

Amando M Tetangco, Jr: Current economic issues in the Philippines

Remarks by Mr Amando M Tetangco, Jr, Governor of the Central Bank of the Philippines (Bangko Sentral ng Pilipinas), for the FOCAP Forum, Makati, 12 February 2008.

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Ladies and gentlemen of the Foreign Correspondents Association of the Philippines, special guests, good morning.

I have been requested to discuss current economic issues this morning. Since you monitor our economy very closely, by the minute in some cases, I will not bore you with the details. Instead I will present the big picture, so to speak, so you will understand where I am coming from. Then I shall focus on the monetary and banking policies of the Bangko Sentral ng Pilipinas.

As you know, the Philippine economy chalked up impressive gains on various fronts in 2007. Our GDP growth was the highest in three decades while our inflation rate was the lowest in twenty years. As I have said, we achieved the ideal convergence of high growth amidst 20-year low inflation in 2007.

We also had a healthy external position, ending 2007 with record high gross international reserves and unprecedented balance of payments surplus. At the same time, our banking system is stronger, with record high resources and deposits as well as capitalization way above the standards set by the Bangko Sentral and the Bank for International Settlements. As a result, we are experiencing a very stable macroeconomic environment that is validated by market confidence in the Philippines.

This is the big picture.

Let me now discuss the challenges that the BSP faces in the pursuit of its mandate of ensuring stable prices and a sound banking system.

The first challenge is the anticipated US economic slowdown. There is a consensus among multilateral institutions, investment banks and credit rating agencies that the US economy will slow down in 2008. However, there is no consensus yet on whether the recent problems in the US subprime markets will push the US economy into a mild slowdown or usher in a recession. Either way, a weaker US economy is expected to slow down global growth, although growth in emerging markets could temper this.

In the case of the Philippines, the projected US slowdown is not seen to have a significant immediate impact. However, we recognize that a longer-than-expected US recession could take its toll on the economy. Given this, the BSP will continue to monitor global developments to ensure that appropriate measures are implemented, when warranted.

The second challenge is global risk emanating from high and volatile international prices of oil. In the absence of a change in OPEC's quota policies or a major global slowdown, international oil prices are likely to remain high due to continued geopolitical and supply risks coupled with strong global demand and continuing speculation in the futures prices of oil. For the Philippines, prolonged high oil prices is a threat to our inflation outlook.

The third challenge is the global financial market turbulence that could result in increased risk aversion towards emerging markets like the Philippines. We saw in the third quarter last year that – as a result of subprime problems in the United States – the reassessment, repricing and adjustment of risk positions affected not only the US market, but also equity bond and exchange markets across the globe.

Although the global financial markets appear to have stabilized, the full impact of the US subprime mortgage market woes has yet to be felt. This could affect the Philippines in two ways. First, growth in the export sector could soften as the US economy, a major trading

partner of the Philippines, slows down. Second, movements in economic prices, e.g., exchange and interest rates, could result from further risk aversion against emerging markets, including the Philippines.

The fourth challenge for the Bangko Sentral is a possible resurgence in domestic liquidity from sustained strong capital inflows on account of our favorable macroeconomic performance. While domestic liquidity growth has declined to more manageable levels after our policy action in May, we still foresee strong foreign exchange inflows in 2008. Since this may threaten our inflation target, the Bangko Sentral will need to continue to monitor this and ensure that the liquidity level is consistent with the inflation objective.

At first blush, these challenges may seem formidable. Yet, the Philippine economy has time and again shown its resilience. I believe therefore that these challenges are, ultimately, manageable.

On the whole, Bangko Sentral's main policy thrusts in 2008 and beyond will focus on maintaining sound macroeconomic fundamentals and a strong financial system that is flexible, innovative, and globally competitive.

A key priority is to maintain our inflation target by maintaining a prudent monetary policy stance supportive of non-inflationary growth.

Average inflation is expected to settle within the target of 4 percent \pm 1 percentage point in 2008 and within 3.5 percent \pm 1 percentage point in 2009. 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. This should enable us to further build up our cushion of international reserves.

On the external sector, our policies will be geared toward: (1) ensuring sustainability of the country's external debt; (2) maintaining a market-determined exchange rate with scope for occasional official action in cases of extreme movements in the peso; (3) maintaining a comfortable level of reserves; and (4) improving the foreign exchange environment further through forex 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 structural reforms and speedier disposition of non-performing assets. At the same time, continuing asset clean-up of banks should help spur credit and investments, thereby generating support for more sustainable economic activity in the medium term.

Other regulatory reforms will be aimed at the further strengthening of corporate governance, risk management, and capitalization through a more effective and efficient enforcement of standards and codes. In particular, prudential regulations shall continue to be aligned with international standards and best practices.

To further develop the domestic capital market, the BSP will continue to work actively with other government agencies and the private sector to complete critical market infrastructure that will 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 quality of financial information to investors, expand private sector access to credit, minimize risks exposure of financial intermediaries, and lower borrowing costs.

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

I am now ready to discuss the issues of particular interest to you. Thank you.