Amando M Tetangco, Jr: The strength of retail – in a wider ASEAN economy

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the Chamber of Thrift Banks (CTB) Annual Convention, Makati City, 19 March 2014.

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Every year, your industry comes together to exchange views on the prospects for the year ahead. With your theme this year "Thrift Banks: Preparing for 2015 ASEAN Integration", the thrift banking industry is recognizing a development that has quietly evolved through the years and will soon crystalize.

ASEAN integration – broadly through the ASEAN Financial Integration Framework or AFIF and more specifically through the ASEAN Banking Integration Framework or ABIF – will come to fruition in line with the ASEAN 2020 vision that was enunciated way back in 2007. It is, in this sense, imminent and the Chamber is being responsive by preparing for this eventuality. In fact, for this Convention, the organizers have lined up experts to tackle different facets of integration.

My role this morning is to describe the broad economic landscape, including the challenges and opportunities, that the thrift banking industry currently faces against the backdrop of ASEAN integration. The Chamber is being strategic in this way, for clearly, understanding one's starting point and initial conditions is just as important as defining one's final destination.

The economy at large

Let me begin therefore with the economy at large. It is tempting to simply cite the array of indicators that show that the macro-economy is strong. In 2013, we again saw the convergence of high growth and stable prices as the country posted a real gross domestic product growth rate of 7.2 percent amid an inflation of three percent. This is on top of the real GDP growth of 6.8 percent and a 3.2 percent inflation rate in 2012.

We need to appreciate these numbers not just because they are better than the performance numbers that came out of 2011 (which were 3.6% real GDP growth and 4.6% inflation rate). Instead, these are excellent numbers because of the calamities that befell us during the period.[1]

On the external front, the balance of payments position was at USD5.1 billion for 2013. And the Gross International Reserves at almost 12 months' worth of imports of goods and payments of services continues to provide ample cushion against external vulnerabilities.

We should certainly point out that the growth of the real economy is supported by and feeds into a banking industry whose strength is well documented. Standard & Poor's latest banking outlook (February 2014) notes that "Philippine banks will likely continue to benefit from the country's buoyant economic prospects in 2014". And in Moody's own banking report (2014 Outlook dated December 2013), the Philippines is the only jurisdiction whose banking system they rate to have a positive outlook.

Thrift banks as an industry may be small when compared to its universal and commercial bank peers. But it is by no means left behind. Peso deposits mobilized grew by 22 percent in

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[1] Typhoon Pablo is the strongest tropical cyclone to ever hit Mindanao. The Zamboanga crisis was a 30-day stand-off. The earthquake in Bohol was the deadliest earthquake the Philippines has experienced in 23 years while Typhoon Yolanda is the most devastating typhoon on record.

2013, loans expanded by 13 percent, total resources rose by 16 percent, while profitability increased by 18 percent.

The challenges that lie ahead

All these should be more than enough reason to be optimistic about the future of the banking industry. But financial markets can swiftly change course… Everyone here is more than aware that the saving that takes a long time to put together could be the investment that loses value in a "mark-to-market" second. And when financial markets get shocked, the impact leaves a mark in both depth and breadth.

As an industry then, your stereotypical challenge is to maximize your strengths while addressing your weaknesses… This brings us to the question of what a thrift bank represents… This is a question of "character" which would define the path that you will take as well as those side roads that you ought to avoid.

As I look at your Asset-Liability structure, I note that 86 percent of your liabilities are peso deposits and 66 percent of assets are in loans. Although your universal and commercial bank peers have peso deposits at roughly the same magnitude (72 percent), U/KBs only have 47 percent of their assets in loans.

This fact is material. Without another avenue for generating revenues, the viability of the thrift bank model must rest in the balance between sourcing retail saving and deploying the same as loans. And as you dig deeper into the loan portfolio, it becomes readily evident that the bulk of the credits lie in consumer finance. From this perspective, consumer finance is therefore at the very crux of what defines thrift banks.

The promise of the Filipino consumer

The good news is that several indicators suggest that the prospects of our consumer finance market remains promising.

Like all other jurisdictions in ASEAN, our population growth has actually slowed substantially from 3.35 percent per annum in 1960 to 1.72 percent in 2012.[2] Despite this, some 35 percent of Filipinos are younger than 15 years old as of end-2012. This percentage is much higher than the rest of ASEAN which averages at only 25.8 percent. It is also much higher than those of China, Japan and South Korea which average 17.7 percent, that of North America at 19.3 percent and the euro area at 15.3 percent.

