Amando M Tetangco, Jr: Vision for resilience and growth

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the General Assembly of the Bankers Association of the Philippines (BAP), Makati, 21 November 2016.

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Let me begin by congratulating you on this industry-led initiative of formalizing a vision for the banking system.

“To support the national goal of catalyzing growth in the country.” – That vision evokes a level of maturity in your appreciation of the relationship between the real and financial sectors. It tells us that you are now not merely existing for yourselves and the firms you represent, but that you would also actively do your part to positively raise overall economic welfare in the country.

Banks are well-positioned to take on the Vision

In the end, we know it will cut both ways. A growing economy provides you with the incentive to build your franchise, and the stronger franchise provides opportunities for businesses to grow. It’s a virtuous cycle.

Indeed, the banking system is well-positioned to help catalyze and sustain economic growth. In just the past 11 years or so, the total resources of the banking system have grown almost three times from P4.5T to P13.1T. Bank capital has continued to be above national standards. Credit growth has been robust. Non-performing loan ratios have continued to decline. You have expanded your financial footprint beyond brick and mortar facilities to e-banking. And throughout all these, you have remained profitable! This performance tells me that you have been able to adjust effectively to the challenges of your operating environment.

This performance has been accompanied by our strong constructive collaboration. Together, we have worked on and put in place, reforms that have helped improve your ability to absorb shocks and contain imbalances, both at the firm and the industry levels. We have emphasized governance and placed more responsibility on the boards of directors. We have embarked on a series of frameworks for enhaced risk management and sound market conduct. We have adapted global reforms and standards and made sure these are in tune with our own domestic needs and requirements.

I know many of the reforms have not been easy to appreciate at first, as you might have perceived that these reforms tended to curtail innovation. But through consultations and persistent dialogue, I know we are on the same page. Innovation will only positively flourish when it occurs in the context of sound business operation and consumer protection as the underlying threads.

The timing of your initiative for an overall banking system vision and roadmap could not have been more opportune. Q3 GDP was announced just last week – 7.1 pct growth, bringing to 71 the number of consecutive quarters of positive economic growth! Domestic aggregate demand continues to be the driver of economic growth. On the supply side, manufacturing remained strong, services showed reasonable growth, and the agriculture sector showed signs of recovery. In other words, our economic growth drivers are diversifying! Demography is also on our side. The median age of the population is now 24.4 years old and we are projected to reach a median age of only 31 years old by 2045. All these have transpired without fuelling inflation.

We are certainly living in exciting times that are rife with opportunities. But even as I say this, we must also be aware that there are challenges to this operating environment. Let me focus on just three. One, Fed normalization. Two, weak and uneven global growth outlook. Three, disruptive technology.

Turning Challenges into Opportunities

The anticipation of the timing of the Fed's next move creates near-term financial market volatility. The question whether markets will perceive the next Fed pronounement as "risk on" or "risk off" matters for daily traders. The era of low US dollar interest rates is ending soon. That brings with it certain collateral actions, including a stronger US dollar and global portfolio rebalancing.

We all know that making money on financial assets in a low/declining interest rate environment is a "no-brainer". All fixed income assets you hold rise in value as interest rates fall. The test for bank presidents and treasurers alike therefore is how to translate these daily movements and market expectations into an overall strategy, as the tide of global monetary conditions change. This is undoubtedly tricky and timing strategic moves is critical.

A second challenge to the operating environment is the continued weakness in global growth prospects. Related to this is the trend among policy makers to look inwardly and tap domestic sources of demand. China is an example. The Chinese authorities have shifted from trade to services as driver of growth. Brexit is another example of the populace wanting to break away from trade. The protectionist-tendency of the pronouncements of US President-elect Trump is yet another example. All these comprise what is now being termed by some as a "retreat from multilateralism".

While we are seeing that this global trend of growing through domestic aggregate demand can break the downward economic spiral for a number of economies, the question is whether such inward perspective is sustainable for global economic growth.

