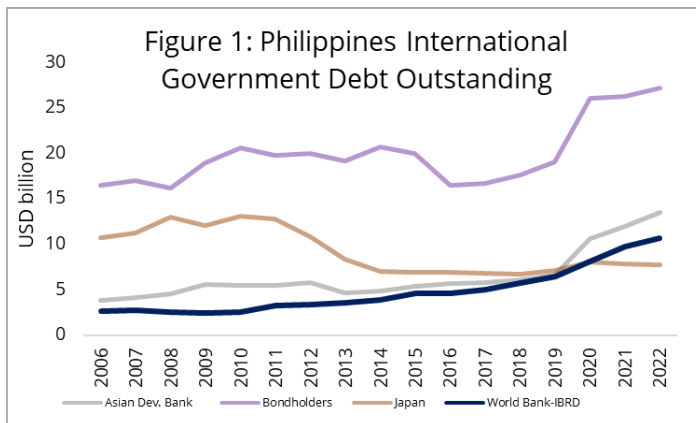


Reducing the Philippines' exposure to interest rate volatility

The World Bank helped the Philippines protect \$11.13 billion against interest rate increases by using the conversion feature of the IBRD Flexible Loan (IFL).

At the request of the Philippines' government, the World Bank executed more than \$11 billion of interest rate swaps with the market to fix the rate of its USD loan portfolio. Such a sizeable transaction was carried out in a few days, eliminating most global interest rate uncertainty in their IBRD debt portfolio. The World Bank Treasury provided the cost-effective execution without the need for the country to face market counterparts directly, avoiding the need for them to negotiate documentation, use credit lines, or post collateral with market counterparts. From an economic standpoint, this transaction has significant relevance. The Philippines is embarking on a multiyear fiscal consolidation effort, and IBRD loans represent the third largest source of international debt for the country (see Figure 1).



Source: World Bank IDS Database

Moreover, the Government of the Philippines is bound by a regulatory ceiling of 7 percent interest rate for loans to qualify as Official Development Assistance (ODA) from International Financial Institutions (IFIs), Thus the need to act to avoid breaching such ceiling.

Background

The Philippines' economy emerged strongly from the COVID-19 pandemic, but since then, it has faced a series of external shocks, ranging from volatile commodity prices to higher global rates. Their prudent policies and prompt decision-making to manage these shocks allowed the country to maintain their investment grade credit rating.

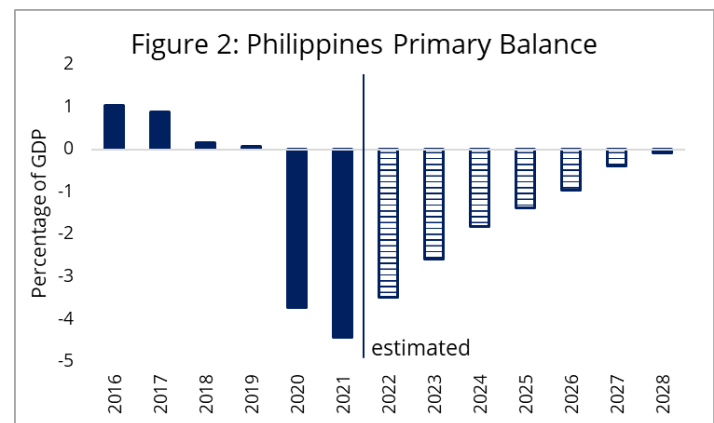
¹ [MTFF Senate Document](#)



Photo Credit Adobe Stock

In 2022, as part of these prudent policies, the authorities published a robust medium-term fiscal framework¹ with explicit fiscal anchors and expanded six-year policy horizon, including: (i) three percent National Government deficit to GDP by 2028, (ii) less than 60 percent National Government debt-to-GDP by 2025.

The roadmap entailed a strong multi-year fiscal effort, reinforcing the country's hard-earned credentials (see figure 2).



