Amando M Tetangco, Jr: Preparing for what lies ahead

Speech by Mr Amando M Tetangco, Jr, Governor of the Central Bank of the Philippines (Bangko Sentral ng Pilipinas), at the 1st Membership Meeting of the Year of the Rotary Club (Manila Polo Club), Manila, 8 January 2009.

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RCM President Romeo Batino, Monetary Board Member Rtn. Raul Boncan, Esteemed members of the Rotary Club of Manila, Friends from the media, Ladies and gentlemen, good afternoon.

Thank you once again for this opportunity to address the Rotarians on your first Membership Meeting of the year. If I am not mistaken, this is the fourth year I am doing this as BSP governor. Time flies, doesn't it? And taking a quick sweep of this room, it doesn't seem like many of you have added on another year! (I don't want to soil my welcome mat at the Rotary Club)

Every year is different, but each year always brings with it renewed hope. The conclusion of one and the beginning of a new year is often a time to reflect – on the events of the year just past and the expectations for the year that is upon us.

You may have read the headlines yesterday, which quoted me as describing 2009 as a critical year. Yes I believe 2009 is critical. To ensure we are prepared for what lies ahead.

2008 was a challenging year. It saw the ideal convergence of low inflation and high growth, that characterized our 2007, get dissipated by high oil prices and the spread of the subprime market woes from the US to global financial markets, with marquee financial names falling one by one. It also was witness to major economies, including the US; Germany and Italy in Europe; Japan, Singapore and Hongkong in Asia descending into recession.

Forecasts for world growth from the private sector as well as multilateral agencies continue to be reviewed and revised downward as more information becomes available.

When I say 2009 is critical – it is not to create fear. But quite the opposite. I want you to be hopeful. You hold among your membership many of the most prominent in business and industry. To many of you, darkness is not darkness for its sake, but rather the absence of light. Because many among you have developed the "killer instincts", when the dark gets bleaker, you see opportunities. Therefore, I encourage you to be the light so darkness will be dispersed. I encourage you further to create more opportunities that will sustain the light.

Many pundits say that the worst is yet to come in the local and international financial markets. I say, no one knows how much deeper or how much longer this downturn will be. So there will continue to be challenges. But I want to add, this won't go on forever. What we need to do now is to make the best of what we can at this time, try to ease some of the "pain" currently experienced, build up safeguards, and prepare for the eventual upturn.

This is why I say 2009 is critical. Our actions and policies this year will help define how prepared we would be when the upturn does come about. Several relatively optimistic analysts forecast a recovery among the major economies could occur as soon as 18 months. So, depending on when you begin to count, and because time does fly, the upturn could be just around the corner!

We ended 2008 on a much sounder footing than most in the region. Philippine growth for the first 3 quarters of 2008 stood at 4.6 percent, quite respectable compared to our ASEAN-5 neighbors. Inflation was on an uptrend and elevated due mainly to highly volatile oil and non-oil commodity prices. We take comfort, however, in that this trend was not unique to the Philippines. At an average inflation for the year of 9.3%, this still compares favorably against ASEAN-5 range of 5.5 to 10.3%. Also, inflation has started to recede faster than expected.

We found ourselves better-situated than others at the end of 2008 precisely because we came into that downturn prepared and with buffers, including a forward-looking monetary policy framework; a healthier reserves level for insurance; and a sound banking system.

2008 – what buffers have we stored?

Let me quickly run through these buffers with some detail.

First of all, the resilience of domestic demand. In previous crises, it was internal activity that kept the economy going. Last year, real growth was broad-based. The major domestic sectors, including agriculture, industry, and services, provided positive contributions to growth. In addition, government spending for infrastructure as well as private consumption supported by steady remittances helped sustain domestic demand.

Second, the discipline of inflation targeting has helped us focus on our primary mandate of price stability. That we were able to maintain inflation at manageable levels helped to create a calmer environment that sustained domestic business.

Third, because we kept to our policy of a market-determined exchange rate, the peso broadly maintained its competitiveness against a basket of currencies of our major trading partners and competitor countries Although it lost much of the gains of 2007 as the country wasn't spared from the heightened risk aversion towards emerging markets, the peso's fall was nevertheless in line with the movement of other currencies in the region, which also fell against the US dollar.

Fourth, with an appropriate FX regulatory environment and a natural pool of talent, we were able to attract FX investments particularly in the BPO sector. Remittances also kept flowing. These allowed us to continue to build our Gross International Reserves to comfortable levels, above international benchmark levels, and therewith continue to register a surplus in the BOP.

Fifth, the banking reforms we had put in place during earlier years have caused the banking system to be only minimally exposed to the troubled global financial institutions and thus remain sound. In addition, the inherent conservatism and the domestic orientation of banks, as well as the BSP's phased-in approach to embracing financial innovation helped to keep our exposure to the global financial turmoil limited. Our 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.

Sixth, through the series of reforms instituted, our monetary and regulatory frameworks have become more flexible. These now allow us to quickly respond to changes in our working environment. For instance, at the time when there was perceived tightness in liquidity and some friction in distribution of both peso and dollar funds at the height of the uncertainty from the global financial turmoil, the BSP was able to expeditiously adopt measures to address these market concerns. Among the measures put in place to address peso and dollar liquidity were a) the relaxation of valuation and collateral requirements for the existing peso repurchase facility, b) the creation of a new dollar repurchase facility and c) the doubling of the budget for e-rediscounting. In the meantime, to address distribution issues, the BSP a) reduced reserve requirements on bank deposits by 2 percentage points and b) maintained a presence in spot and swap FX markets. In addition, to address temporary concerns due to the difficulty in valuation of emerging market debt assets, the BSP allowed the reclassification of certain debt holdings of banks from their trading accounts to their held-to-maturity accounts.

