Amando M Tetangco, Jr: The Philippines – creating opportunities through effective governance

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (the central bank of the Philippines), at the Philippine Mid-Year Economic Briefing 2010, Makati City, Metro Manila, 18 August 2010.

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Members of the governments' economic team, other Cabinet members, excellencies of the diplomatic corps, our partners from the private sector and multilateral institutions, our friends from the media, colleagues from government, ladies and gentlemen, good morning.

Thank you for joining us in this economic briefing.

Over the next few minutes, allow me to share with you the BSP's legal mandate, the key reforms we have implemented and our assessment of the macroeconomic opportunities that have been created in the process. I would also like to share with you our thoughts on the challenges that lie ahead and the BSP's policy strategies to meet these challenges with a view to creating more opportunities to achieve more durable and inclusive growth for the Philippine economy.

Let me start with a review of the major reforms that the BSP has adopted in pursuit of its mandated responsibilities.

First, on monetary policy – the BSP has adopted the inflation targeting framework that has provided us with a disciplined approach to safeguarding price stability. The forward-looking perspective under the framework as well as the associated transparency and accountability practices have helped better anchor the inflation expectations of the markets and the public. This, in turn, has contributed to improved inflation management and to well-contained inflation dynamics.

Let us look at the numbers.

Stable food prices have helped temper inflation pressures, despite the occurrence of the El Niño phenomenon early this year. From January to July 2010, headline inflation fluctuated between 3.9 percent and 4.4 percent, staying within the Government's target range of 3.5–5.5 percent for 2010.

The benign inflation environment has given the BSP the flexibility to keep policy rates steady. With stable domestic financial conditions, the BSP also started a measured and paced unwinding of its accommodative monetary policy stance in the first half of the year.

Second, on external sector policy – the BSP adheres to a flexible exchange rate system and to an appropriately designed foreign exchange regulatory framework. The BSP also has in place an external debt management strategy that helps promote debt sustainability. As a result, we have seen the emergence of strong external payments dynamics, providing comfortable buffers against external shocks.

Reflecting these prudent external sector policies, the country's balance of payments (BOP) position posted a surplus of US$3.2 billion in the first half of the year. The resilience of OF remittances and the sharp recovery of exports contributed largely to the country's favorable external payments dynamics.

The country's external debt profile continues to improve. Six years ago, our external debt-to-GDP ratio was around 70 percent. As of March 2010, this ratio was down to 33 percent.

The long-dated maturity structure of our foreign currency debt, helps limit rollover and foreign exchange risks. The country's debt service burden as percent of GDP, which had previously hovered around 10 percent [2001–2003], eased to 6 percent as of March 2010.

International reserves have climbed to new highs, providing strong coverage for both imports and short-term external debt. At end-July 2010, the GIR stood at US$48.6 billion. At this level, the GIR can cover 9 months of imports and is equivalent to 9.3 times the country's short-term external debt based on original maturity and 5.1 times based on residual maturity, thus providing a strong cushion against external shocks.

As a result of the strong external liquidity position, the Philippine peso has remained broadly stable. The trends in the real effective exchange rate (REER) show that the peso has generally maintained its international competitiveness over the last ten years. With generally lower inflation rates, the Philippine peso has accommodated some appreciation, but without undermining external price competitiveness.

Third, on financial sector policy – the BSP has put in place critical reforms geared toward maintaining a healthy banking system. The package of reforms includes the disposal of banks' bad assets, the promotion of good corporate governance and transparency practices, and the upgrading of risk management standards. As a result, we have today an efficient, sound, and competitive financial system.

These critical reforms have been successful in steadily expanding and strengthening the banking system. Indicators of the health of the banking system continue to post favorable readings, with asset levels and bank earnings continuing to improve. The capital adequacy ratio remained high at 16 percent and non-performing loans also remained generally low at less than 4 percent of total loans.

The favorable performance of the domestic financial markets reflects the upturn in the country's economic prospects. Thus, despite global market volatility following sovereign debt concerns in Europe and uncertainties regarding the depth and breadth of the global economic recovery, the spillovers on our domestic financial markets have been limited.

With continued improvements in domestic economic conditions and a broadly favorable global outlook, we foresee a firmer growth path for the Philippine economy in 2010.

Inflation is expected to stay within the target range of 3.5 to 5.5 percent for 2010. The outlook for the BOP position and the GIR level continues to be favorable, with the current account projected to remain in surplus.

While we expect the economy to continue to perform strongly, we remain conscious of the risks and challenges that lie ahead.

First is the multispeed recovery across the globe. Growth in emerging countries is outpacing growth in advanced economies. Given global interdependencies and linkages, this could result in sub-par global growth over the medium term.

Second, the potential heavy inflow of capital into the country, as risk appetites perk up, can lead to liquidity management problems which could pose inflationary risks.

Third, the rebound of the global economy could create upward pressures on commodity prices and fan inflation.

The BSP's responses to these challenges are, as always, founded on its primary mandate of promoting monetary and financial stability.

In particular, our focus in the area of monetary policy will be on addressing the risks to price stability and re-examining policy settings when warranted.

On the external front, our priority is to promote policies that will help shield the economy against adverse shocks.

On the financial sector, the BSP will endeavor to maintain a well-functioning banking system that will efficiently mobilize funds and channel them to productive uses.

The BSP's policy commitments, going forward, are supportive of the Government's agenda of creating an enabling environment for durable, sustainable and inclusive growth and broad-based development, including through the pursuit of far-reaching and meaningful structural reforms and disciplined macroeconomic policies.

Ladies and gentlemen, the fundamental strengths of the Philippine economy, which saw us through a tough period, provide a huge opportunity for us to consolidate the gains we have achieved thus far and allow us to create an environment that will propel the economy forward.

The BSP, together with the other government agencies, are firmly committed to continue pursuing sound macroeconomic management and structural reforms to address the challenges ahead.

To this end, let us be guided by our shared commitment to serve the general good and by our common desire to make better things happen for the Philippines.

Thank you.