

Amando M Tetangco, Jr: Microfinance – the bright spot in these challenging times

Speech by Mr Amando M Tetangco, Jr, Governor of the Central Bank of the Philippines (Bangko Sentral ng Pilipinas), at the 2009 RBAP-MABS National Roundtable Conference, Manila, 12 May 2009.

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Mr. Francis Ganson, Chairman, Rural Bankers Research and Development Foundation; the officers and members of the Rural Bankers Association of the Philippines (RBAP); our partners from the USAID led by Christian Hougen and John Owens; fellow advocates in the microfinance sector; special guests, ladies and gentlemen, good afternoon.

We at the Bangko Sentral ng Pilipinas are happy that the the National Roundtable Conference of RBAP – Microenterprise Access to Banking Services (MABS) has chosen for its theme “Microfinance: The Bright Spot in These Challenging Times”.

Indeed, we believe that microfinance is an effective countercyclical tool for softening the negative effects of economic crises, particularly to the most vulnerable segment of the economy. Former United Nations Secretary General Kofi Anan once said that microfinance recognizes that poor people are remarkable reservoirs of energy and knowledge; that while the lack of access to financial services may be a sign of poverty, it is also an untapped opportunity to create markets, bring people in from the margins and give them the tools with which to help themselves.

Especially during challenging times, it is microfinance that can provide much-needed support for our entrepreneurial poor. But before I discuss microfinance, I will give a brief overview of our present operating environment and why we live in challenging times.

The current global economic crisis is a source of worry.

Even countries that do not have strong financial links to the US, Europe or the other markets that have been most affected are now seeing effects through real flows and financial losses on trade activities.

As the global economy slows down, jobs are jeopardized and unemployment figures in the directly affected countries tend to rise. In fact, there are Filipino workers here and overseas that have been laid off.

We have learned that no economy is immune from the effects of the present global crisis, described as the most serious since the Great Depression.

However, economies with sound economic fundamentals are likely to fare better than others.

Given the structural and market reforms we had painstakingly put in place since the Asian Financial Crisis, it can be said that the present crisis came at a time when the Philippine economy is in a position of relative strength.

Indeed, our sound macroeconomic fundamentals have served us well. In the face of this crisis, the Philippine economy remains resilient, relative to our peers in the region.

Let me quickly run thru some numbers to show the “buffers” we have built.

Our domestic economy has remained steady.

In 2008, GDP grew by 4.6%, still within our long-term trend growth rate, and quite respectable when compared against our neighbors.

The outlook for this year remains positive, although at a slower pace of growth. Nevertheless, this is not bad at all considering that the Philippines is one of the few Asian countries seen to grow and ride out this severe global economic recession.

Our inflation rate continues to decelerate.

Headline inflation in April was reported at 4.8 pct from 6.4% the previous month. Core inflation has similarly slowed down (to 5pct from 5.6 pct).

The forecast average inflation for 2009 is at 3.4 pct, well within our set target range of at 2.5-4.5%.

Our Balance of Payments is expected to continue to be in positive territory through the year.

We continue to see a current account surplus from sustained remittances and receipts from the BPO sector.

Because of our healthy external position, we have been able to build up our gross international reserves to a record-high level of \$39.5 billion in April, enough to pay for more than 6 months' worth of imports of goods and services.

The positive external surplus will continue to support the peso.

With our policy for a market-determined exchange rate, the peso is expected to remain competitive as this moves in tandem with the other currencies in the region.

Our banking system remains sound.

Thanks to the innate conservatism of our banks and the phased-in approach by the regulator to financial innovation, Philippine banks' exposure to toxic assets has been minimal.

Also due to reforms implemented in earlier years to clean up bank balance sheets, strengthen bank capitalization through Basel II, improve governance structures, enhance risk management systems, and adhere to international accounting standards, the banking system remains sound and stable.

Our asset base continues to expand, asset quality has greatly improved with NPL ratio now at pre-1997 crisis level, and capital adequacy has remained above national and international standards.

And we did not see a freezing of credit markets similar to what was happening in the US and Europe then.

Given all these indicators, one could say "so far, so good".

Nevertheless, we are aware that risks remain.

