Rafael Buenaventura: New Year message 2005

Speech by Mr Rafael Buenaventura, Governor of Bangko Sentral ng Pilipinas (Central Bank of the Philippines), at the Annual Reception for the Banking Community, Manila, 18 January 2005.

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A warm welcome to all!

Let me begin by thanking all of you for joining us tonight at this traditional annual reception to officially welcome 2005.

But more than your presence tonight, we thank you for your full cooperation and support in working with us to keep our economy steadily moving forward, to preserve overall confidence, and to steadfastly implement reforms.

The year 2004 was again another very challenging year for the banking community, being a presidential election year with all the uncertainty that usually surrounds such a major political event. We also bore witness in the second half to a sharp increase in oil prices that inevitably had major impact on the whole economy.

But in spite of all these, the economy still turned in a very respectable outcome. GDP growth is estimated at 6.2 percent. Headline inflation has picked up to around 7.9 percent in December 2004, due mainly to the feed through from energy price adjustments and other supply side shocks, but more broad-based inflationary pressures were held in check. Our accumulation of international reserves, at $16.1 billion at end-December 2004, was at the high end of our expectations. The peso exchange rate finished firmly at P56.267 and has been appreciating since then.

Undoubtedly, record remittance inflows that will definitely exceed P8 billion for the whole of 2004 has once again shored up our economy. Commendable outcomes were also contributed by our export sector. On the domestic front, healthy consumer demand helped keep the economic momentum going.

In the financial system, the reform agenda relentlessly forged ahead undeterred by all the potential distractions.

The long overdue asset cleanup finally got going under the SPV law. As of end 2004 about P26 billion was already done and another P54 billion was firmly in the pipeline or a total of P80 billion so far. Assuming these transactions would all be completed in due course, we can look forward to a lowering of the NPL ratio to less than 10 percent by end-2005 from the current 13-14 percent level, given 2005 economic growth projection.

Still, the improving NPL outlook would still be more than double than the pre-1997 crisis ratio of less than 5 percent. This underscores the enormity of the remaining clean-up task ahead.

The incentives under the SPV Law expire on April 8, 2005. There isn’t much time left. There is a possibility of an extension on the basis of strong representations being made by the banking industry. As a practical matter, the BSP will not object to an extension, but candidly speaking, we will have serious concerns over an overly long extension that will only likely weaken the resolve to face the music. Another year should be reasonable. If this results in another P100 billion in transactions, then we can see the NPL ratio going down further to around 7.5 percent in 2005.

Whatever extension is given by Congress, all our banks that still carry large NPAs in their portfolio are well advised to bite the bullet soonest and clean up their balance sheets. Don’t do it because the BSP says so. Do it because it is primarily in your interest to do so. Going forward, that burden can only become heavier especially as regulations evolve to force fair valuation of all financial assets in the context of migration to IAS in reckoning accounts. The implementation of Basle II will also lead to heavier risk weighting on NPAs.

In general, the prudential standards on the banking system will continue to keep rising as we seek closer alignment with international standards. We have already announced that banks should be IAS compliant by end-2005. We really have no choice on this. Our ratings cannot afford it. We have likewise defined the roadmap to make the banking system compliant with Basle II by 2007. Given the complexity and deep impact of these changes, it is necessary to begin preparations right away.

The ultimate success of the banking reform agenda depends to a very large extent on Congressional action to amend the BSP Charter primarily to strengthen the institutional arrangements for banking supervision. This especially pertains to providing better legal protection to BSP personnel in the course of the performance of their official duties. Other countries protect their regulators which make them more effective. Hopefully, the necessary legislation will be finally delivered this year.

We are also keenly advocating the enactment of a law that will enable us to establish a strong credit information bureau that will anchor a comprehensive credit information system. The benefits of this are enormous in providing wider credit access especially to small borrowers, in lowering the cost of borrowing of responsible borrowers, and in reducing the credit risk exposure of the banking system.

You are also aware that we have been trying to leverage the fruits of banking reform with a complementary effort to develop the domestic capital market. Clearly, given the dominant role of the banking system in our financial system, our banks will need to play a major role. Here the challenge is the willingness to reform market practices to achieve greater transparency, efficiency, and investor protection. We need our banks and other major market players to be willing to sacrifice the acceptable but mediocre status quo for something that is better for the economy in the long run. Even now our commitment and resolve is being tested as we endeavor to stamp out long-standing market malpractices. Rating agencies have criticized us on some practices that we are now trying to correct. These practices have also prevented us from developing a deeper capital market.

The complexity of the financial reform agenda has required the financial regulators to cooperate more closely. Last year, we took an important step in this direction. In partnership with the SEC, the Insurance Commission, and PDIC, we formed the Financial Sector Forum (FSF) last July. The FSF has steadily gained momentum and we are now working on a full agenda to harmonize our supervisory and regulatory efforts, to strengthen information exchange and to promote better consumer protection. We expect the FSF to hit its full stride this year.

Even as we have strived to forge an efficient and modern financial system, the access of the poor to the financial system has been our constant special priority. And indeed, the success of microfinance has been a pride and joy of the BSP. By the way, we are observing this year the International Year of Microcredit under the leadership of the United Nations. We look forward to further strengthening our commitment to sustainable microfinance.

In less than six months, there will be a changing of the guard at BSP as the majority of the Monetary Board and I complete our full six year term.

The famous Manila Bay sunset beckons. But we are not yet quite ready to follow its inviting siren call.

The challenge of upholding financial stability is a never ending one. Rest assured that we will pursue the necessary reforms to the very last day we are in office before we gladly yield the drivers seat to our successors.

Let me end by thanking the BAP and its enlightened leadership for working with us to implement many essential but often times painful reforms.

A happy new year to all!