

Amando M Tetangco, Jr: The Central Bank of the Philippines' expectations for business and the economy

Speech by Mr Amando M Tetangco, Jr, Governor of the Central Bank of the Philippines (Bangko Sentral ng Pilipinas), at a breakfast meeting for the Tuesday Club, Manila, 8 January 2008.

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I would like to greet everyone at this breakfast meeting a happy, though perhaps a more challenging, new year!

As we move over to this new year, let me take a general stock of our positive achievements in the past year, which ended with the economy experiencing one of the best macroeconomic fundamentals in two decades.

We achieved the ideal convergence of high growth and low inflation: GDP growth rate of 7.1% in the first three quarters last year, the highest in 30 years, while inflation rate remained at low levels (3.2% as of November 2007), comparable to those in developed economies.

The Philippine peso continued to rise against the US dollar, thereby shielding the economy from the inflationary impact of record high oil prices and generating significant savings for government in terms of debt service.

We also had a healthy external position with GIR at an unprecedented high level of \$33.7 billion as of December 2007, as well as the highest recorded BOP surplus at \$7.8 billion for January to November 2007. Interest rates remained on a generally downward trend, with the 91-day T-Bill full-year average rate at its lowest ever.

Equally important, our banking system continued to be sound with record high resources and deposits.

What do we foresee for 2008? We anticipate some headwinds, but they are likely to be manageable. Given the current relative strength of our economy, the primary risks emanate from external developments including 1) the ongoing sub-prime related financial market turbulence; 2) the continued surge in foreign capital inflows; and 3), the elevated prices of world crude oil and other non-oil commodities.

Let me quickly go through each of these. The global financial markets appear to have stabilized from their gyrations in the third quarter last year. Still, the full impact of the US subprime mortgage market woes on the real sector has yet to be felt. This could affect us in two ways: 1) on the trade side: as the US economy, which still accounts for about 18 percent of our total foreign trade, slows down, and; 2) on movements in economic prices, e.g., exchange and interest rates: as the response of the US and other major central banks to the expected global economic slowdown unfolds. The latter could result in further risk aversion against emerging markets, including the Philippines.

The second challenge emanates from continued strong capital inflows to the country as a result of an important pull factor: the Philippines' favorable macroeconomic performance. You may have heard me refer to this as the problem of plenty. I would like to emphasize that while these inflows provide an opportunity to boost long-term growth, they also pose substantial short-term macroeconomic challenges. It is the lag between the inflow of foreign exchange and corresponding domestic liquidity infusion and its eventual utilization that is critical. How that lag is managed could spell the difference between an inflationary situation and a manageable one. A further challenge is finding the appropriate mix of measures so this liquidity is channeled to more productive investments, particularly into infrastructure.

Lastly, the high and volatile international prices of oil, particularly if they remain high for a protracted period of time, continue to be a challenge.

Given the headwinds in the global arena, the challenge for policymakers is to craft sound macroeconomic policies that will further strengthen the domestic economy.

On the part of the BSP, our policy thrusts in 2008 are to maintain a stable macroeconomic environment that is supportive of a growing economy, and to build a more resilient financial system that is flexible in the face of growing global competition and innovation.

Managing risks to inflation and inflation expectations remains a key policy priority of the BSP.

On the external front, our policies will be geared toward: (1) ensuring sustainability of the country's external debt; (2) maintaining an essentially market-determined exchange rate with scope for occasional official action to smoothen sharp movements in the rate; (3) maintaining a comfortable level of reserves; and (4) further improving the foreign exchange environment through FX deregulation.

Reforms in the financial sector will be geared toward maintaining a strong banking system and a vibrant capital market. The BSP remains committed to strengthening the banking system through continued structural reforms and speedier disposition of non-performing assets. The asset clean-up of banks should help spur credit and investments, and contribute in providing the basis for more sustainable economic activity in the medium term.

To further develop the domestic capital market, the BSP will continue to work actively with other government agencies and the private sector for the completion of critical market infrastructure to enhance system integrity and overall market confidence. We will continue to push for the passage of key legislations intended to accelerate the development of the domestic capital market. In particular, we shall push for the implementation of a centralized credit information bureau to improve the availability and the quality of financial information to investors, expand private sector access to credit, and minimize exposure to risks of financial intermediaries.

On the basis of these policy directions, and looking ahead, the outlook for the monetary, external and banking sectors continues to be favorable.

Average inflation fell below the target of 4-5 percent in 2007. It is expected to settle within the target in 2008 of 4 percent \pm 1 percentage point. The external payments position is expected to remain a source of strength for the economy over the near term. Dollar inflows from remittances and foreign investments are expected to remain robust and will continue to provide support for the peso. This should enable us to further build up our cushion of international reserves.

On the banking system, we expect to see a further expansion of bank assets and capitalization, as well as a further improvement in bank asset quality.

These are the broad strokes of the economic picture of the year just past and for 2008. I am now ready for a discussion of specific questions and issues of interest to you.