Thus, in October 2008, at the height of the uncertainty surrounding this crisis, the BSP implemented preemptive measures to boost domestic liquidity. The following are among these measures:

- Enhancement of the BSP's standing peso repo facility by expanding allowable collateral and relaxing valuation on these;
- Creation of a US dollar repo facility to augment dollar liquidity in the foreign exchange market and ensure the ready availability of credit for imports and other legitimate funding requirements;
- Increase in the budget for our peso rediscounting facility to P60 billion; and
- Reduction in the regular reserve requirements on bank deposits and deposit substitutes by two percentage points.

In addition, the BSP took the opportunity to reduce policy rates in the light of easing inflation expectations.

During the last four policy meetings, the Monetary Board cut BSP's policy rates by a total of 150 basis points. Combined, the lower cost of money and increased liquidity should support continued economic growth.

We will continue to monitor developments to ensure that our policy settings remain appropriate and balanced.

Nevertheless, while there has been monetary easing, the BSP remains unrelenting in its pursuit of reforms. We will continue to pursue greater efficiency, better risk management, stronger capitalization, improved disclosure and transparency practices, and enhanced corporate governance standards in the banking system.

So far, the reforms we have implemented have allowed our banks to efficiently perform their central role of channeling funds to productive uses, as well as in managing and distributing risks.

Having a more efficient and liquid Philippine banking sector has helped mitigate the risk of what is called the negative feedback loop from the global financial crisis.

Having said these, there is a critical question that we have to face:

Will the global financial crisis affect the world's microfinance sector?

Microfinance scholars have grappled with the first question. Unfortunately, the results from their initial studies remain inconclusive.

One study by the United States Agency for International Development (USAID), published in March 2009 and entitled "Will the Bottom of the Pyramid Hit Bottom?"¹ states that (and I quote) the crisis may ultimately lead to a squeeze in MFIs' profitability. Due to the credit crunch, MFIs, especially those with limited deposit taking facilities, will have reduced access to commercial wholesale funds to finance their loan portfolios. Scarce private credit and higher borrowing costs would likewise stunt their portfolios. MFIs would also be competing for fewer and more expensive funds for their operations and expansion.

The relative increase in prices and an overall slowdown in economic activities will also affect the profitability of clients' businesses, thus constraining their household incomes. As a result, leading MFI clients may fall back on loan obligations or withdraw their savings.

On the other hand, a paper entitled "The global financial crisis and its impact on microfinance"² written for the Consultative Group to Assist the Poor (CGAP) last February 2009, claims that the effects of the crisis on microfinance are actually well-managed.

Authors of the paper claim that while there may be some anecdotal evidence, there have been no major negative changes in the profitability or risk profiles of MFIs. Their study was based on the 2008 4th Quarter figures of Symbiotics 50 Benchmark which tracks large microfinance institutions worldwide.

The authors however recognize that microfinance as it is today, given greater links to domestic and international financial markets, may still be affected by the financial crisis. However, they iterate that past investments in building a sound foundation for the sector and the vast untapped market of credit worthy clients will ensure that microfinance remains resilient amidst this current crisis.

Given these, the next question is whether the global crisis will impact Philippine microfinance. Will it have adverse effects or darken the prospects and opportunities of Philippine MFIs?

¹ "Will the Bottom of the Pyramid Hit Bottom? The Effects of the Global Credit Crisis on the Microfinance Sector". Barbara Magnoni and Jennifer Powers, produced for review by the United States Agency for International Development (USAID). March 2009.

² "The Global Financial Crisis and its Impact on Microfinance". Elizabeth Littlefield and Christoph Kneiding for the Consultative Group to Assist the Poor (CGAP) Focus Note No. 52. February 2009.

We at the Bangko Sentral believe that as our macroeconomy has proven resilient to crisis, we can expect the same resiliency in our microfinance industry. In fact, bright spots abound in Philippine microfinance.

For instance, since microfinance in the country has been increasingly led by banks, the risks to the liability side of microfinance institutions remain more manageable.

Banks, as deposit taking institutions, are less reliant on external sources of funds and therefore less vulnerable to any reversals in foreign capital flows and shifts in investor preferences as a result of the crisis.

While the diversification and commercialization of sources of funding has been seen as a positive industry development, retail deposits remain significant as a stable core funding base.

Further, our microfinance institutions, especially banks with microfinance operations, have demonstrated the necessary commitment to institutional strengthening.

More and more, we are seeing banks upgrading their risk management systems to be able to adequately and appropriately identify possible risks, such as credit and liquidity risk; and how they will be managed.