What these numbers mean is that the Philippines will see a greater proportion of its population becoming consumers in the next few decades. This leaves the future market for consumer needs very potent.

This is not to say that the current consumer market is not already attractive. World Bank data show, for example, that cellular subscriptions per 100 individuals is already at nearly 107 in the Philippines, higher than the 94 subscriptions average for the BCLMV countries (Brunei, Cambodia, Lao, Myanmar and Vietnam), and the 66 subscriptions for China, Japan and Korea.

Our internet penetration rate is not that far off, where we have about 36 internet users per 100 individuals versus the 40 on average in China, Japan and Korea and the 45 users for Singapore, Thailand, Malaysia and Indonesia collectively. But as we develop our young population to be more tech-savvy, one surely expects our numbers to keep on rising.

I really do not have to mention the bigger ticket items since this is your area of focus. But to put it on record, we have seen outstanding auto loans, credit card receivables and residential

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2 All the data in this section are taken from the World Bank's World Development Indicators 2013 edition.

real estate loans booked by thrift banks increase by Php 33 billion, Php 253 million and Php 29 billion respectively over the past three years alone. This translates to annualized growth rates of 15 percent, 14 percent and nine percent respectively.

ASEAN integration and the consumer market

Ladies and gentlemen, clearly, demographics favor you. Furthermore, ASEAN integration opens up a bigger regional market. After all, the economic prospects of ASEAN as a whole have always been premised on its retail market. ASEAN has a base of over 600 million individuals in 10 jurisdictions whose collective GDP in 2012 amounted to USD2.27 trillion. While this amount only represents 3.13 percent of the world's nominal GDP, ASEAN as a collective aggrupation would be the world's 8th largest economy, only following the US, China, Japan, Germany, France, UK and Brazil.[3]

Prospects for Philippine thrift banks

On the whole then, an integrated ASEAN is a natural treasure trove for the consumer finance market. With ASEAN gross saving as a percentage to GDP just above 30 percent while the world is at under 22 percent, the potential for ASEAN is not just its size but also its saving.[4]

As an industry structured to mobilize retail saving and generate credit exposures to the consumer finance market, the prospects seem tailor-fit for you. In fact, within that framework, the Philippines does stand out even further because of the specific demographic profile that I described earlier.

Does this mean then that your corporate future is secured?

Unfortunately, the potential that is ASEAN and our own demographic advantages do not, on their own, create balance sheets. There are still strategic decisions to be made and tactical plans to be executed for these identified positives to be reflected as reality on your balance sheets.

What is clear at this juncture is that market competition is changing the traditional niches. Internally, the larger banks are extending their network into areas where smaller banks traditionally operate while banks have increasingly tapped into the consumer finance space.

Externally, ASEAN is poised to further integrate under the mantra of an ASEAN that is for ASEAN. Just as we will be exposed to the opportunities of a bigger regional market, our economic prospects will also be targeted by interested regional entities.

In both cases, they create competitive pressure for TBs and this, in our view, presents the main strategic issue for thrift banks. Despite all the gains achieved in recent years, you and I will agree that status quo cannot be an option.

The ideal solution is to "right size", getting bigger so that you are better equipped to handle competitive risks while getting smaller in risk exposures where the bank cannot develop a competitive advantage within a reasonable period.

This is all about managing risks, a familiar point that the BSP has raised at every opportunity. The difference between today and last year's convention, however, is that the financial market has re-calibrated towards higher interest rate levels… the much awaited Fed taper has begun and the normalization in easy money conditions has commenced… Furthermore, the ASEAN's collective resolve to transform into an economic community is upon us.

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3 Based on nominal 2012 GDP denominated in USD. The ranking is consistent across tables provided separately by the United Nations, the IMF and the World Bank.

4 Raw data from the World Development Indicators.

Ladies and gentlemen, the prospects for thrift banks in the Philippines indeed appear to be very strong. But the attractiveness of those prospects is also catching the attention of other banks in the Philippines and most likely, also of banks in the region. You simply have to get stronger to compete in this evolving market. How you become stronger and in what form remains the critical issue before you.

I would like to believe that a thriving domestic economy, supportive demographics and your traditional strength in consumer finance should give you a healthy level of confidence as you find your place under the ASEAN sun. These, along with the innate Filipino ingenuity and talent in thriving amid challenges, should serve you well in this journey.

I am sure that your resource speakers today will provide various insights and direction during their respective presentations. I then wish you a very productive convention and I thank you for your attention.

Maraming salamat po sa inyong lahat.