Seventh, we have put a premium on communication strategy. At all times, but particularly during a period of uncertainty, accurate and timely information is vital. The BSP heightened its consultation with stakeholders by holding more frequent dialogues and conducting periodic surveys to capture consumer and business sentiments. We realize that having an open two-way communication makes for more effective, efficient and responsive policy making.

Seven is a “complete” number as they say, so I will end my list here. Let me summarize by saying the BSP has endeavored to create and maintain an environment supportive of our objectives of stable prices and sustainable long-term growth.

2009 – what’s in store?

With these buffers in place but at the same time mindful of the challenges that are still upon us, how must we be in 2009 so we could limit the adverse impact of the crisis and be prepared for the expected upturn?

Just like the eagle on a prey, we need to sharpen our senses – we need to be sensitive to the signals around us – sights sounds and scents. We need to be aware not only of our immediate surrounding but also of what may lie around. We need to not only be present-thinking but forward-looking also. You can’t be complacent. You need to be prescient.

I do not particularly espouse the Darwinian theory. But Mr. Darwin may have been on to something when he said, “that which will survive is the species which is most adaptable to change.” (Please pardon literary freedom for my paraphrase).

I declared earlier that we ended 2008 fairly unscathed from the global financial turmoil, but real risks are still lurking. Further uncertainty in the global financial markets; recessionary trends that could spread to regions beyond the developed world; and volatilities in commodity prices, particularly oil.

Policy thrusts for 2009

How shall we translate into policies for 2009 both the need to be anticipatory (like the eagle) and adaptable to change (as Dr. Darwin posited)? Let me quickly run by some specifics:

Monetary policy in 2009 will continue to focus on our primary mandate of price stability. As inflation risks moderate, the BSP will carefully consider opportunities for monetary policy easing amidst potential tightening financial conditions. We will also continue to ensure appropriate levels of market liquidity to maintain the efficient functioning of the financial markets. Through this, we hope to provide the necessary conditions that will allow economic growth to continue. We will at the same time 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. We expect to continue to post a surplus in our BOP, mainly still due to steady OF remittances and receipts from the BPO sector. This will give us the opportunity to further beef up reserves for insurance. We will continue to pursue a market-determined exchange rate to allow us to maintain external competitiveness. We will also engage in policies that would sustain a manageable external debt profile.

Banking sector policies will continue to reinforce the banking system’s soundness. Most analyses point to the lack of regulation as one of the root causes of the US subprime market crisis, it is tempting therefore to swing to the other extreme of over regulation. I don’t believe BSP would move towards that direction, given our gradualist and consultative approach to regulation. Instead what I believe may occur is a move towards greater accountability coupled with greater granularity of regulation. I have always believed that markets and regulation can and must co-exist. The trick is to craft regulation that would make the markets work.

We will therefore remain committed to sustaining key financial and banking sector reforms that would lead to greater efficiency, risk management, stronger capital base, improved disclosure practices and transparency, and enhanced corporate governance standards in the banking system.

Realizing that the current crisis has taken on a global nature, we will further strengthen engagements with regional peers to share information, discuss emerging developments, and pool resources, if necessary even foreign exchange reserves. It's interesting that the current financial turmoil took on a turn for the better once the major economies began to act in concert. Confidence had been quickly eroding until then. The coordinated and cooperative policies, that were put in place by the US and European central banks and finance ministries beginning October last year, helped to restore some traction in the markets and subsequently improve market confidence not only towards the major economies, but also towards emerging markets.

Conclusion

2008 was a difficult year, to say the least. The global economies reached some highs and lows not seen in over a hundred years.

Philosopher George Santayana, who I just found out traces some historical associations to the Philippines, said "Those who do not remember the past are condemned to repeat it."

The Philippines is not a newbie in terms of crisis, we have faced quite a number of those in the past. Each crisis we encountered was unique in its roots and causes. But we have learned from each, every time. It's too early to make prescriptions, given that much is still to unfold. But as I end today's remarks, I'd like to share some themes we may pick up even at this stage from this current crisis. I take these from our own acronym – BSP. Some of you may have read this from a previous interview but I thought it would be appropriate for this audience. I repeat it hear with some slight modification.

B – Be prepared, keep your tools sharp (Review cost structures, enhance product offerings)

S – Stay alert to spot opportunities (Consider trends and structural changes, enlarge market scope, do research)

P – Push ahead!

As I scan this audience, I see a wealth of experience that covers the breadth and depth of the crises the Philippines has gone through in the last three decades. So I know, what I have just shared as lessons with you is not news to you.

The BSP is doing its part to limit the impact of the crisis and to anticipate the upturn, but we cannot do this alone. We need the full support and cooperation of the private sector and those among your ranks to make us and the whole nation ready for that upturn.

Let us preserve what we have stored in 2008 and, together, let us build further on these in 2009.

Thank you for the opportunity to share these thoughts with you.

I wish you and your loved ones all the best possible for 2009!