For the Philippines, strong domestic aggregate demand, particularly private consumption, has long shielded us from external shocks. Even during the Asian Financial Crisis, we were not as affected because we were not as open as others in the region. However, there is a need to explore ways of broadening the domestic economic base. Infrastructure is key to this. Human capital is another important element. We need to be able to connect our domestic markets through networks of roads, airports, seaports, etc. But we also need a smart population to find solutions to natural disasters and to find ways of improving efficiency, among others. Fortunately, for the Philipines we have both monetary and fiscal space to allow the government to ramp up spending on infrastructure and put in place projects to raise human capacity.

Another factor to reflect upon is the integration of ASEAN, which is certainly underway. The BSP has already signed the Heads of Agreement with Bank Negara Malaysia. And I am pleased to report that we are about to initiate formal discussions with the Bank of Thailand and with the OJK of Indonesia under the same ABIF guidelines.

As we consider supply chains and regional integration, we must be mindful of the trend of "disruptive innovation". In other words, finding new ways of doing old things. Technological improvements are helping define new ways for you to "enter" into and be integrated in the supply chain. While there are many of you who will continue to be on the big loan origination side, a number of you can find value in generating economic activity through retail banking. Still a number of you will be able to find a niche in providing alternative digital solutions. In doing so, there is a need to be mindful that using financial technology could lead to new and unanticipated financial, business, consumer protection risks as well as cybersecurity risks. This is why, even as we encourage technology solutions, we also admonish banks to do so with caution and without sacrificing financial stability and the protection of your ultimate customer, the consumer.

Is there a role for monetary policy in your vision?

The BSP will partner with you to achieve your vision. As I have said, we have put in place what we see as a balanced regulatory environment – one that encourages innovation, practiced under safe and sound business models.

We have also endeavored to create a monetary environment of stable inflation and a market-determined exchange rate to help you plan better for the medium-term.

At the moment, our view is that inflaton will be manageable over the policy horizon. In 2016, inflation will average below the lower end of the target band, but in 2017 and 2018, we see full-year inflation averaging closer to the middle of the target range of 2-4 pct. For the BSP, this means there is no compelling reason to adjust the stance of monetary policy.

You may ask, will this view be affected should the Fed hike in December? Perhaps, if other factors also move. But we don't necessarily have to move in sync with the Fed.

On the exchange rate, I've been asked lately whether the BSP is worried about certain exchange rate levels being breached. Our view here is that for as long as movements in the exchange rates are not "out-of-line" against fundamentals and if these are not exaggerated to dislodge expectations, the BSP can allow for the exchange rate to move (either up or down). Otherwise, we reserve scope for official action to stem excessive volatility. Right now, we don't see a need to veer away from this FX rate policy.

Our Journey on the Roadmap

You have set a clear vision for the banking system, with interlocking outcomes of Access, Efficiency, Growth, and Stabiliy. The tools the BSP will take with it on this journey with you are the tried and tested tools of: an enabling environment that benefits from the collaboration between the market and regulators, clear but reasonably high standards for governance and risk management, and that commitment to clearly communicate policy intent in a timely manner.

The GFC has taught us that attaining price stability does not ensure financial stability. At the same time, the GFC also taught us that banks operating individually in a safe and sound manner will not be enough. We need to take a holistic view of risks, specifically those that comingle and cut across markets, institutions, transactions and agents.

Our proposed amendments to the BSP Charter would greatly help the BSP in this regard, particularly in its macroprudential surveillance and network analysis role. We therefore continue to solicit your support for our proposals, including those for more relevant data. I encourage you to look more closely at the proposed amendments where sufficient safeguards and checks and balances are incorporated.

Concluding remarks

Let me conclude by urging all in this Assembly to remain focused on financial stability and the well-being of our ultimate stakeholder — the financial consumer who entrusts upon banks their hard-earned savings or looks upon banks to have a better future. After all, it is for him that we are laying a foundation to enable/capacitate him today, so he can build a better tomorrow for himself and his family.

Thank you for your continued support throughout the years at Mabuhay po kayong lahat!