Amando M Tetangco, Jr: Macroeconomic prudence – a review of the Philippine economy in 2009

Statement by Mr Amando M Tetangco, Jr, Governor of the Central Bank of the Philippines (Bangko Sentral ng Pilipinas), at the Tuesday Club Breakfast Meeting, Manila, 6 January 2009.

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Let me begin by wishing everyone a "calmer", hopefully "not too" challenging 2009 ahead of us. Last year, I was also your guest around this time. Then, I greeted you a "happy, though perhaps more challenging year!" If you recall, we were then coming out of 2007, which saw the country experience the "ideal convergence of high growth and low inflation". But on the heels of 2007, we began to feel some of the impact of the US subprime mortgage problem. Subsequent market events have certainly proven me correct, haven't they?

In fact, the country faced two major challenges. First, volatile international prices of oil and non-oil commodities which caused inflation to accelerate globally, particularly in the first half of the year. Second, the broadening of the reach of the impact of the US subprime mortgage problem – from the US subprime market alone to the US financial market, to the global financial markets and then to the US and major REAL economies, and now the global real economy.

These challenges translated to lower-than-first-forecasted real GDP growth and higher-than-targeted inflation. Nevertheless, the country still ended 2008 on much better footing than most of our Asian counterparts.

Specifically, Philippine growth for the first 3 quarters of 2008 stood at 4.6 percent, significantly lower than the NG's initial target but still within the country's long-term growth trend and quite respectable compared to our ASEAN neighbors. Inflation, on the other hand, peaked at 12.4 pct in August from a level of 4.9 pct at the start of the year. The average inflation for the first 11 months of 9.4 was significantly higher than the target range of 4 pct +/- 1 percentage point. This upswing in inflation was, however, not unique to the Philippines in 2008, given that this trend was largely due to elevated and highly volatile international oil and food prices.

On the exchange rate, the peso lost much of the gains it tucked in 2007, due principally to heightened risk aversion towards emerging markets including the Philippines as the global financial turmoil spread. The peso depreciated 13.3 pct against the US dollar in 2008 against an 18.8 pct appreciation in 2007. This loss in value was, nonetheless, in line with movements of other currencies in the region, which also depreciated against the US dollar. In addition, in terms of the Real Effective Exchange Rate over the past eight years, the peso has largely maintained its competitiveness against a basket of currencies of our major trading partners and competitor countries.

In the meantime, we have been able to keep the Gross International Reserves at comfortable levels. GIR stood at $36.8 B at end November 2008, an increase of about $3 B over the end 2007 level. The build-up in GIR has allowed us to keep the BOP in surplus in 2008. At almost $37 B, GIR is 5.8 months' of imports and 2.5 times short-term debt based on residual maturity. These ratios are at least twice the international benchmark levels of 3 months of imports and 1 time the debt ratio.

The banking system remains sound. The series of banking reforms put in place over the last five years, and among others, the inherent conservatism and the domestic orientation of banks, as well as the BSP's phased-in approach to embracing financial innovation, have resulted in minimal exposure of the banking system to the troubled international financial institutions. In addition, banks continue to be capitalized above the BIS standard and BSP regulatory requirement; bank balance sheets are at their strongest since the 1997 Asian financial crisis; and assets continue to grow.

What do we foresee for 2009?

2009 will be a critical year. It could define how we will perform when the markets turn around. If you read most analyses of the US and major economies' downtrend, the expectation is these could last about 18 months. Therefore, depending on when you begin your count, recovery in the US and maybe globally could begin in 2010. No one, however, can say for certain how deep and how long the global downtrend would be, nor how far markets would retreat. Therefore it is incumbent upon us to continue to brace for further uncertainty in the global financial markets, recessionary trends that would spread to regions beyond the developed world; and volatilities in commodity prices, particularly oil.

How shall we respond to the unfolding environment?

Monetary policy in 2009 will continue to be anchored on inflation targeting. The discipline of the inflation-targeting framework that we adopted in 2002 has helped the BSP focus more on its primary mandate of price stability. More specifically, as inflation risks moderate, BSP will carefully consider opportunities for monetary policy easing amidst tightening financial conditions. We will continue to ensure appropriate levels of market liquidity to maintain confidence in and the efficient functioning of the financial markets. We will calibrate monetary policy to protect our people's real income and purchasing power. We will endeavor to keep inflation at manageable levels as this creates the environment for sustainable long-term growth.

The BSP's external sector policy will remain focused on ensuring our external vulnerabilities are limited. More specifically, we will beef up reserves for insurance; maintain a market-determined (thereby externally competitive) exchange rate and we will continue to review our FX regulatory environment.

Banking sector policies will revolve around buttressing the banking system's soundness. The reforms we have so far put in place have created the environment which has resulted in the system's minimal exposure to the global financial market turbulence. We will continue on this track.

Conclusion

I began these brief remarks declaring we have ended 2008 on a much sounder footing than most of our Asian neighbors. So far, we have not been as affected by the global financial turmoil.

I also said that 2009 would be critical in crafting policy that would allow us to be ready take to advantage of the upturns in the global slowdown when they do materialize.

As we concluded 2008 and now look forward to 2009, we reflect upon how we have been able to remain fairly resilient in the face of the challenges we faced in 2008 – macroeconomic prudence. That is, consistently building buffers during the good times to provide us a shield during the bad times. As 2009 rolls in, we will press on with this strategy that has so far kept us in good stead.