

## BSP YIELD CURVE: WHAT WE KNOW SO FAR

- With the Bangko Sentral ng Pilipinas (BSP) announcing the need for a “credible” yield curve, the Bankers Association of the Philippines (BAP) responded that the current Bloomberg Valuation Service (BVAL) has remained a credible benchmark in the valuation of government securities and pricing of bank loans.
- The BSP currently has an array of tools to siphon excess liquidity from the financial system, including the recently issued 56-day BSP bill last June 30, 2023 to further tighten money supply.
- On July 5, 2023, the BSP debuted a new and more dynamic overnight reference rate based on the secondary market rate of the 28-day BSP bill.

**Financial Markets Sector**  
Philippine Rates Outlook  
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### Past and present yield curves

Last June 21, 2023, former Bangko Sentral ng Pilipinas (BSP) Governor Felipe Medalla called for a new yield curve to be established by 2024. “A credible yield curve must arise from active trading or marketable securities, provide yields for various tenors, make these yields usable to all parties and can be replicated as needed,” Medalla said.

His successor, new BSP Governor Eli Remolona, recently clarified that “We want it to be a yield curve that represents liquidity at different maturities. We’re talking to banks about market-making (and) to make sure there’s liquidity around the 2-year and 5-year (tenors).” This is likely in response to the Philippine Peso Bloomberg Valuation Service (PHP BVAL) and how its exact calculation methodology is not available to the public, especially for benchmark yields on tenors with no trading activity.

The Bankers Association of the Philippines (BAP), which administers the PHP BVAL yield curve, released a statement that it shares the BSP’s desire to have a yield curve “based on actively traded securities that result in high-volume transactions in the market.” The organization said that at present, 5-, 7-, and 10-year securities are already actively traded while 12-, 15-, and 20-year securities receive strong interest from market participants. The yields on these securities are used in the calculation of PHP BVAL which is “a globally recognized benchmark methodology that is utilized in over 100 jurisdictions” and that it is “credible as it even addresses scenarios of limited market activity.”

Previous yield curve calculation methodologies were available to the public. However, they had limitations on what made them effective benchmarks for the valuation of fixed income securities and pricing of loans denominated in Philippine Pesos. The BAP was still the administrator, while the Philippine Dealing System (PDS) Holdings Corp. was the calculation agent for these benchmarks.

The PDS Treasury Fixing (PDST-F) was the simple average of the best 60% of firm bid yields for securities with a face value of at least PHP 50 million at 11:15 AM daily. This calculation was done for twelve tenors: 1, 3, and 6 months, and 1, 2, 3, 4, 5, 7, 10, 20, and 25 years. For bonds and loans with remaining tenors in-between the fixed tenors, a simple linear interpolation method was used to determine the appropriate rate. Publication of PDST-F ceased on April 1, 2015.

It was succeeded by the calculation of the PDS Treasury Reference Rates AM (PDST-R1) and PM (PDST-R2). These benchmarks are calculated from the weighted average yields of done trades totaling at least PHP 50 million or the best firm bids in the absence of done deals. PDST-R1 uses data from 9:00 AM to 11:15 AM while PDST-R2 uses data from 9:00 AM to 4:15 PM. The use of these two calculation methodologies ended on October 26, 2018.

Due to the illiquidity of the Philippine government securities market in tenors outside of 2, 5, and 10 years, PDST-F and PDST-R1/R2 historical yields tended to look more volatile. The introduction of PHP BVAL was meant address the issue of illiquid tenors. The BAP assigned the calculation of benchmark yields to Bloomberg and its proprietary calculation methodology. Although PHP BVAL did not have a publicly available calculation methodology for comparison, it resulted in much smoother historical yields compared to PDST-F and PDST-R1/R2.

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Chart 1. Comparison of 10-year Philippine interest rate benchmarks 2010-2023

