Amando M Tetangco, Jr: The Philippine economy – amidst global headwinds, leveraging on domestic tailwinds to stay the course

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the Foreign Correspondents Association of the Philippines (FOCAP) Media Forum, Manila 29 November 2013.

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Good morning.

In the American tradition, today, the day after Thanksgiving Day, is called "Black Friday" – the "official" first day of Christmas shopping. Picture herds of early birds lining up retail stores to catch the biggest sales. Consumer watchdogs in America would be detailing on Monday whether this year's Black Friday recorded a larger sales number than previous years. Undoubtedly, the result of the surveys would provide the Fed with additional input as they decide whether to taper sooner rather than later. The numbers could also help answer the question of whether the Fed has been successful in steering domestic consumption enough to sustain positive economic growth.

So far, so good…

In the last few years, external factors, particularly, the Fed signals have exerted greater impact on the domestic market. This has been the case on two fronts – 1) financial market volatility and, 2) external trade. The other external risks we have been watchful of are the tepid recovery in Europe, the impact of Abenomics, and the growth story in China.

So far, our calibrated use of our economic policy tool kit – both traditional policy tools and macroprudential measures – has been successful in taming financial market volatility and in supporting domestic aggregate demand to help make up for any weaknesses in external trade. Just to cite some indicators. Q3 2013 growth at 7.0 percent is the 59th consecutive quarter of positive GDP growth since 1999. The last five consecutive quarters all registered growth rates of 7 percent or more. This is not a fluke. The Philippine growth story has structural roots. Inflation has been within target for the last four years. Our current account has consistently been in surplus for over a decade now. Our gross international reserves have been at record highs. And our banking system balance sheets remain strong, with NPL ratios continuing their decline to levels lower than pre-1997 crisis.

Shall we, however, continue to live in this Goldilocks world – where everything seems to be just right – where the porridge is not too hot, or too cold. Where the bed is neither too hard nor too soft. Where the chair is not too big or not too small? Are there other risks that lurk? How do we intend to respond to these? Would we be surprised like Goldilocks was when the Bear family arrived and found Goldilocks sleeping in one of the beds?

Then came the storm…

In a way, Yolanda can be considered as a "surprise" that hit us. Regions 6, 7, and 8 account for about 12.7 pct of 2012 GDP. Latest estimates from the NDRRMC, put damage to property, industry and agriculture in these regions at P24.5B (as of 26 Nov 2013).

What is the impact of Yolanda on domestic growth? On domestic inflation? Current assessments show that the impact on overall GDP in 2013 would be manageable. The expected expenditures for relief, rehab and reconstruction should help keep GDP in 2013 and 2014 within the NG target.

Inflation, on the other hand, will likely increase in November and December from the October level of 2.9 pct. But given that the weight of the affected regions in the national CPI is relatively small, the impact of the regional price increases over the two month period on the overall inflation in 2013 should also not be that significant. Over the balance of the policy horizon, inflation is expected to stay around the middle of the target range.

Risks remain…

Before Yolanda, BSP had been keeping a close watch on the spillover effects of global developments. Specifically, 1) rapid domestic liquidity growth, 2) strong domestic credit growth; and 3) potential asset bubbles. I am often asked the questions – Is the BSP not worried about strong liquidity growth, which tipped 30 percent in August and September? Is the BSP not concerned with credit growth, which has been growing at double digit for over a year now? Does the BSP see an asset bubble? Let me consider each briefly.

On liquidity growth – The uptick in liquidity growth will only be for a short transition period, as banks adjust to operational refinements to the access to the BSP's SDA facility. With banks rebalancing portfolios to take these changes into consideration, banks could be expected to more expeditiously and effectively channel the SDA funds to the productive sectors.

On credit growth – In our assessment, the banks have made very deliberate choices to continue to lend bulk of their funds to the relatively capital-intensive productive sectors of the economy, i.e., the manufacturing and real estate sectors. Our surveys show also that even as banks have increased their lending activities, they have not relaxed their lending standards. We are confident that given the current regulatory environment and the banks' observed risk appetite, banks will continue to be discriminating in the projects they will fund. Indeed, there is room to grow further in this respect, given our ratio of credit to GDP remains below that of our peers in the region.

On strong asset prices – We do not yet see asset bubbles forming. But developments bear watching. Our assessments show that demand for real property assets continues to be based on fundamentals, i.e., there is real demand from OFWs, expatriates, and the BPO sector. The demand is also indicative of the increase in the incomes of these sectors, as well as the growing young professional segment of the economy. The changing lifestyle of these workers has led to an increase in requirements for housing near the workplace during the week as they go home to the province only on weekends.

The BSP has been "criticized" as fuelling a credit and asset bubble through low interest rates. I would say, this view is rather narrow. The BSP has reduced its policy rates to support growth to the extent the inflation outlook has allowed it to. In addition, we have deployed macroprudential measures during the early stages of strong capital inflows and even earlier to help tighten regulatory screws. These include concentration limits on real estate lending, limits on open FX positions, and higher risk weight for NDF transactions. The BSP is mindful that there are many moving parts to the economic equation, and we will always consider the financial stability implications of our policy actions.

What is our game plan for dealing with these issues and their attendant risks?

The country has sufficient policy space to deal with external shocks and their spillovers to the domestic economy.

For one, the benign inflation environment affords the BSP the flexibility to fine-tune policy settings, as necessary, to support the domestic economy. The emerging estimates over the policy horizon continue to show within-target inflation. Therefore at this time, policy settings appear to continue to be appropriate. Even as inflation is within our comfort zones, we have it at the front burner. Our commitment to price stability is not only for its own sake but because this lays down the conditions for sustainable and balanced growth.

At the same time, prudent fiscal management has enabled the NG to keep the fiscal deficit within target and on track with fiscal objectives.[1] The NG has gained fiscal space that could be utilized to boost the economy, when necessary.

In addition, the BSP has also enhanced its policy toolkit to include macroprudential measures that would address the financial stability pressures of external factors such as capital flows.

The BSP will continue to maintain a flexible exchange rate policy that allows the market essentially to determine the exchange rate, but with scope for official action to ensure against excessive volatilities.

We have also been actively pursuing banking sector reforms that will enhance the soundness of the system, engender healthy domestic competition while enabling our banks to level up against peers in the region. Alongside beefing up the banking sector, we will continue to broaden our efforts at financial literacy and inclusion.

Conclusion:

While the country is exposed to global headwinds, and some domestic storm surges, we are focused on our price and financial stability mandates. In the presence of global headwinds, we have the tools that would allow us to capitalize on domestic tailwinds.

Warren Buffet once said, “You only find out who is swimming naked when the tide goes out”. Well, ladies and gentlemen, I am confident that when the tide does go out, the Philippines will be found well-clothed.

[1] Jan–Sept 2013 Programmed deficit is P144.5B vs. Actual deficit of P101.2B.