Amando M Tetangco, Jr: Review of 2012 plus global and domestic developments shaping 2013

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (the central bank of the Philippines), at the Rotary Club of Manila's First Membership Meeting for 2013, Manila, 3 January 2013.

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Introduction

Officers and members of the Rotary Club of Manila (RCM), led by President Obet Pagdanganan, who are joined by the officers and members of the Rotary Club of Leon Guinto headed by President Lody Garcia and of the Rotary Club of Manila-Sta Ana led by President Marci Bautista and of the Inner Wheel Club of Manila, led by Pres. Dolly Gupit, esteemed guests, ladies and gentlemen, let me begin by greeting you all a Peaceful and Prosperous 2013.

It is a pleasure, once again, to be part of the Rotary Club of Manila's first Membership Meeting of the year and to have the opportunity to share with Rotarians the BSP's views on the year just past and the expected global and domestic developments that could help shape the year ahead of us.

Having done this for five or six years now, I've lost count, I feel like I am a member of this jolly group already. Although I know I have to put in more time to earn one of those metal badges of honor.

I am told that to deserve that golden metallic nameplate will take decades. Unfortunately, the BSP Charter has imposed a two-term limit to the central bank governor.

Before I digress any further, I hope you will not mind if I, as one who feels part of the group already, would go directly to the meat of my remarks this afternoon.

2012 – A year of transition for the global economy

2012 has been described by economic analysts as a year of transition.

The year began with economic policy makers in the advanced economies wrapped with uncertainty about whether their politicians would be able to deliver the required votes on economic reforms essential for the resolution of the European sovereign debt crisis and the aversion of the US fiscal cliff. Markets were jittery and credit spreads were high.

In the meantime, emerging market (EM) economies policy makers on the other side of the globe while doing relatively better, had become increasingly concerned with "spillover" to their economies, given the relative importance of Europe and the US as trading partners to these economies.

In meeting after meeting among EM central bankers, the questions we asked of each other were: "How could we avoid any adverse effect on our own economies? How much would any spillover be?"

Crisis prevention and mitigation had thus become the mantra of policy makers across the globe.

In a major way, central bankers stepped in while the markets waited for the political resolution to the twin issues.

Central bankers became the catalysts for preventing another global financial crisis from erupting. Among others, the ECB's OMT (or Outright Monetary Transactions Program) and the Fed's QE3 (or its third offering of Quantitative Easing) provided the financial markets with both the “actual” liquidity and the “psychological” calm that they needed to break their crisis mentality.

Now, Europe seems to be getting closer to a resolution to its debt problems. The US economic growth appears to be gaining some traction, although it is still a work in progress.

Even as the medium-term implications are still unclear, the fact that the US fiscal cliff has been avoided over the weekend provided support to the markets when they opened yesterday.

Risk appetite has again emerged. And as one commentary I read said, “Happy New Year – Risk on!”

In our own backyard and in response to these dual concerns, the BSP calibrated domestic monetary conditions by cutting our policy rates by a cumulative 100 basis points. This move reduced our borrowing rate from 4.5 percent to 3.5 percent.

The BSP was able to reduce its policy rates by this much because the domestic inflation outlook continues to be manageable.

The easy monetary policy encouraged banks to also reduce their lending rates, thereby supporting domestic investment and consumption.

The Philippine banking system remained sound and stable in 2012, allowing it to effectively intermediate funds to productive uses even during times of global uncertainty.

Our banking system continued to experience solid asset growth, improve the quality of its assets, and keep its capitalization above international norms and national standards.

As events unfolded, the projected weak growth in the advanced economies didn’t spill over to all emerging markets in the form we thought they would.

As you are aware, the Philippine economy grew stronger-than-expected in the first three quarters of 2012.

The 6.5 percent growth posted during the period surpassed the national government’s (NG) target range of 5.0–6.0 percent growth for the year.

In fact, the country’s growth in the third quarter of 2012 of 7.1 percent was the highest among the ASEAN countries, which all posted positive growth.

Indonesia grew at 6.2 percent, Malaysia 5.2. percent, Vietnam 4.7 percent, Thailand 3.0 percent, and Singapore 0.3 percent.

In addition to easy monetary conditions, the timely increases in government spending and increased private sector activity helped the Philippines stay on this uptrend.

The robust output growth was achieved in a low inflation environment.

Headline inflation during the first eleven months of 2012 of 3.2 percent remains well-within the government’s inflation target range of 3.0–5.0 percent for the year. This would make 2012 the fourth consecutive year that the BSP is able to keep inflation to within the government’s target range.

With this continued benign inflation outlook, businesses could expect the BSP to keep interest rates at low levels in 2013.

In other words, ladies and gentlemen, the Philippines has again achieved the sought-after alignment of strong growth and low inflation…

This could lead one to ask: Is the Philippine economy a super economy that it appears to have been immune from any adverse impact from global developments?

The answer – ladies and gentlemen – is no, it isn’t.

2012 – A year of continued strong capital flows for the Philippines. A year that tested institutions

Global developments did spill over to the Philippines but not in the form of slower economic growth.

Global developments spilled over to the Philippines in the form of surges in capital flows to the economy. Which have been manifested in volatilities in the financial markets.

Take the exchange rate. This slide shows that in 2012, the peso has been on an appreciating trend.

Take a look at the stock market. This slide shows an appreciating trend also for the stock market.

Take a look at the Tbills market, where yields have been on a downtrend.

All these point to strong investor interest in our currency, our stock market and our GS market. In this year of transition, our better growth prospects have continued to make the economy a magnet for capital flows. With investment grade status just around the corner, we could continue to see more foreign capital come into our domestic financial markets.

