

Amando M Tetangco, Jr: The Philippine economy: developments and prospects

Speech by Mr Amando M Tetangco, Jr, Governor of the Central Bank of the Philippines, at the 4th National Convention, Chinese – Filipino Business Club Inc, Manila, 9 February 2006.

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The officers and members of the Chinese-Filipino Business Club, Inc. led by President Rufino Ko Pio, special guests, ladies and gentlemen, good afternoon. Thank you for inviting me to join you at your 4th National Convention. I am truly glad for this opportunity to be with you.

Chinese-Filipino businessmen represent a very important segment of the Philippine economy. You have a unique place in our economy as you personify the convergence of the best from two cultures: the highly admired Chinese work ethic combined with Filipino ingenuity. This formidable combination has given wings to a strong entrepreneurial spirit that has helped strengthen the backbone of the Philippine economy.

I am pleased therefore to give you an overview of how our economy performed in 2005, the developments that can affect your business and how we at the Bangko Sentral ng Pilipinas see the prospects for the Philippine economy. Later, we can have a discussion on economic issues of particular interest to you.

Recent economic developments

I will now give you a brief overview of recent economic developments.

We had to deal with many challenges in 2005. Among others: we had to grapple with the impact of record high oil prices; slower growth in exports; the El Nino weather phenomenon which stunted the growth of agricultural output; credit ratings downgrade; and domestic political concerns.

And yet, in the face of all these, our economy proved its resilience and fundamental strength. Our domestic economy, as measured by gross domestic product, continued to expand and managed to grow by 5.1%.

As businessmen, you know that achieving such growth, in a year marked with challenges, did not happen by chance; it resulted from the continuous implementation of a comprehensive economic reform program involving both the government and the private sector.

Part of this reform program is fiscal consolidation, which is now generating benefits for the country. The combined effects of government's cost cutting programs, improved tax collection efforts, and higher revenues from sin taxes and the EVAT, brought down the government's fiscal deficit in 2005 to P146.5 billion, substantially lower than the programmed deficit of P180 billion.

This has led government to say that it is now possible for us to have a balanced budget by 2008. When this happens, our government will no longer be compelled to borrow money to finance its regular operations. This is an important step in our effort to reduce the share of debt payments to the national budget; this will allow us to spend more for infrastructure that supports economic growth and basic services that improve the quality of life of Filipinos.

It is also noteworthy that we were able to keep inflation at single-digit levels in spite of record high oil prices and sustained economic growth. From 8.4 percent at the beginning of 2005, headline inflation fell to 6.6 percent by year-end, due mainly to declining food prices, the easing of oil prices from record levels, as well as the appreciation of the peso against the US dollar.

The country's external position also strengthened in the past year. Overall balance of payments position for 2005 stood at a surplus of US\$2.4 billion, a turnaround from the previous year's large deficit. This was made possible by overseas Filipino workers whose remittances in 2005 reached nearly \$11 billion, the highest on record; higher investment inflows also contributed to this surplus.

By December 2005, these dramatic surges in remittances and investments allowed the Bangko Sentral ng Pilipinas to build up its international reserves to its highest yearend level so far: at \$18.5 billion. In January 2006, our international reserves breached \$20 billion for the first time ever, with the

addition of proceeds from loans obtained by the National Government and BSP's investment income from abroad.

Meanwhile, the country's external debt as of end-September 2005 dropped from the year-ago level, with medium- to long-term debt accounting for almost 90 percent of the total. This indicates better manageability and sustainability of our external debt.

Another positive development is the continuous improvement in the soundness of our banking system. As a whole, our banking sector is well-capitalized, with capital adequacy ratio well above the international standard. At the same time, asset quality of banks continued to improve with non-performing loans of universal and commercial banks at 8.74 percent as of November 2005. This is the lowest level in more than seven years.

Altogether, these positive economic trends have boosted confidence in the economy, as reflected in an increasingly stronger peso. In fact, our peso emerged as the top performing currency in Asia in 2005.

Outlook for 2006

In the light of our better-than-expected economic performance in 2005, we are confident we will be able to achieve our targets this year.

Among others, we expect our economy to continue to expand at a reasonable pace, led by services, industry, and agriculture sectors. Nevertheless, since oil prices continue to be a concern, GDP growth rate, according to the DBCC, may range between 5.7% and 6.3%.