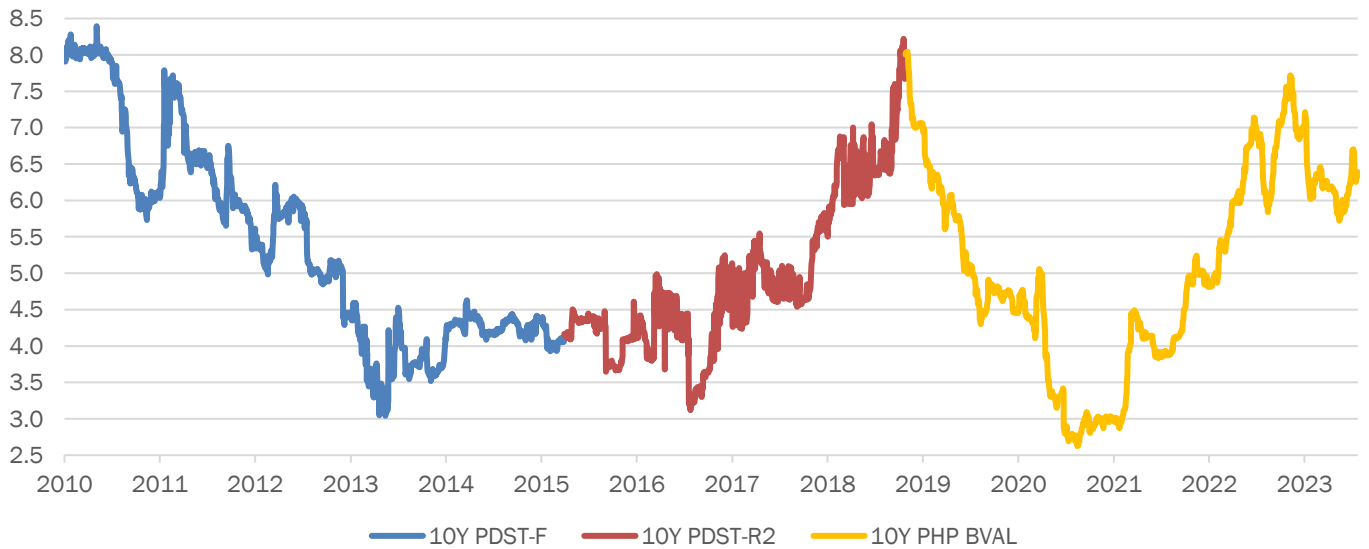
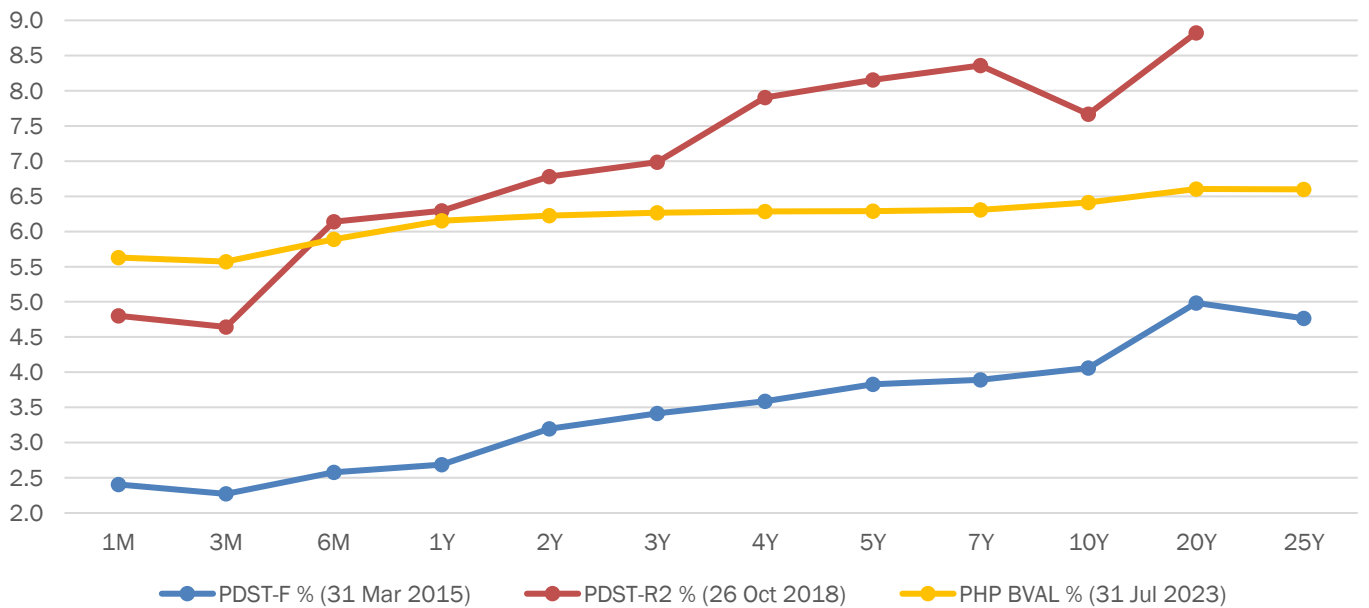


