

Amando M Tetangco, Jr: The Philippines – macroeconomic outlook for 2008

Speech by Mr Amando M Tetangco, Jr, Governor of the Central Bank of the Philippines (Bangko Sentral ng Pilipinas), at the oath-taking of the officers and directors of the Economic Journalists Association of the Philippines, Makati, 11 February 2008.

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President Donna Gatdula, other distinguished officers and members of the Economic Journalists Association of the Philippines, special guests, friends, good evening.

It is a great pleasure for me to address this induction ceremony and this gathering of highly informed watchers of the Philippine economy. As economic journalists, you continue to be a major channel for transparency and provider of key economic information for the business community. From the point of view of the BSP, you have also played a vital role in our efforts to communicate the basis and implications of monetary policy to the markets and the general community.

I am doubly pleased because I see many familiar faces, including the relatively new reporters on the beat and those I met long before I became governor. But don't worry – I will not disclose how long ago that was.

Instead, I will focus on the topic you have asked me to discuss tonight: the macroeconomic outlook for 2008.

To put things in perspective and to provide context for our outlook, I will begin my presentation with a review of the past years.

Economic developments

I am sure you have read or heard in fact some of you have written that the Philippines is now experiencing the most stable economic environment in more than two decades. This is not just a "tale". The numbers support this story. The Philippine economy grew at the highest GDP growth rate of 7.3 percent in three decades in 2007. This growth rate was above the Government's target of 6.1-6.7 percent set for 2007. This was boosted by the expansion of services and the impressive performance of both agriculture and industry. On the demand side, growth was driven by government consumption and investments.

This strong growth was achieved in a period of benign inflation. Headline inflation last year stood at 2.8 percent, the lowest in 20 years. This is now comparable to developed economies.

In turn, low inflation has resulted in lower interest rates, again the lowest in 21 years. This has brought down the cost of money for borrowers, whether personal or corporate.

In this respect, we achieved a good convergence of high growth and low inflation.

In addition, our external position was at its best in 2007. The overall BOP position closed 2007 with a surplus of US\$8.6 billion, the highest on record. This reflects improved market sentiment as evidenced by higher foreign investment as well as continued vibrancy of overseas remittances and other services receipts. This helped raise the country's gross international reserves (GIR) to a record high of \$34.4 billion as of end-January 2008. And with the weakening dollar, the peso emerged as one of Asia's stronger currencies.

These developments were matched by positive indicators pointing to a stronger Philippine banking sector. Bank deposits were up while bank capitalization exceeded both domestic and international standards. Bank lending to most sectors of the economy expanded last year and bank asset quality improved with NPL ratio closer to its single digit, pre-crisis level.

Another positive development on the domestic front was the solid gains in the National Government's fiscal consolidation program. Revenue collections improved while deficit and debt levels dropped.

Indeed, by many performance measures, 2007 was a most auspicious year for the Philippine economy.

Outlook and challenges

Looking forward, can we sustain this positive momentum? What do we see in 2008 and beyond?

Well, we expect economic growth to continue, driven by a broad-based expansion led by the services sector as well as robust growth in aggregate demand. In fact, as reckoned by the Development Budget Coordination Committee (DBCC), GDP likely to grow at a healthy pace of about 6.3-7.0 percent in 2008.

On the monetary front, emerging BSP forecasts continue to indicate a manageable inflation path. We expect to see average inflation settling within the 2008 target of 4 percent, plus or minus one percentage point. This target is supported by slowing growth in domestic liquidity, a strong peso, moderate risks to agricultural production, and well-anchored inflation expectations. For 2009, we see inflation within the 3.5 percent plus or minus one percent point range.

Likewise, the external payments position is expected to remain a source of strength for the economy over the near term. In particular, dollar inflows from remittances and foreign investments are expected to remain strong. This should enable us to further build up our cushion of international reserves.

We also expect to see a stronger banking system in 2008 as banks further increase their capitalization and improve their ability to anticipate and manage risks.

Ladies and gentlemen of EJAP, this general outlook is dependent of course on how we manage the challenges that we face.

