Amando M Tetangco, Jr: Capital market - a cornerstone of BSP financial reform agenda

Speech by Mr Amando M Tetangco, Governor of the Central Bank of the Philippines, to the Investment House Association of the Philippines (IHAP), Manila, 23 August 2005.

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Distinguished officers and members of the Investment House Association of the Philippines (IHAP), ladies and gentlemen, good afternoon!

Allow me to first of all congratulate the incoming board of directors and officers of IHAP. Let me also thank you for this invitation to be your keynote speaker and inducting officer.

Since 1973, investment houses under the IHAP umbrella have carved their place in the economy as important financial intermediaries. You are therefore a vital partner of the BSP in building a more resilient and efficient financial system and a more expedient capital market development. More recently, your participation in establishing the fixed income exchange is one manifestation of your significant contribution toward taking the steps to develop the local securities market.

Former BSP Governor Paeng Buenaventura has laid down the blueprint of capital market development as a vital component of the country's financial reform agenda for sustainable economic growth. As his successor, I am equally committed to ensure the continuity and consistency of our policy reforms.

This afternoon, I will discuss the policies and programs of BSP on capital market development.

Economic overview

To put things in perspective, let me first give you an assessment of the economy.

Overall, our economic fundamentals remain generally sound in the midst of political noise. For the first quarter of 2005, the country's gross domestic product (GDP) grew by 4.6 percent and driven primarily by growth in the services and industrial sectors.

BSP's prudent monetary policy, anchored on inflation targeting, kept key overnight policy rates steady. Ample liquidity in the market and improvement in the government's fiscal position served to push the yields of bellwether 91-day Treasury bill rates down to 5.6 percent.

Headline inflation decelerated to 7.1 percent in July, posting an average of 8.2 percent for the first seven months of the year.

Our peso has been relatively resilient, trading below the P56/US$ level.

In the external sector, the balance of payments (BOP) posted a surplus of US$783 million for the first quarter of 2005l this is a turnaround from the US$378 million deficit in the same quarter last year.

Meanwhile, remittances from overseas Filipino workers sustained double-digit growths. inflows for the month of June 2005 posted a 32.1 percent growth (US$935 million) compared to same month last year. the cumulative level of remittances for the first semester reached US$4.9 billion, 21.5 percent higher than a year ago's level. This is due to increased deployment of higher-paid skilled professionals and improved access to formal remittance channels.

Accordingly, we continue to enjoy a comfortable reserve position with our gross international reserves (GIR) at us$17.7 billion in July 2005.

Impetus for capital market reform

A growing economy, such as ours, requires a steady flow of financing from both local and foreign sources. In sustaining this development, the economy needs a healthy financial system. A financial system that is built upon two strong pillars: a robust banking system and a fully-functioning capital market.

Why is it necessary to develop our domestic capital market simultaneous with the restructuring of the banking system?

A fully developed capital market can stimulate domestic savings and provide investment opportunities. compared to our Asian neighbors like Malaysia and Thailand, we have a smaller savings-to-GDP ratio at 21 percent. Domestic savings onshore are channeled to productive output crucial to economic development like infrastructure projects.

A sound capital market also improves the financial environment with the offer of alternative financial instruments. At present, government papers dominate the local capital market with minimal alternative for other financial instruments. A marked difference with other countries where private debt issuance is far more significant.

Also, the 1997 Asian financial crisis was a painful reminder of our vulnerability to external shocks due to our excessive dependence on the local banking system.

BSP initiatives

Cognizant of this challenge, Bangko Sentral has laid down a broad range of financial system reforms to complement and accelerate the development of the capital market.

We initiated the groundwork through asset clean-up of banks to restore the credit supply to the economy. For the first semester of 2005, the non-performing loan (NPL) ratio of universal and commercial banks[1] was back to a single-digit level at 9.2 percent. This is a reversal from a peak of 18.8 percent in October 2001 due to asset dispositions under the Special Purpose Vehicle (SPV) Law. Hopefully, we can restore asset quality to pre-crisis levels once the extension of the SPAV Law is accomplished.