How has the BSP addressed these surges in capital flows?

BSP follows a pragmatic approach. We employ a menu of policy options – our enhanced policy tool kit.

First, our use of policy tools is targeted. For structural flows (such as strong remittances and other current account receipts), we allow for some currency appreciation. It would be imprudent to go against a trend supported by fundamental flows.

But for the speculative kind, we impose market-based regulations aimed at providing the incentive structure for market participants to correctly price their transactions, taking into account associated risks.

Second, we use tools to address systemic risks.

As we showed through earlier graphs on the movements in the peso, PSE and GS, capital flows have not only impacted the exchange rate. They also affected the other financial markets and economic prices.

During this crisis, we learned that monetary policy tools are not enough to contain the broad-based impact of capital flows. During this crisis, we learned that there is a need to complement monetary policy with macroprudential policy tools.

The BSP has never targeted an exchange rate level nor mandated specific price levels for specific market transactions. Instead, our policy has been to craft regulations that would help ensure that market participants appreciate the inherent risks of the transactions they enter into. In the case of capital flows, the market must be aware that flows which come in quickly into the economy, could also just as quickly flow out. This is often referred to as sudden stop or capital flow reversal.

So far, this policy has resulted in containing the volatility in exchange rate movements to within the middle of the range of other regional currencies, although the peso has performed relatively more strongly than in previous years.

In an environment where the movement of the exchange rate determines the financial wealth of different economic sectors and affects different sectors differently, this policy has been determined as fair.

Beyond capital flow management policies, the economy has been successful against shocks from external volatilities because of past reforms that have built stronger institutions. What are some of these?

First, a disciplined monetary policy framework, with a clear focus on our mandate. Second, sound and stable banking system, as reflected in well-capitalized and better-governed banks. Third, a robust external position and payment dynamics characterized by continued build-up in foreign exchange reserves and a lower external debt-to-GDP ratio. The NG is targeting a GDP growth of 6–7% in 2013 while for inflation, its 2013 target range is 3–5%.

Clearly, the Philippines performed quite well in 2012.

While 2012 was a year of transition for the global economy. For the Philippines, I believe, 2012 could more appropriately be characterized as a year of consolidation, when all the outcomes, as desired from reforms instituted, have essentially fallen into place and fitted together. Sound macroeconomic policies and structural reforms have led to investor confidence and steady economic growth in a non-inflationary environment.

2013 – Are we out of the woods yet? No, continued vigilance is needed amid relative stability

Going into 2013 in a state of relative calm, is the global economy out of the woods? With the confluence of strong domestic growth and low inflation, is the Philippines in a clearing?

While we expect the Philippines to be resilient, we are also aware that the country is not fully immune to the volatilities in the external front. While there seems to be relative global stability at the moment, risks remain.

What are some of these risks?

- There may be delays in further political reforms needed for dealing with the euro area sovereign debt crisis.
- The US still faces sizable medium-term fiscal tightening.
- These two risks are highly politically-related problems, which again may require central banks in advanced economies to keep easy monetary conditions.
- In turn, these could lead to more capital flows to emerging economies.
- We are also monitoring developments in China, to see if we would see a slowdown or a return to strong growth that together with a recovery in the US, could push global commodity prices higher.
- We are also watchful of geopolitical developments in the Middle East as these could impact on the supply chain for oil.

These are some of the risks that we keep an eye on. Given the highly integrated nature of economic and financial transactions today, external developments such as these, could impact on our domestic growth and inflation processes – including on domestic utility and gas pump prices.

BSP's policy thrusts moving forward

The BSP welcomes the seeming respite from crisis which we are now experiencing, but we continue to keep our ears close to the ground to identify looming pressures. More specifically:

On monetary policy, we will sharpen economic surveillance of shifts in the domestic and global inflation dynamics, including any brewing asset price pressures.

On financial sector policy, we continue to improve the microprudential supervision of banks and pursue macroprudential regulation with equal vigor to address potential systemic risks. In line with this, we will implement the Basel 3 capital requirements for universal and commercial banks (U/KBs) by January 2014.

Beyond the preservation of monetary and financial stability, the BSP will also continue its advocacies to support local enterprises, promote inclusive growth and help alleviate poverty. Thus, the BSP will sustain its advocacies on microfinance, financial inclusion, consumer protection and financial education with greater energy.

On the external front, the BSP will continue to maintain a market-determined exchange rate; keep a comfortable level of reserves; and continue to promote external debt sustainability by keeping the country's outstanding external debt manageable.

In 2013, as policies further engender a sound domestic macroeconomy, we foresee continued solid economic growth amidst stable prices, a relatively stable exchange rate, and a responsive banking system that is able to withstand significant external shocks.

Conclusion

Ladies and gentlemen, 2012 was a year of transition for the global economy and a year of further strengthening and consolidation for the Philippine economy.

In the face of the relative economic stability we have gained during this transition, and the support of domestic policy makers in our period of consolidation, it is my hope that Rotarians would make 2013 a year of expansion. A year when all of you would seek – more actively – every opportunity to create a better life not only for yourselves, but for a greater majority of our countrymen.

Transition brings a traveler from one point in his journey to the next. Consolidation strengthens his foothold at every point. Expansion provides the traveler with more options during his journey.

The private sector represented by Rotarians, and the government are all travelers on this economic journey. It is my hope , therefore, that as you and the BSP take on the challenges that our path throw at us, we would be able to continue working together to bring our country to the next point. One that is prosperous for more, if not for all, Filipinos.