Amando M Tetangco, Jr: Seizing opportunities amid a growing banking environment

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (the central bank of the Philippines), at the Asian Bankers' Philippines International Banking Convention. Makati City, 29 August 2014.

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The theme of your convention this year is "The Drive for Growth and Sustainability in the Philippine Banking System". This is quite timely in light of the government's goal to push the real economy onto a sustainable upward growth trajectory. Given that an essential component to achieving this goal is a resilient, responsive and responsible banking system, today's convention presents a good platform for discussing the state of the Philippine economy and the banking system. We hope the different sessions would help bring to fore ways by which we can harness the power of the banking system to raise economic growth so that it would deliver a higher quality of life for more.

Opportunities

Let me begin therefore with an overview of the opportunities that could drive growth. Well, the Philippines is listed as the world's 12th largest in terms of population. We are a country of 100 million people, mostly young, with a median age projected to stay around 30 years in the next two decades.

Ours is a growing and consuming population which transacts about 2.5 billion payments per month in cash and check payments with electronic transactions at only 1% of the total. This represents opportunities to technology innovations that will extend the reach of efficient and competitive payments systems across our country. After all, our people embrace technology and mobile communications in a manner that has raised our mobile phones to around 110 million, more than our population.

In the last nine quarters, we saw deposit accounts grow by nearly 7 million or 17.5% to nearly 47 million. About 93% of the new accounts have outstanding balances of about one hundred thousand pesos or less. This shows sustained expansion of the retail base of savers. This is a base that represents those who have learned the value of safekeeping their hard-earned savings and who perhaps aspire to migrate from savers to investors in the future.

Ladies and gentlemen, these are just a few figures and trends that define opportunities.

Macroeconomic perspectives

Indeed, the Philippines is a land of opportunity and growth. And the opportunities here go beyond the consumer market. For a better perspective, let us take a macro-point of view.

First, the country's GDP growth continues to be above its long-term average. Although there has been some moderation in growth, the country's GDP continues to prove resilient against external and domestic headwinds. Philippine economic growth accelerated to 6.4 percent in the second quarter of 2014, the second fastest among major Asian countries tied with Malaysia.

This growth trend supports the view of the BSP that the economy has the capacity to absorb the recent tightening in monetary policy settings.

Second, inflation has been within the national government's target ranges in the last five years and is expected to remain so over the policy horizon, albeit closer to the upper end of our target range. This, notwithstanding risks to the inflation outlook that include price pressures from higher food prices short-term volatility in international oil prices and pending petitions for adjustments in power rates and transport fares. The BSP is closely monitoring these risks and their impact on inflation.

Third, the country continues to enjoy a healthy external liquidity position, which should provide a strong buffer against potential external shocks. The current account continues to perform well due to resilient remittances from Overseas Filipinos, sustained rise in BPO revenues, and higher tourist receipts.

Cash remittances from OFs coursed through banks for the period January to June 2014 reached US$11.4 billion, higher by 5.8 percent compared to the same period a year ago. The country's Gross International Reserves stood at US$80.6 billion as of end-July 2014, enough to cover 11 months' worth of imports of goods and payments of services and income. That level is also equivalent to 7.7 times the country's short-term external debt based on original maturity, and 5.6 times based on residual maturity. These figures are above commonly used standards for these metrics.

Fourth, our banking sector's scorecard as of June 2014 shows consolidated figures for assets, loans, deposits and capital at uniformly record high levels. In particular: assets were at P10.28 trillion; loans stood at P5.2 trillion; deposits climbed to P7.9 trillion; capital registered at P1.2 trillion. In addition, our semestral stress tests validate that our universal and commercial banks are in a position to withstand extreme but plausible shocks in credit and market risks.

Credit conditions, on the other hand, remain supportive of economic growth. Double-digit growth in bank loans continues, rising by 20% in June 2014 for universal and commercial banks. The sustained expansion in bank lending reflects the strong underpinnings of the domestic economy. Nevertheless, as in other jurisdictions, we are on guard for any possible build-up of asset price bubbles and its implications for the system and the economy, especially in the context of monetary policy normalization.

At this juncture, we are pleased to note that the NPL ratio of universal and commercial banks remains low at only 2.1% as of June 2014. This is a good indication that sustained loan growth has not come at the expense of credit quality.

Given all these, it can therefore be said that the financial pie has expanded and is getting even bigger as the real economy continues to expand.

Policy tracks towards strengthening the banking system

Even as we say this, however, economic literature presents evidence that for an economy to continue to expand, it is essential to have a well-functioning banking and financial system. Indeed economic growth helps to grow the financial sector, just as the finanical sector supports economic growth.

