Opening remarks

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A very good morning to all and welcome to this year's Annual Research Conference.

Bangko Sentral ng Pilipinas (BSP), which is currently celebrating the 70th year of central banking in the Philippines, is pleased to co-host this conference with the Bank for International Settlements.

The theme for this year is "Inflation dynamics in Asia and the Pacific". For central bankers, this provides an opportunity to discuss and think about issues that have direct implications for the core mandate of central banks. For academics and research economists, this is a policy-relevant research area that may be openly shared and discussed.

The Great Financial Crisis (GFC) that started in 2008 challenged conventional monetary policy, pushed many central banks outside of their comfort zones, and dramatically altered the landscape of monetary policy. While it was a challenging time for policymakers, it provided fertile ground for macroeconomic research.

A particular topic which received much attention among macroeconomists and central bankers both after and during the GFC was inflation dynamics. An advanced Google search for the phrase "inflation dynamics" for the pre-crisis period of 1997–2007 yielded 4,490 articles. For the post-GFC period of 2009–19, the search generated 13,000 articles – an increase of almost 190%.[2]

Of course, we are all well aware of the challenges faced by central banks in advanced economies (AEs) after the GFC; that despite rock-bottom interest rates and massive liquidity injections, inflation in their economies remained muted. Why this was so was the subject of many studies.

But perhaps one of the reasons for the rapidly rising number of studies on inflation dynamics is the remarkable decline in global inflation which began even before the GFC. For the AEs, this appears to have started in the 1990s, and for the emerging market economies (EMEs), the trend became apparent in the 2000s.

On a regional basis, Asian countries show lower inflation trends among EMEs.[3] Studies reveal that a confluence of both structural and policy-related factors have contributed to this trend in the region.

These include the marked increase in and changing patterns of international trade, especially with the accession of China to the World Trade Organization; technological innovation; trade and financial market integration; demographic transition; structural reforms in labour and product markets that led to greater competition and lesser price rigidities; and more resilient policy frameworks in some

[1] Governor, Bangko Sentral ng Pilipinas.

[2] The search excluded patents and citations, and was conducted on 24 July 2019.

[3] Based on the IMF *World Economic Outlook* April 2019 database.

emerging market and developing economies – particularly the successful adoption of inflation targeting as well as more effective and transparent exchange rates, and monetary and fiscal policy frameworks.[4]

For central bankers, understanding inflation dynamics in relation to other economic variables is crucial. Most, if not all, central bankers will agree with me that controlling inflation is a demanding task. Yes, the central bank can influence inflation by tightening and easing monetary policy. However, the transmission process involves long and variable lags and a degree of uncertainty amid the continuously evolving structure of an economy. Add to this the increasing influence of global and regional factors on domestic inflation. Given these challenges, central banks need to adopt a robust communication strategy to effectively anchor inflation expectations.

As a case in point, the Philippines' headline inflation decelerated from an average of 15.1% in the 1980s to 9.7% in the 1990s. This slowed further to 3.8% from 2002 – when the country adopted the inflation targeting framework – to 2018.

The implementation of the inflation targeting framework in the last 16 years has enabled BSP to manage inflation and to keep it within manageable bounds. This has provided support to greater economic activity, despite international and domestic shocks.

Moreover, the improved transparency, greater accountability and more effective communication resulting from the implementation of inflation targeting have enhanced BSP's credibility. This has led to the continued anchoring of market inflation expectations to monetary policy decisions.

However, in the first few years after the GFC, BSP experienced pressure in its monetary operations as short-term market interest rates diverged from the BSP policy rate. This was mainly due to strong capital inflows arising from the highly accommodative monetary policies and extraordinary liquidity support of central banks in AEs, the steady stream of remittances from overseas Filipinos, and revenues from business process outsourcing.

To address this divergence, BSP launched the interest rate corridor system in June 2016 to enhance the transmission of monetary policy by guiding money market interest rates towards its policy rate.

At the time of writing, this objective has already been achieved as the market rate is now moving in line with BSP's policy rate. In the long term, recalibrations and additions to its monetary policy tools will strengthen BSP's influence on the demand for and supply of money. I am pleased to note that the recently enacted amendments to the BSP charter have restored our authority to issue our own debt securities (even during normal times), which further enhances our monetary policy toolkit.

Further, we will continue to pursue the reduction of reserve requirements from the current 16% to single-digit levels by 2023 to promote a more efficient financial system. This is part of BSP's broad financial sector reform agenda.

We expect that all these actions will aid in the further development of Philippine capital markets by fostering money market transactions and active liquidity management by Philippine banks.

4 See J Ha, A Kose and F Ohnsorge, "Inflation in emerging and developing economies: evolution, drivers and policies", *World Bank Publications*, March 2019.

Indeed, BSP's monetary policy framework has been an effective tool in mitigating the risks emanating from home and abroad. However, we recognise that as the domestic and world economy evolves, all our tools need to be kept constantly appraised. We continually take measures to further enhance the implementation of our inflation targeting framework by improving our array of models, data and software, and the capabilities of our technical staff and modellers.

We likewise ensure prudent exercise of judgment by using all relevant data in our policy decisions. Moreover, we recognise the value of being able to communicate the basis of BSP's policy decisions in a manner that is easy for the public to understand.

All these concepts, and more, will be the subject of this conference's discussions in the next two days. We can rely on an eminent group of economists, who have joined us to present their work and examine issues concerning inflation dynamics and monetary policy.

As central bankers and policymakers, we appreciate this effort to continuously expand our understanding of inflation dynamics and its implications for monetary policy. This is especially so amid the current global economic environment, which continues to shift with the ongoing policy uncertainties and structural changes.

I wish you all a very fruitful conference and a pleasant stay in Manila.