Chart 2. Comparison of PDST Reference Rates and PHP BVAL Yield Curves



### BSP monetary policy tools

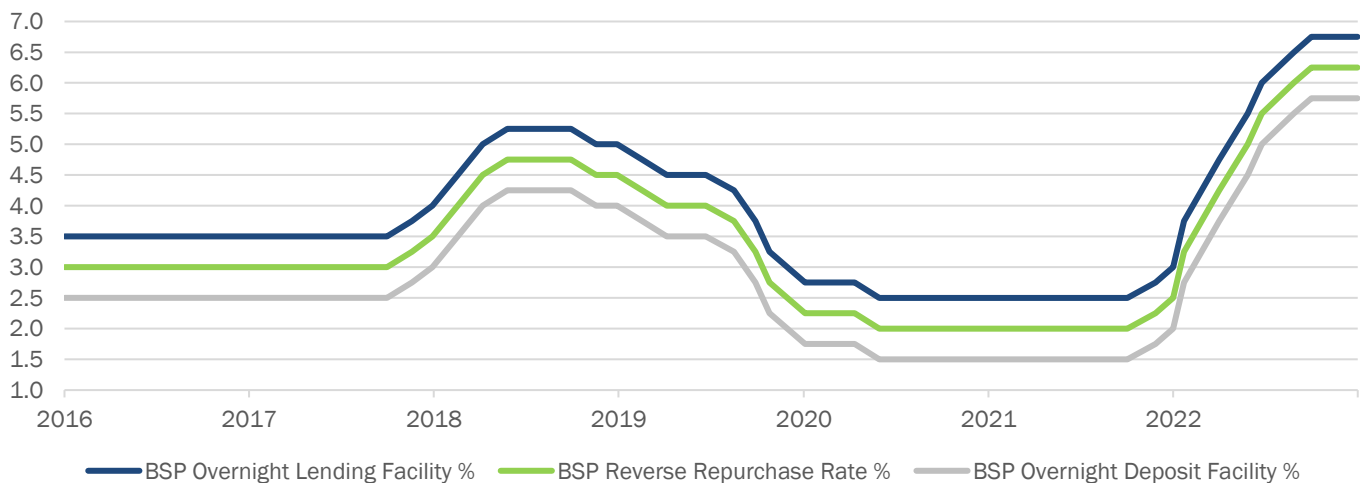
BSP Gov. Remolona also hopes that the new yield curve can give the central bank “an extra mechanism for the transmission of monetary policy.” Existing monetary policy tools manage liquidity from the financial system. These include the interest rate corridor, term deposit auction facility, and BSP securities.

The interest rate corridor (IRC) is a system that the BSP officially adopted in June 2016 for guiding short-term market interest rates towards the central bank’s policy rate, which is at 6.25% as of this writing. Also known as the reverse repurchase rate (RRP), this is the rate at which banks are able to place a limited amount of funds with the BSP overnight in exchange for the central bank’s government securities. There is an overnight lending facility (OLF) set 50 basis points (bps) above the RRP (6.75%) at which banks may borrow from the BSP for sudden liquidity requirements. Finally, there is an overnight deposit facility (ODF) set 50 bps below the RRP (5.75%) at which banks may place the rest of their excess funds overnight.

