Amando M Tetangco, Jr: The Philippine economy – primes for a sustainable and solid growth

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (the central bank of the Philippines), at the Euromoney Philippine Investment Forum, Manila, 12 March 2013.

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Secretary Cesar Purisima, other government officials, Mr. Tony Shale, CEO of Euromoney Institutional Investor Asia, distinguished leaders and members of the business and investor community, honored guests, ladies and gentlemen, good afternoon.

Over the recent period, there has been a welcome spate of rosy and positive commentaries on the Philippine economy.

We have been described as an emerging Asian tiger.

The venerable New York Times has labeled the Philippines as the economic bright spot in Asia.

The World Bank has observed that macroeconomic stability is now the new normal in the Philippines.

The IMF has singled out the Philippines for being the only country whose growth forecast it has upgraded.

The IMF 2013 growth forecast was set at 4.7 percent earlier on but was revised twice to reach 6 percent this January.[1]

The IMF is not the only multilateral financial institution that has upgraded the growth forecast of the Philippine economy.

The World Bank upgraded its outlook on the Philippines' 2013 economic growth from 5 percent (October) to 6.2 percent (December).[2]

The Asian Development Bank likewise raised its earlier 2013 forecast of 4.8 percent (April 2012) to 5.5 percent 6 months later (October).[3]

These assessments are consistent with the series of sovereign credit rating upgrades received by the Philippines even as the credit ratings of many other countries have been downgraded. In fact, it could be said that the financial markets have already voted the Philippines as investment grade as evident in the pricing of our credit default risk in the same range as investment grade economies.

All these assessments were driven mainly by the solid performance of the Philippine economy across various metrics. These include:

- Robust and broad-based economic growth;
- Low and stable inflation;
- Strong external payments position;

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[1] IMF Statement at the Conclusion of the 2013 Article IV Consultation Mission to the Philippines, Press Release No. 13/21, January 23, 2013

[2] The World Bank East Asia and Pacific Economic Update December 2012

[3] Asian Development Outlook 2012

- Sound and stable banking system; and
- Much improved fiscal performance.

These macroeconomic conditions did not happen by chance. Far from it. In fact, these trends are all the more noteworthy in that they are happening against a backdrop of persistent and strong headwinds in the global economy.

The progress in the economic front is the outcome of prudent and disciplined monetary and fiscal policymaking. And these conditions are sustainable because of strong and well-grounded policy frameworks in place. These include:

1. The government is committed to sound fiscal policy. The government is appropriately focused on strengthening the quality of fiscal adjustments. It has increased spending for critical social priorities and economic infrastructures while keeping a watchful eye on the medium-term objective of fiscal consolidation.
2. The government continues to pursue a reform agenda that is aimed at raising the economy's flexibility and unlocking the country's growth potential.
3. A forward-looking monetary policy framework that has helped strengthen our commitment to non-inflationary economic growth. We have met our inflation target for the past consecutive four years (2009–2012), even as the economy's engines have powered ahead;
4. An enhanced policy toolkit that is geared to respond to the challenges brought about by strong capital inflows;
5. Finally, supervisory and regulatory practices that are benchmarked against international best practices. This is reflected in well-capitalized and better-governed banks that are able to efficiently perform financial intermediation and risk management.

There are therefore fundamental reasons to believe that continued macroeconomic discipline and reforms can push the growth trajectory further to a path that will allow the economy to not only survive the global headwinds but to adapt and to thrive in a more challenging operating environment.

As we are aware of the headway that has been made, we are equally mindful of the challenges and the risks to the favorable economic outlook. I can assure you that there are a lot of "responsible adults" in the room. These are policymakers who are attentive to the overt as well as the underappreciated risks to the Philippine growth story.