The first is slower world economic growth. This emanates from expectations of subdued growth in the US due to difficulties in the mortgage market and weaker consumption spending stemming from high energy prices and falling house prices. For the Philippines, this could mean weaker exports and lower remittance receipts. However, we expect that sustained strong domestic demand and increased investments will help temper the impact of the global slowdown.

The second is volatile and high global prices of oil and other commodities. If these commodity prices remain high for a protracted period of time, it could threaten our inflation outlook.

The third is the global financial turbulence. Although the global financial markets appear to have stabilized, we have yet to see the full impact of the US subprime mortgage crisis. Its impact on the Philippines has been limited; however, an economic slowdown in a major trading partner such as the US could adversely affect our export sector, while movements in interest rates could generate risk aversion against emerging markets including the Philippines. So far, there has been limited impact on the Philippines but we need to keep watch of these developments.

The fourth is plentiful domestic liquidity from sustained strong foreign exchange inflows. While liquidity growth has slowed down as a result of the Bangko Sentral's efforts to siphon off excess funds from the market, emerging trends in monetary aggregates still need to be checked, in line with expectations of sustained foreign exchange inflows.

Policy directions

These are serious challenges that we face: the first three are beyond the control of domestic policy while the last can be influenced by both monetary and fiscal policies. Nevertheless, we believe that, ultimately, they are manageable.

On the part of the Bangko Sentral our policies will be focused on the following:

- A. Monetary policy will remain focused on managing the risks to inflation such as the likelihood of second-round effects and closely monitoring developments in liquidity conditions.
- B. On the external sector, our policies will be geared toward:
 - ensuring sustainability of the country's external debt;
 - maintaining a market-determined exchange rate with scope for occasional official action in cases of sharp movements in the peso;
 - maintaining a comfortable level of reserves; and
 - improving the foreign exchange environment further through forex deregulation.
- C. Banking policy, on the other hand, will continue to focus on three main objectives:
 - promoting a stronger and more stable financial system;
 - developing the domestic capital market to make it more supportive of investments growth; and
 - providing easier access to funds by small and medium-sized businesses as well as micro enterprises.

In addition, the Bangko Sentral will continue to foster an environment that will facilitate further disposal of banks' non-performing assets.

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

Meanwhile, microfinance shall continue to be the BSP's program for poverty alleviation, with collateral-free loans providing the entrepreneurial poor (e-poor) with much needed capital to start a micro enterprise.

The BSP will also continue to push for the passage of key legislative bills to accelerate the development of the local capital market and further strengthen the regulatory authority.

In particular, we shall push for the implementation of a centralized credit information bureau to improve the quality of financial information to investors, expand private sector access to credit, minimize exposure to risks of financial intermediaries, and lower cost of borrowing.

We will likewise work actively with other government agencies and the private sector for the completion of critical market infrastructure to enhance system integrity and overall market confidence.

At the same time, we will intensify our economic and financial education program so that Filipinos can participate in, and benefit from, our economic gains. In this advocacy, I earnestly ask for your support. Other Filipinos can participate in opportunities that economic development brings if such are brought to their attention and they are made to understand its potential.

This is the reason why we have been conducting nationwide lectures on investment options for Overseas Filipinos and their dependents. And starting June this year, 11 million public elementary students will be taught lessons on money management to help them develop the

habit of saving and investing. With this, I hope we can nurture a new generation of financially literate Filipinos.

Conclusion

Ladies and gentlemen, let me close this message by saying that the Philippine economy is likely to weather the challenges it faces, both domestic and external. I believe that with the fundamental strength of the economy backed by the government's firm commitment to continue to pursue needed reforms, there exists a sound basis for a sustained non-inflationary growth in the country.

Finally, I congratulate EJAP for its continuing program to professionalize business reporting in our country. I hope your efforts to develop and upgrade the skills of your members will be successful. In this regard, you can count on us at the Bangko Sentral for support.

Doris, in her introduction of me, referred to my Chinese zodiac sign so let me now complete that by wishing you all a Happy New year of the Earth Rat! It is my understanding that the 2008 Rat begins a new 12-year cycle as such it promises change, new beginnings and new attitudes. On behalf of the Bangko Sentral, therefore, I wish all the new officers of EJAP, as you face a new "year", a fruitful and successful term.

Mabuhay ang EJAP! Thank you all and good night.