Inflation is seen to rise slightly early this year, as a result of high oil prices and the vat rate adjustment. However, the continued stability of the peso should help cushion its impact. In the second half of 2006, we expect inflation to follow a decelerating trend as cost-push pressures subside.

Meanwhile, market interest rates are likely to remain stable during the year, due to improving fiscal position of the government, ample liquidity in the financial system and projected modest growth in bank lending.

On the external front, dollar inflows from OFW remittances and foreign investments are expected to remain strong in 2006 as deployment of more workers escalate and as more high-salaried workers get jobs overseas. This should boost our external position and further build up our gross international reserves. It also underpins our expectations of a generally stable peso in 2006.

Policy directions

For the BSP, our principal thrust over the near term will be oriented towards responding to inflationary risks and delivering price stability over the policy horizon.

The BSP will also intensify its efforts to strengthen the financial system, further enhance the effectiveness of its supervision and regulation of banks, and help promote the development of the domestic capital market.

We will continue to foster an environment that will facilitate further disposal of banks' non-performing assets. For those of you in the market for real estate, I recommend you take a look at the non-performing assets of banks that are up for sale. The rates are attractive for buyers as banks now conform with the risk-based provisioning required by the Bangko Sentral. Our policy is to require banks that take on more risks, to have correspondingly higher capitalization. The asset cleanup of banks should spur credit and investments, thereby creating the basis for more sustainable growth in the medium term.

Other key financial reforms will focus on aligning prudential regulation of the banking system with international standards and best practices, strengthening corporate governance standards as well as market discipline mechanisms, and further enhancements on our payments system.

In the area of capital market development, the BSP will continue its active collaboration with other government agencies and the private sector for the completion of necessary infrastructure that would enhance system integrity and overall market confidence. The operation of the fixed income exchange and the implementation of the third-party custodian scheme are part of the initiatives to accelerate the

development of the domestic capital market. This is a priority program as a deep, dynamic and liquid domestic capital market will provide a valuable alternative source of funds with less foreign exchange risk.

We will also continue to lobby for the passage of key legislation aimed at developing the local capital market and strengthening our regulatory authority.

In addition, we are working closely with Congress on the creation of a centralized credit information bureau system and the establishment of credit rating agencies. These should enhance the quality of financial information available to investors, enhance private sector access to credit, and minimize exposure to risks of financial intermediaries.

The Bangko Sentral will also continue to promote microfinance, as its flagship program for poverty alleviation. The collateral-free loans, ranging from P5,000 to P150,000 have been effective in providing our entrepreneurial poor, or what we call the e-poor, with much needed capital to start a microenterprise. So far, banks have provided microfinance to more than 750,000 borrowers. Some of you may be surprised to know that the average repayment rate of our e-poor on their microfinance loans is 98%! This is so much better than the repayment record of banks from their major borrowers. In fact, microfinance is now a source of profits for many banks.

I hope your organization can also provide support for our microfinance program. For instance, you can teach our entrepreneurial poor the basic principles of running a profitable business, in other words share some of the secrets of your success. By doing so, we will be able to liberate more of our countrymen from poverty.

I am pleased to inform all of you that the microfinance program of the Philippines has already developed a good success record. In fact, no less than the United Nations gave an award to the Philippines for its institutional approach to microfinance, which makes it responsive to its e-poor clients and ensures its long-term sustainability. I hope this inspires you to join us in promoting microfinance to alleviate poverty in our country.

Concluding remarks

Ladies and gentlemen of the Chinese-Filipino Business Club, there is no doubt, we have made solid economic gains; even foreign media have taken notice. For instance, the International Herald Tribune noted that investors are now looking to the Philippines, often shunned in the past for being "The sick man of Asia."

And while there is still much that we need to fix in our economy, we can do this better and faster if the government and the private sector will cooperate and work more closely together in making our economy efficient and more globally competitive. The success of policymakers' efforts to sustain economic growth ultimately depends on the support of the private sector; you and I know, government cannot do everything on its own.

In this regard, I commend the tireless efforts of industry groups such as the Chinese- Filipino business club for its role in keeping the economy healthy and buzzing with activity. Moreover, I congratulate your organization for its spirit of volunteerism in supporting community projects. May your tribe increase.

It is my hope that you will become even more proactive in ensuring the long-term growth of our economy.

Finally, I wish the leadership and members of the CFBCI good health, wealth and good fortune, at all times. Marami pong salamat.