Commitment to maintaining the quality of your microfinance loan portfolios has also been evident. I am happy to note that a culture of zero tolerance for delinquency and vigilance in monitoring of portfolio at risk is clearly evident among MABs banks. These are practices you must sustain, in good times and in bad.

On the part of the Bangko Sentral, we will continue with our policy approach of enabling banks, particularly rural banks, to increase the scale and scope of their microfinance operations.

- Our regulations for microfinance have created the enabling environment for its practice to fully flourish within the banking sector.
- We have also liberalized the branching regime, and we will continue to review this as conditions warrant. Our branching regulations also provide particular incentives for microfinance-oriented banks such as the ability to branch out even in the restricted areas of Metro Manila as well as the ability to collect savings from microfinance clients through other banking offices.
- The BSP has also been receptive to various product and technological innovations in banking services.
- We have also allowed the outsourcing of some banking functions to help improve your operating efficiency.
- Rural banks now have more opportunities to provide a wider range of services and products to their clients such as electronic money, FCDUs, and investments in ATM networks.

Moving forward, I propose that we make these bright spots brighter. In this, we have our own roles to play.

On the part of the BSP, we shall remain unrelenting in our commitment to strengthen the banking institutions through improvements in capital positions and enhanced capacities to manage risks.

Our commitment to broaden financial inclusion is undiminished; in fact, it has been heightened by the financial crisis. Given its importance, we will be more proactive in exploring ways to increase access to financial services, particularly for those who remain unbanked and unserved by the financial system.

I believe that all of you, as our partners, share these goals. I therefore take this opportunity to thank the 91 rural banks participating in MABS, including their nearly 500 banking offices, for being at the forefront of delivering microfinance services to millions of Filipino microentrepreneurs. Ladies and gentlemen, let us give our MABS-participating rural banks a well-deserved round of applause!

Indeed, you are the crucial channels for countryside development and the catalysts for promoting a truly inclusive financial system. You can therefore count on Bangko Sentral's continuing support in this important task.

While banks have accomplished much, you cannot be complacent nor rest on your laurels: Clearly, more needs to be done!

You must continuously monitor the quality of your loan portfolios and vigilantly maintain low portfolio at risk (PAR). Of course, this must be balanced with your commitment to continuously serve your microfinance clients.

I am certain you have realized that microfinance clients who repay their loans faithfully are motivated in part by their desire to promptly access follow-on loans. This ensured access to finance is very important for our microentrepreneurs.

Another important commitment is for banks to maintain strong capital positions. Capital adequacy is central to ensuring that banks have sufficient buffer whenever risks turn into losses. Remember that our banking sector's strong capital position is one of the main reasons why it has remained resilient amidst the continuing global financial crisis.

I do look forward to banks becoming more proactive, rather than reactive, in terms of strengthening their capital positions.

Finally, I wish that microfinance institutions will look at this crisis as an opportune time to push for reforms to further strengthen the microfinance industry to find ways to improve efficiencies, to strengthen governance structures to enhance the quality of its management to diversify funding, to become more transparent and to strengthen consumer protection.

Microfinance institutions may also continue to expand and tap new markets, of course with appropriate caution and preparation.

For instance, some microfinance institutions see market growth potential from returning overseas Filipinos who begin to engage in various entrepreneurial activities.

From current indications, the global economic crisis has not negatively impacted Philippine microfinance. However, it is imperative that we all remain vigilant in these challenging times.

We have seen how microfinance has improved the lives of millions of our entrepreneurial poor. The yearly Microentrepreneur of the Year Awards program, where MABS banks always have a winner, is a regular reminder to us that access to financial services coupled with hard work, ingenuity and perseverance are powerful empowering tools for breaking out of poverty and building a better life not only for the microentrepreneurs themselves, but for their families and communities as well.

You and I know of many Filipino success stories rooted in microfinance. The success of our microentrepreneurs continues to inspire and bring hope that it can be replicated throughout our country and liberate more Filipinos from poverty.

This is the reason why we are all here today. This is the reason why we commit to work together to broaden and deepen the reach of microfinance.

I hope therefore that this RBAP-MABS roundtable conference will be fruitful and successful in transforming our microfinance sector to be stronger, better, and even more responsive to the needs of our microentrepreneurs.

Again, my congratulations to all those involved in our microfinance sector a truly bright spot in these challenging times.

Mabuhay ang microfinance! Mabuhay ang Pilipinas! Salamat sa inyong lahat!
Thank you and good day!