.
- Adequate fx reserves and large policy space (monetary) can help to buffer the PHP.

RPGB: Long runway

Since the start of 2019, we have held a constructive view on Philippine local government bonds (RPGB) and believed that they would outperform Asian peers. RPGB's year-to-date performance has validated our view. From a total return perspective, 10Y RPGBs have garnered the highest return of 9.6% (fixed income: 9.1%, fx: 0.5%).

10Y Local Government Bond - YTD Total Return

In our view, RPGBs could continue to shine though the expected drivers of outperformance have likely shifted. New Bangko Sentral ng Philipinas (BSP) Governor Benjamin Diokno is perceived to be more pro-growth and dovish than his predecessor. He has talked about the room to ease monetary policy (via policy rate cuts) and the possibility of a faster pace of reduction to banks' reserve requirement ratio. With interest rate support expected to weaken, fx return potential could be undermined. But that is more than compensated by greater fixed income return potential. Interestingly, judging by how flat the rate curves currently are (RPGB 2Y/10Y spread at -9bps, PHUSD NDS 1Y/5Y spread at -28bps, PH T-bill 3M/1Y spread at +33bps), markets may not have priced in much of the expected easing (yet). If inflation falls further and as a result, prospects for easing increase, RPGBs should see a decent-sized rally.

Besides BSP's easing bias, flows could also be supportive of RPGB performance. Moderating inflation and higher real yields should reverse residents' bond outflows of 2018. Externally, the global economic and monetary environment could be conducive to a pick-up in foreign demand. Against the backdrop of a mild global synchronized slowdown, Philippines' more domestically-driven and high-growth (6-7%) economy puts it in a favorable light. The high yields on RPGBs (~6%) are also particularly attractive at a time when core central banks are on pause and investors are reaching for yields. This is somewhat confirmed by latest BSP data which show very strong foreign buying of government bonds (USD481mn) in January and February.

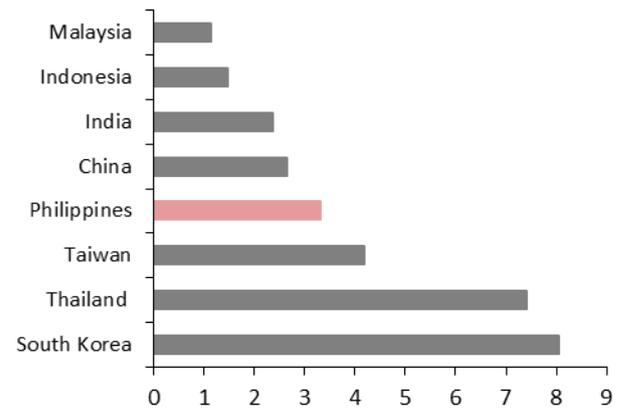
PHP: Other modes of defence

Compared to other Asian central banks, markets are probably expecting a much greater degree of easing from the BSP. This has likely led to the Philippine Peso (PHP) underperforming in recent weeks. In our view, it is premature to write off the PHP based solely on expectations of weaker interest rate differentials. As we have written in January, the PHP can hold up relatively well in EM-negative scenarios. This is especially relevant against the present global backdrop of rising growth worries (greater downside risks to Asia FX, safe haven status underpinning USD).

Relative to other Asian currencies, the PHP's drivers are more idiosyncratic/domestic-oriented. Sensitivities to external risk factors (e.g. China's growth slowdown, stronger US dollar, EM contagion etc) seem to be low.

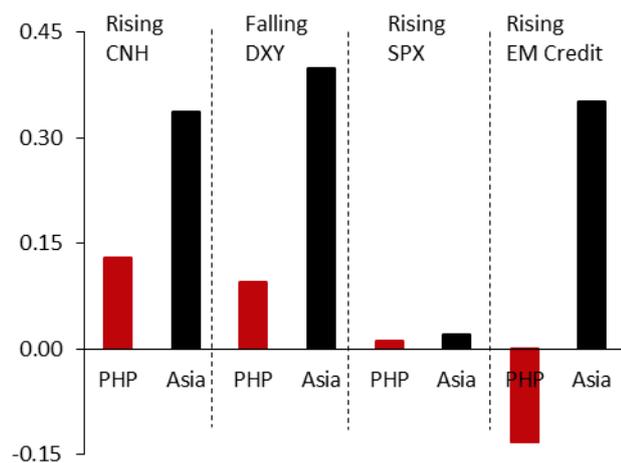
While the PHP is not supported by a current account surplus, it has other buffers. Philippines' FX reserves adequacy ranks well vs peers. Most importantly, BSP's 175bps of policy rate hikes in 2018 (most in Asia) has created much policy space that can be drawn on to support growth (via cuts). In the event of a deeper global growth slowdown, this could mean lesser need for PHP depreciation to act as the shock absorber.

Reserves to Gross External Financing *



* FX Reserves at end-2018 / (2018 Current Account + Short-Term External Debt at end-2018)
Source: Bloomberg, Central banks websites

PHP's Betas



Source: Bloomberg

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).

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