What are the challenges? What are the latent pressure points in the economy? Let me cite three major ones, from the BSP's standpoint:

1. Managing capital flow surges – an issue repeatedly mentioned this morning
2. Ensuring financial stability
3. Going the distance with structural reforms

In this challenging period of very strong capital flows and expectations of continuing strong capital flows, or as one economist has called it the whipsaw of huge capital movements, the question is – do monetary authorities still have the firepower and yet be market-friendly in their policy responses?

To this, my response is yes. The BSP has recognized long ago the need to deploy a deep toolkit in addressing the contemporary challenges confronting emerging market central banks that are at the receiving end of strong capital flows. It has used a variety of instruments to achieve low and stable inflation, prevent excessive volatility in the exchange rate and maintain broad financial stability.

As a result of BSP's signature circumspection, the evidence suggests that the sizable FX inflows have not led to significant adverse macroeconomic and financial consequences.

- Reserve accumulation in response to the surges in capital inflows does not appear to have led to excessive money creation.
- The limited impact of capital flows on monetary aggregate growth suggests that sterilization policies have been broadly effective.
- Credit growth has not contributed to macroeconomic imbalances, as inflation has remained low.

A second – and related – challenge is the need to ensure continued financial stability.

The recent global financial crisis showed that sole focus on price stability is not sufficient to attain macroeconomic stability. Policymakers need to deliver more than stable prices if they are to achieve sustained and stable growth. Price stability does not guarantee financial stability. The BSP, therefore, is attentive to pressure points that could impact on both price stability and financial stability.

To ensure financial stability we have utilized prudential measures to manage capital inflows and moderate, if not prevent, the build-up of excesses in specific sectors and in the banking system. Prudential policies are the instrument of choice and employed as the first line of defense against financial stability risks.

Given the current regime of low interest rates – driven in large part by the surge of foreign capital into domestic financial markets and the limited absorptive capacity of the economy in the short term – the BSP is keeping a watchful eye on developments in the asset markets. We pay particular attention to what is happening in the equity and property markets, as these markets are interest-rate sensitive and could be prone to bubbly behavior.

We see that while activity in these markets has been buoyant, the key indicators are growing broadly within trend, reflecting both cyclical as well as structural or fundamental forces. It is also important to note that indebtedness in the Philippines is still quite low. Domestic credit-to-GDP ratio at 50.4 percent (Q4 2012) still ranks one of the lowest in the region.[4] This would suggest that the risk of excessive leverage is less and the threat to financial stability is likewise lower, should asset prices correct.

The third challenge involves going the distance in the pursuit of the reform agenda.

1. We are implementing the capital adequacy framework of Basel III in January 2014. We will also be closely studying the other building blocks of the Basel III reform agenda to see how and when we can incorporate these into domestic regulatory environment.
2. Capital market reform will be a priority. This will include ensuring that an appropriate market infrastructure is in place. The infrastructure will not only improve the quality of markets, which will help mitigate financial stability risk. But infrastructure will also promote the absorption of the inflows, which will ultimately lead to an expansion of the economy. By improving financial intermediation in the system, a well-functioning capital market will help unlock the economy's productive potential and strengthen its capacity to withstand shocks.

Right now, we see an economy that is on an even keel, on surer footing, poised for higher growth, riding on a momentum of change that offers the promise of not only stronger growth but also one that is more inclusive and more durable.

[4] Note: Latest available: Indonesia 40.2; Malaysia 133.3; Singapore 151.8; Thailand 129.4; Japan 221.2; China 153.1; Korea 104.1

The challenge is to keep the momentum of positive change strong. The appropriate response to current favorable winds is not to sit back and relax, not to pop champagne corks as William asked this morning, but to treat them as an ideal opportunity to strengthen the underpinnings of the economy's foundations. The BSP will strive to have monetary policy that will provide an environment where credit and liquidity growth will remain supportive of economic growth while maintaining price stability. We will also continue to work on reforms that will deepen the financial system. We will continue to monitor financial and asset markets and be responsive to emerging risks. We will continue to work with the government in pushing the agenda for reforms to ensure macroeconomic stability.