As the financial environment becomes increasingly global and liberalized, BSP saw the need to align the local banking practices with internationally accepted standards. We are upgrading the banking system's capitalization and risk management standards to be fully compliant with Basel II by 2007l we are also institutionalizing corporate governance and financial transparency. By yearend, the banking industry will adopt the new international accounting standards (IAS/IFRS). The Monetary Board very recently approved the implementing guidelines.

We are likewise improving the current regulatory framework through close coordination with other local and foreign financial regulators. I am happy to report that the Financial Sector Forum, our partnership with local financial regulators (SEC, IC and PDIC), is now fully operational with major projects currently underway. These projects include conglomerate mapping, information sharing, joint examination arrangements, rules harmonization and financial literacy.

The domestic capital market remains shallow and underdeveloped. In response, the BSP has issued various circulars diversifying the financial products available in the capital market. traded papers like unsecured subordinated debts (as Tier 2 supplementary capital), long-term negotiable certificates of deposits or LTNCDs, documented repos, and securitization structures create market-oriented opportunities for banks and other players and deepen the capital market.

The BSP has also been fully supportive of the establishment of the Fixed-Income Exchange (FIE) as an infrastructure for the secondary trading of fixed income and other debt securities. This envisages the trading, clearing, settlement and delivery of securities in a transparent and efficient manner. Recently, the BSP issued the implementing rules of Circular No. 392 to fully operationalize the rules on proper delivery of securities including the role of third party custodians. We are just awaiting the last missing step that is the interconnection of all key debt market participants to ROSS[2] to create a truly seamless infrastructure for fixed income.

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[1] Combined resources of which account for almost 90 percent of the total resources of the banking system.

[2] Registry of scriptless securities of the Bureau of Treasury.

We have also started revitalizing the trust business to widen investor base with the gradual phase out of common trust fund (CTF) for a better product called unit investment trust fund (UITF). UITFs enhance the credibility of pooled funds to investors as the value of investments is mark-to-market, paving the way for long-term investment opportunities.

Finally, we are encouraging the entry of more rating agencies to complement the establishment of an exchange traded papers. Rating agencies play an important role in guiding investors towards informed decision-making and in ensuring the proper disclosure of investment information.

Future directions

We have done much of the groundwork. What we need now is a decisive follow through. I must admit, we have encountered some resistance and minor set-backs along the way. But as Chinese industrialist Yin Ming Shan puts it, “Purest gold fears no fire”. This also speaks for our intentions to make the capital market work.

Although we have made some milestones with the passage of the Securitization Law, the SPV Law and the elimination of documentary stamp tax in secondary trading, there are remaining measures in our legislative agenda that need to be pursued: the amendment of the BSP Charter, Corporate Recovery Act, Personal Equity and Retirement Account (PERA) Bill, Revised Investment Company Act (RICA), Credit Information System Act, revised Corporation Code of the Philippines, Iinsurance Code of the Philippines and Pre-Need Code of the Philippines. These pieces of legislation are central to capital market reform and IHAP’s support can strengthen our stand against the grueling legislative mill.

In addition, a larger pool of institutional investors like insurance companies, mutual funds, UITFs and pension funds can also provide the required boost to the market.

Our capital market also needs strong issuers to expand the variety and supply of instruments for investors. Using government papers as basis for pricing other long-term issues, I am encouraging private corporations whose leaders are present in the audience today, to issue quality papers and advance our advocacy on capital market development.

Concluding remarks

As a final note, I thank IHAP for this opportunity to share our advocacy on creating a well functioning capital market. Leadership is believing in causes and accepting the responsibility of motivating others to act on those causes with the same faith. Your enthusiasm and continuing support inspire us to pursue the remaining points in our overall financial reform package with renewed vigor.

Thank you and more power!