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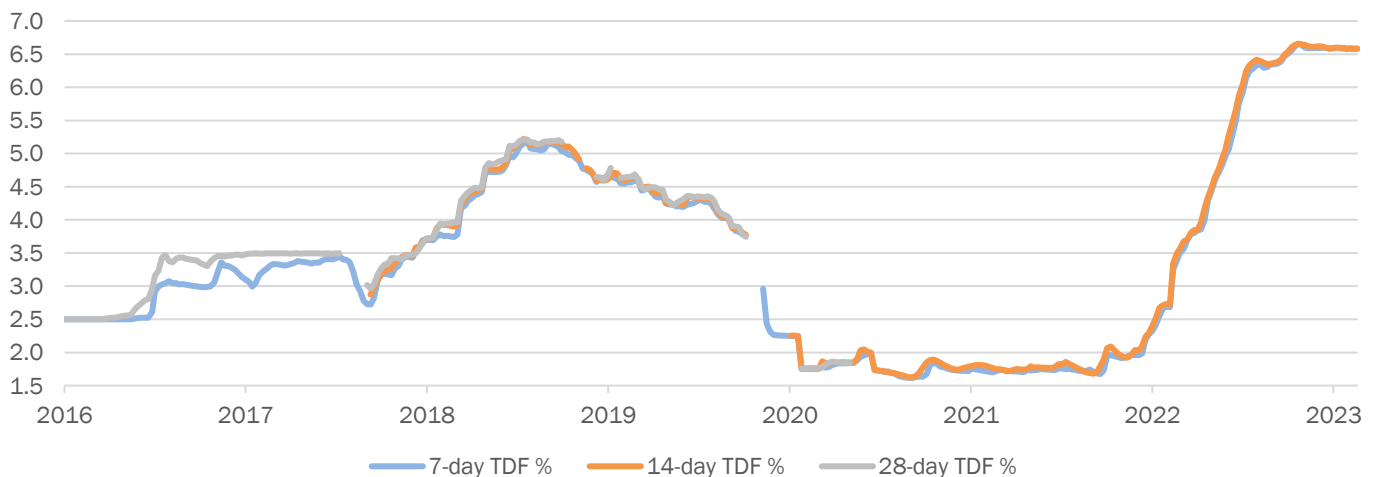
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Chart 3. BSP Interest Rate Corridor (IRC) System 2016-2023



The term deposit auction facility (TDF) is another liquidity absorption facility, initially created due to the BSP’s inability to issue its own debt instruments in the past. There were originally three tenors – 7 days, 14 days, and 28 days – but the 28-day TDF was phased out in October 2020 to make way for the new BSP securities. English auctions for 7-day and 14-day TDF are held once a week with firm auction offers announced two business days ahead. Banks may bid a minimum of PHP 10 million to a maximum of 20% of the auction offer per tenor. At the most recent auction last July 26, 2023, the 7-day and 14-day TDF were awarded at 6.5806% and 6.5864% respectively.

Chart 4. BSP Term Deposit Auction Facility (TDF) 2016-2023



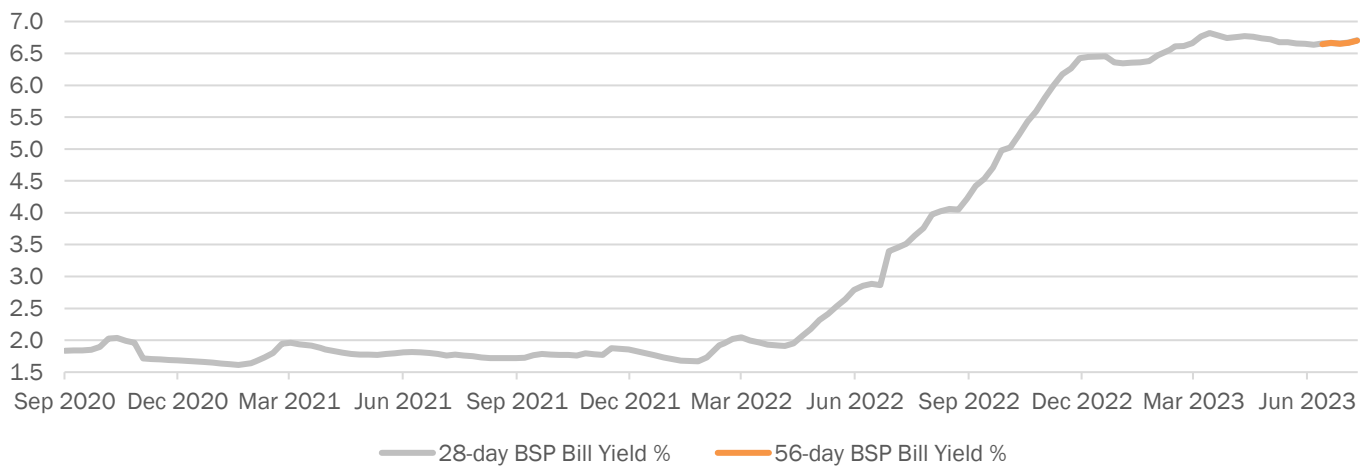
BSP securities are debt instruments issued by the central bank. Republic Act (RA) 11211, enacted in February 2019, restored the BSP’s authority to freely issue negotiable debt securities for regular monetary operations as opposed to exceptional times of extraordinary movements in price levels. The first 28-day BSP bill was issued in September 2020 as a means to manage liquidity during the height of the COVID-19 pandemic. This was soon followed by the issuance of the first 56-day bill last June 30, 2023 as an additional tenor in the BSP’s monetary policy toolkit. The BSP previously said that it will initially offer bills in view of the prevailing market preference for shorter tenors and the central bank has yet to issue longer-term securities.

