Amando M Tetangco, Jr: The constellation of monetary challenges and responses

Speech by Mr Amando M Tetangco, Jr, Governor of the Central Bank of the Philippines (Bangko Sentral ng Pilipinas), at the Philippine Economic Briefing, Makati City, 12 September 2007.

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I. The current economic constellation

Both the domestic and international business communities affirm that the Philippines is now experiencing the most stable macroeconomic environment in a decade.

The inflation rate has been low and stable, with the outlook for inflation benign. This has allowed monetary authorities to maintain interest rates at low and stable levels also.

Our balance of payments remains in surplus, bolstered by the current account, which is also in surplus, in fact for four (4) consecutive years now. We have built up our international reserves to a record-high of $30.3 billion, adequate to more than cover our short-term liquidity requirements. Our strong external position enabled the BSP and the NG to prepay foreign debts amounting to US$ 2.1 billion in 2006 and another $0.9 billion in the first half of 2007. These have markedly improved our external debt ratios. Included in these payments was the prepayment in full of the country’s outstanding obligations to the IMF in December 2006, a milestone in the Philippines’ relationship with the IMF since it effectively ended the country’s use of IMF resources after nearly four and a half decades.

Our banking system is growing at double digit rates in both asset size and deposit base, improving in profitability and continues to be capitalized well-above international standards.

Investor attention and responses to the current constellation of economic data have been significantly positive as evidenced by the following developments, particularly during the first half of the year:

- The stock market reached seven-year highs
- The peso appreciated on account of strong export earnings and sustained overseas remittances.
- Our sovereign credit spreads compressed.
- Yields on domestic securities fell to record lows.

The questions, however, that may be in your minds now are: Can these gains be sustained? Will the economic momentum be able to weather the recent domestic and global market adjustments and volatilities?

My quick answer is yes.

Our macroeconomic fundamentals are sound. Because our underlying fundamentals are the result of the fiscal, macroeconomic, banking and financial sector reforms that have been undertaken vigorously and continue to be pursued, I believe we are resilient and therefore less vulnerable to domestic and external uncertainties.

II. The challenges to monetary policy formulation

On the part of the BSP, we formulate monetary policy against an assessment of global and domestic economic issues and developments.

We are mindful of the range of circumstances in recent times which draws important challenges for Philippine monetary policy. Plentiful global liquidity. The strong foreign exchange inflows into Asia. The build-up of international reserves. The marked appreciation of regional currencies against the US dollar. Financial innovations. Yield-seeking activities of agents, and now more recently, a reassessment of risk appetite and repricing of risks. A possible further tightening of global credit conditions. The fragility of US growth. Volatile oil and commodity prices.

All these challenge us as we endeavor to provide a sound monetary policy environment, while advancing reforms that promote growth and respond to changes in global financial conditions. Our resolve to follow good governance and international best practices in our reform agenda has provided us the discipline necessary to craft appropriate responses and avoid steps that could distort rational market behavior.

III. The courses of action

Let me put forward three essentials in response to these challenges.

One, we will remain focused on achieving our inflation target. Our monetary policy will continue to be responsive and forward-looking. Our inflation targeting approach has proven to be effective as a monetary anchor and provides us with an array of policy tools against turbulent economic and financial conditions.

Two, we will maintain our market-determined exchange rate policy, while complementing this with a liberalization of our foreign exchange regulations to allow greater access to foreign exchange for outward investments. We have already put out the “first wave” of FX liberalization measures, a “second wave” will be implemented before the end of the year.

Third, we will continue to undertake steps to strengthen the domestic financial system and help manage risks attendant to financial market developments.

In the banking sector, we are focused on good governance, asset-clean up, capital build-up and industry consolidation. We want to see stronger, well-governed, better-capitalized banks that would be effective channels of monetary policy. In other words, stable financial institutions that perform the intermediation function between the sources and users of funds, fully cognizant of the risks attendant to this role.

As driven by the changing profit dynamics brought about by our adoption of international accounting and the Basel II capital adequacy standards, we are encouraging banks to look for ways to capture economies of scale. This would make them more capable of investing in the required technologies (i.e., risk-based technologies) thereby making them more competitive in an increasingly challenging local and global environment.

These and other long-term structural reforms will continue to support a favorable investment climate and enhance productivity through investments in our growth sectors.

IV. The clever response from you

We are aware that the core investor is always in search, not just of higher and higher returns, but rather of “quality” returns. We are also aware that countries with good governance frameworks, wide-ranging structural reforms and appropriate macroeconomic policies are always on such investors’ shortlist in their search for high effective returns.

I believe, the Philippines’ macroeconomic fundamentals as well as the reforms that have been instituted in the banking sector make us a clear choice for the core investor.

The recent volatilities related to the US subprime mortgage market are not likely to have a direct significant impact on our banking system. Philippine banks’ exposure to the CDO market is a minuscule 0.2 percent of the total banking system's assets, none of which have subprime mortgages as underlying assets.

Apart from this, sufficient liquidity in the domestic financial system, as well as the increased tapping by corporates of long-term domestic funding for their expansion needs, will help reduce the influence or effects of external developments on our markets. As always, should there be need for more liquidity in the system, the BSP will act to maintain order and stability in the markets.

As the country pursues further reforms that support growth and reduce our vulnerabilities to external shocks, I ask investors to focus on our fundamentals. I am confident that this pattern of strong macroeconomic fundamentals will be sustained and favor a constellation of bullish opportunities and expectations for the Philippine economy.