

## **Amando M Tetangco, Jr: Focus on the Central Bank of the Philippines' core mandate of promoting price and financial stability**

Opening statement by Mr Amando M Tetangco, Jr, Governor of the Central Bank of the Philippines (Bangko Sentral ng Pilipinas), at the Foreign Correspondents Association of the Philippines (FOCAP) Forum, Manila, 4 December 2006.

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I am pleased to address you in this forum organized by the Foreign Correspondents Association of the Philippines. Your continued interest in the Philippine economy has greatly helped in shaping the quality of information provided to the international community. Fora such as this offers us an excellent opportunity to engage various stakeholders in policy dialogue.

My short remarks today will focus on the BSP's core mandate of promoting price stability and financial stability and how the institution has responded to the challenges facing it.

As Fed Chairman Bernanke aptly puts it "monetary policy is most effective when it is coherent, consistent, and predictable, while at all times leaving full scope for flexibility and the use of judgment as conditions may require". This highlights the fundamental role of transparency and communication in inflation targeting. The more that the public understands the logic of our policy framework and decisions, the more we are able to better manage inflation expectations and the more their behavior will facilitate the achievement of the price stability objective.

An encouraging development is that inflation has been on a decelerating trend beginning the second quarter of this year, much earlier than expected. What is BSP's view on the inflation outlook? In our Third Quarter Inflation Report, released in October, we noted that our short run prognosis points to subdued supply pressures and uneven demand conditions. Subsequently, on November 2, the monetary board decided to maintain the BSP's key policy rates. At the same time, the tiering scheme on banks' placements with the BSP under the RP/RRP and special deposits accounts windows was restored. This measure is intended to encourage banks to seek alternatives to placing their excess funds with the BSP such as lending to the public.

Looking ahead, the BSP is fully aware that it still has to contend with the obvious danger to inflation posed by oil prices and the potential surge in liquidity growth from strong foreign exchange inflows. As risks to inflation are judged to remain tilted on the upside, the BSP will continue to keep a close watch on incipient inflationary pressures, especially those emanating from the demand side, and will stand ready to undertake the necessary monetary action.

Addressing supply-side risks also remains a key policy priority. Toward this end, the BSP actively pursues stronger representation with relevant government agencies in support of supply-side intervention measures that seek to maintain stability of basic food supplies.

Targeting inflation does not mean being indifferent to exchange rate movements. The exchange rate plays an important role in the transmission of monetary policy because of its direct impact on prices of traded goods and its indirect impact on aggregate demand. While the BSP leaves the determination of the value of the peso to market forces, there is scope for occasional BSP action to dampen excessive volatility in the exchange rate that could potentially undermine the price stability objective.

On the external front, we expect that the balance of payments (BOP) will remain strong. Current projections indicate a surplus that will be sustained by continued inflows from OFW remittances and strong exports of goods and services. Improving investor sentiment is also expected to boost the capital and financial accounts.

Turning now to the Philippine banking system, the system remains fundamentally stable and sound. This owes in large part to efforts to enhance financial intermediation and improve risk management by banks. We also continue to improve upon the core aspects of banking operations and enhance the regulatory framework for the effective conduct of banking supervision. Specifically, our focus is on realigning local regulations with international standards, particularly those pertaining to corporate governance, financial reporting and capital adequacy.

We are gearing up for Basel II, which calls for the adoption of risk-based capital for banks. As a first step towards Basel II, higher risk-weightings on NPLs have been introduced. The upshot of this is that banks are now compelled to adopt more formal procedures for quantifying risk and collecting

information. The realignment has affected the BSP as well. We have moved from a compliance-based supervision to a risk-based approach to supervision.

The BSP also continues to advance its reform initiatives to develop the capital market infrastructure. Some important measures have been taken to create a better market infrastructure, enhance transparency and instill market discipline. The full implementation of the third-party custodian system that ensures proper delivery, accounting and monitoring of all securities sold was also actively pursued.

We are also actively supporting various legislative initiatives that are intended to foster financial market development. Notable among these is the proposed creation of a centralized credit information bureau system to improve the quality of financial information available to investors, enhance private sector access to credit, and minimize exposure to risks of financial intermediaries.

I deliberately planned to keep my remarks short to have a longer Q & A session. I look forward therefore to a productive, open, and stimulating discussion.