Amando M Tetangco, Jr: Upgrades and strong growth – dealing with the short-term to get to the end goal

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (the central bank of the Philippines), at The Asset Forum, Makati City, 26 June 2013.

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These are interesting times…

As I survey this ballroom, I see that in our midst are some of the individuals most affected by the global and domestic developments over the last few weeks. I was on my way – literally on the road – to a Governors' meeting in Switzerland on Thursday when news of the market's reaction to the Fed's statements hit my blackberry. The divergence in what the guidance the Fed meant to convey about its policy and how the market interpreted Mr. Bernanke's statements and his assessment of the state of the US economy has created some furor across financial markets around the globe, including our own local financial markets.

I have been asked what I thought about the recent market movements. I say, this market price action is a good thing. It is good because it helps put a brake somehow on the exuberance, and thereby help reduce some of the risks from bubble formation in certain asset classes that could lead to more financial market imbalances. Have the movements been excessive? Well, rather than answering that question, I would say, the recent market movement can help separate the "wheat" from the "chaff" – or to those who enjoy a good glass of beer, help raise the "head" to the top of the glass. When these separations are completed, the process could actually create opportunities for those who keep their eye on the ball. Let me therefore repeat… we live in very interesting times.

Times like this remind me of the one clear fact I have learned, first as head of BSP's Treasury and now as BSP Governor – "There is always volatility on the way to recovery. The road to recovery is never a straight path." And the one clear lesson I have learned from periods of volatility is this: "Keep the main things, main." In other words, focus on your goal and don't be distracted because volatility is inevitable. I hope you will indulge me when I say that my nearly four decades of central banking experience bear me on this assertion.

To help me keep the main things main when I am faced with any situation, I follow three simple steps, "my triple A's" which will essentially be the outline of my remarks this afternoon: 1) Appreciate the knowns – what is in my arsenal. 2) Anticipate the unknowns – what are the risks that my arsenal can't handle now. And finally, 3) Act on the known, mindful that there are unknowns – or how can I be creative to address the potential impact of what could transpire when the knowns become entangled with the previously unknown?

First, let's appreciate the knowns. Ladies and gentlemen, the events of the last couple of weeks notwithstanding, these are what we undeniably know:

1. The Philippine fundamentals are intact. Friends, this is not a cliché. It is not meant to be a bumper sticker. It is a statement that I hope you would not take lightly. On one hand, Q1 2013 GDP grew at 7.8 percent. Divorcing from the fact that this was the highest Q1 growth in the region (better even than China's), this growth was supported by capital formation and public spending on infrastructure. In other words, the economy is being buoyed by expenditures that would cement the growth to a sustainable level. At the same time, year-to-date average inflation of 3.0 percent is at the lower end of our inflation target range. Over the policy horizon, the BSP expects inflation to fall well-within the government's official target range of 3-5 percent.

Clearly, the Philippine fundamental story remains solid as we continue to enjoy the positive convergence of high growth and low inflation.

2. The Philippine banking system is sound. Again, this is not to be taken as a trite phrase. The banking system is growing steadily, creating a solid base for domestic retail funding. It is also more than adequately capitalized and the BSP does not foresee any major difficulties for the system to meet the requirements of the early adoption of the capital requirements of Basel 3 in January 2014.

3. The Philippine external position is robust. The GIR at over $82B has been supported by strong current account receipts that are not easily affected by changes in the global operating environment. At about 12 months' worth of imports of goods and services, the GIR provides a hearty cushion to external shocks.

4. The Philippines' liquidity conditions are adequate and credit growth is robust. Together, these two support healthy economic growth.

Ladies and gentlemen, these statements are undeniable. And these developments have led to the country achieving investment grade rating from two of the three major western credit rating agencies. In fact, the organizers of this event have built this forum on the theme of the country's investment grade rating, which I will come to shortly.

So, then you might ask, if it is all good, then why have the domestic financial markets sold off in the last few days? To answer this, let's now move to the second step: Anticipate the unknowns.

Our financial markets have been affected by the recent global developments because financial markets have become increasingly integrated. We pushed hard to achieve investment grade rating precisely because, in a globally integrated market, the independent rating of a credit rating agency helps market participants distinguish between good and better investment destinations. Add to this, the combination of the accommodative monetary policy in the advanced economies, on one hand, and the good growth prospects in emerging market economies (such as the Philippines), on the other. The confluence of these elements has indeed made the Philippines a magnet for capital flows, i.e., portfolio flows that are looking for better yields.

Still, the good story behind the investment grade rating and strong capital flows begs the question, why the sell off? I'm afraid given our collective years of market experience, you would agree with me when I say that there are three specific risks an integrated financial market faces – Capital flow reversal, market overshooting, and the loss of market confidence. If we are able to scope these risks, our problems would possibly go away. To scope these risks, however, both policy makers and market participants must measure two things – 1) speed and 2) magnitude. We must find answers to the questions of – by how much and how fast could capital flow reverse? By how much and in which direction will market overshoot? By how much and in what form would loss of market confidence manifest itself? The problems would go away even faster, if there is a convergence in the assessments of policy makers and the market in all of these.

But these variables are not easily quantifiable with any measure of accuracy. To address this problem, the BSP has therefore had to constantly sharpen our market surveillance skills, enhance our forecasting models, and widen the breadth of our regional cooperation efforts. I hope the market is able to appreciate this fact and see that we have achieved some amount of success in all these fronts.

Which brings me to the third step – Act on the known, but be mindful of the unknown. This is a policy that the BSP adheres to with diligence and circumspection. Our recent monetary policy actions, responses in the form of macroprudential measures and refinements to the manner in which we conduct our open market operations are examples of this.

Ladies and gentlemen, the Philippines, in part through the efforts of the BSP, has sufficient cushions to ride out the recent bout of financial market volatility and take advantage of the opportunities that would present themselves as the Fed-forecasted US economic growth indeed gains more solid traction. Liquidity – both peso and dollar – remains ample and the

BSP is prepared to ensure that the financial system remains adequately lubricated during this period of global normalization.

I know that was quite a mouthful and from the perspective of treasury players, perhaps too broad and macro. I know that what the market really wants to hear from the BSP governor is this – where are the exchange and interest rates headed?

I don't want to suffer the same fate as Bernanke had. So I will make it clear – my message today is this: the Philippine fundamentals are solid, and we have built up safeguards to ride out the volatilities. Therefore, at the moment, there is no need for us to deviate from our current policy stance.

The exchange rate will continue to be market-determined, and the BSP will maintain its strategic market presence to avoid excesses in volatilities and to provide appropriate market guidance.

Monetary policy will continue to be conducted in consideration of the inflation outlook and mindful of any financial stability pressures, which in our current assessment are benign.

The challenge for all of us is preparedness. The BSP will continue to work towards an operating environment that would help businesses and consumers plan for the medium and long-term. In the near-term, however, we look to you in the market to help mitigate market volatilities so that those whom we both serve could cross through, get past these volatilities and in the end reach their ultimate goals of a better life ahead. Maraming salamat.