Source: IMF WEO October 2023

According to the October 2023 IMF Article IV Mission fiscal consolidation as envisaged under the Medium-Term Fiscal Framework is on track. This reflects a strong revenue performance and lower current spending while maintaining infrastructure outlays at or above five percent of GDP.²

In this context, containing external risks such as uncertain global interest rates, was of utmost importance to the Philippines. Currently, about 16 percent of national government revenues are dedicated to servicing the interest bill.

² [IMF Staff Completes 2023 Article IV Mission to the Philippines](#)

Debt Management Objectives

- Reduce the interest-rate risk of the debt portfolio.
- Improve predictability of debt service obligations.

IBRD Financial Solution

The IBRD Flexible Loan (IFL) includes options to manage interest rate risks over the life of the loan. These options are part of the General Conditions for IBRD Financing and can be executed at any time at a borrower's request. [Conversion Provisions](#) allow the borrower to fix and unfix, cap, or collar the variable reference rate of all or part of the disbursed and outstanding balance of an IBRD loan. Borrowers can establish a pre-specified schedule of rate fixings (e.g., on each interest payment date, annually, or some other frequency) at loan negotiation or request conversions on an *ad-hoc* basis anytime during the life of the loan. Such orders may have a pre-determined limit so that fixing never occurs above a desired level. Furthermore, the client can also unfix or refix the rate on disbursed amounts at any time during the life of the loan.

The Philippines Department of Finance requested the World Bank to work with its Bureau of Treasury to fix the interest rate on its IBRD loan portfolio to reduce exposure to interest rate volatility. Leveraging its triple-A credit rating and large network of market counterparties, the World Bank executed \$11.13 billion of interest rate swaps with the market, providing the Philippines with the needed hedging solution at competitive terms in line with their expectations.

Transaction Structure

World Bank Treasury's Role

- The World Bank Treasury analyzed the Philippines IBRD portfolio and shared various options, including caps and collars, conversions to other currencies, full and partial

maturity conversions, indicative quotes, and various scenario analyses.

- Once the financial product was selected, the team worked with the Bureau of Treasury to provide guidance on the process for fixing the reference rates.
- Finally, the Treasury, working with the World Bank Finance and Accounting team, provided the best cost-effective execution for the swap transactions with counterparty banks, transacting \$11.13 billion notional of interest rate swaps in a few days.

Outcome

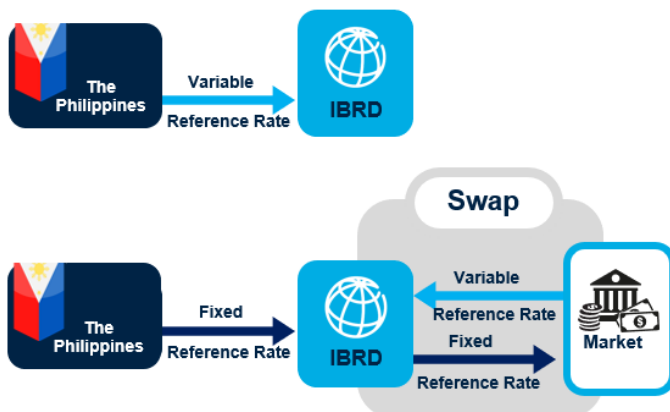
The interest rate conversions significantly reduced interest rate risk in the Philippines' external debt portfolio. The liability management exercise will mitigate the impact of unforeseen increases in interest rates on the budget, bringing more predictability to the implementation of priority expenditures. The Conversion Provisions made the process administratively cost-effective and straightforward for the Philippines.³

They were also able to avoid exposure to counterparty risk, avoid posting collateral on derivative positions, or pay additional fees.

Other risk management solutions from IBRD

Interest rate conversions are among the many ways the World Bank helps member countries become more resilient to economic shocks. IBRD provides multiple [Financial Risk Management](#) solutions to help clients.

IBRD's triple-A credit rating, market presence, and convening power allow the World Bank Treasury team to develop innovative new products to help clients maximize financing and mitigate risk.



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³ [Department of Finance Press Release](#)