Similar to the TDF, BSP bills are offered via English auctions on a weekly basis or as necessary depending on market demand, conditions, and liquidity forecasts. The BSP may call for early redemption of issued securities and this will also be done via auction. Only banks may participate in the auction while both banks and trust entities can trade in the secondary market through PDS Group. These institutions are not allowed to sell the securities to clients, but trusts are allowed to include them in unit investment trust fund (UITF) portfolios. The BSP closely coordinates with the Bureau of Treasury (BTr) to ensure that issuances do not compete with the government securities market in terms of tenors and timing of issuance. At the most recent auction last July 28, 2023, the 28-day and 56-day BSP bills were awarded at an average of 6.7048% and 6.6999% respectively.

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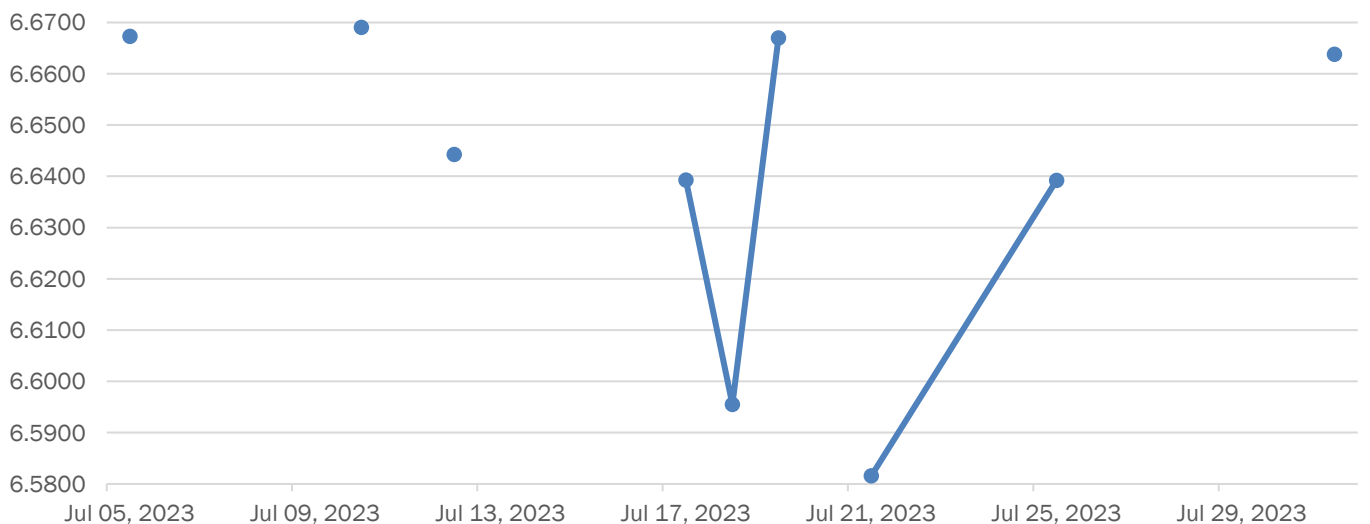
Chart 5. BSP Securities Yields 2020-2023



### A new overnight reference rate

On July 5, 2023, the BSP started publishing a new overnight (O/N) reference rate that is translated from the secondary market rate of the 28-day BSP bill worked backwards to an overnight tenor. It is not yet clear what purpose the O/N reference rate will serve as a benchmark but it is possible that the central bank is observing its day-to-day changes to see how the RRP can eventually be transitioned into a variable overnight policy rate. One limitation that has been observed so far is that if there is no secondary trading of the 28-day BSP bill, then no O/N reference rate will be published for the day. Last July 31, 2023 the O/N reference rate was published at 6.6638% or roughly 41 bps above RRP.

Chart 6. BSP Overnight Reference Rate July 2023



In practice, the BSP awards the fixed 6.25% RRP rate at fixed amounts. Starting July 14, 2023, the BSP has been accepting all bids in the RRP. Eventually, the RRP will transition from auctions at a single fixed rate to variable rates.

More details will be disclosed as the BSP works toward a January 2024 deadline. What is clear is that the central bank has enough monetary policy tools to serve as benchmark yields from overnight to 56-day tenors. We will continue to monitor how these tools are integrated with existing government securities to form the BSP’s new yield curve.

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