Consistent with this, the BSP has adopted essentially five tracks to strengthen our own banking system:

1. First, we have adopted regulations that would help ensure that our banks continue to operate soundly. In particular, we adopted the principles of the capital requirements for Basel 3, in "one go" and at a higher level than Basel standards starting January 2014.

Basel 3 is meant to reduce the risk of systemic banking crisis, with the quality of capital further improved to ensure its ability to absorb losses. Based on March 2014 Basel 3 CAR report, Philippine banks remained above the regulatory minimum requirement. On solo basis, CAR stood at 15.45%, of which Common Equity Tier 1 ratio accounts 13.44%. The BSP and the banking sector are collaborating on the forthcoming implementation of the other components of the Basel 3 framework.

2. Second, we continue to refine regulations to achieve greater financial inclusion, particularly leveraging off of technology by optimizing the use of electronic money. To illustrate, it took more than 160 years before the number of local bank offices reached 9,884 yet it only took 4 years before the number of e-money agents reached 10,620.

At the same time, the BSP continues to strengthen consumer protection with the release of a comprehensive consumer protection framework.

3. Third, we have worked to strengthen the governance in banks. In particular, we have imposed fit and proper criteria on directors, while clearly articulating their duties and responsibilities, including the expectation for each board member to exercise objective judgment at all times. Banks also have to institutionalize a Compliance System to reinforce checks and balances in the institution. Further, we have highlighted the importance of having an effective risk management system. All these are accompanied by regular monitoring and strengthened enforcement actions.

4. Fourth, we have fully supported the further liberalization of the entry of foreign banks into the Philippine market.

5. Fifth, we are committed to the timely and appropriate adoption of international banking reforms to our domestic economic conditions. We subscribe to the general principles and objectives of the international reform agenda, but we are also pragmatic in our approach to their adoption. While we are in agreement with the goals, we believe that implementation must follow the principle of proportionality to country-specific circumstances.

One such reform concerns Financial Market Infrastructures or FMIs, the piping that allows trades to be processed and critical risk information to be properly monitored. For a market such as the Philippines, this is critical but it is also a clear challenge.

Certainly, we need FMI pipelines to execute market transactions, provide transparency, ensure price discovery, introduce risk mitigation, and generate efficiencies. Nevertheless, many of the FMIs identified by global reforms may not be in synch with the scale of market activity and associated risk in most Asian jurisdictions.

Central counterparties, trade repositories and exchanges for OTC derivatives, among others, require a fair amount of investment and a lot of preparation. This is work that does not only involve the BSP, but other financial market regulators as well.

This is the reason why the financial market infrastructure as well as the other international reforms are being discussed at the Financial Sector Forum, which is composed of the BSP, the Insurance Commission, the Securities and Exchange Commission, and the Philippine Deposit Insurance Corporation.

Quality Improvement among our banks

Ladies and gentlemen, we have followed these policy tracks to strengthen our banking system. Within this framework, our banks could generally have the leeway to take on more risk exposures, if they so choose. In addition, the regulatory framework is such that it would allow banks to be able to withstand added, if not healthy, competition.

There are evolving competitive forces expected to come from banks outside the region which have an interest to service activities in the country as well as future Qualified ASEAN Banks (QABs) who exemplify ASEAN integration.

I am confident in the ability of our banks to be up to these challenges. Yes, we may not be a big market with big banks but our continuing reform agenda has made our banks stronger and more stable. And we have an economy whose prospects attract the interest of not just a few.

In Moody's recent publication on banking system outlooks covering 67 jurisdictions, the Philippines was the only banking jurisdiction rated positive. Add to this the fact that the

Economist Intelligence Unit (EIU) has rated our micro-finance policy framework as the best in the world for the past five years.

Indeed, there is something to be said about the quality of our banking environment and of the institutions that operate in it. With ample funding liquidity, the challenge for our banks is to identify those initiatives in the real economy, which can reasonably absorb available funding.

Challenges

Today, the Philippine banking industry is vastly different from what it was during the Asian Financial Crisis. We have achieved sizeable gains since then.

Moving forward, part of the challenge is to recognize that gains are never absolute. In this imperfect world, there is always something that can be made better or something that market needs to change in time especially since we operate in a global environment that is in constant change.

Among others, heightened financial and trade integration make our own domestic operations vulnerable to external factors. The most significant of these factors is the speed and degree of normalization of monetary policies in advanced economies and how these would impact their own growth prospects. Geopolitical risks that could impact trade and prices of international commodities add to our list of challenges.

On the domestic front, as I mentioned near the top of my remarks, the risks that tilt future inflation to the upside are mainly weather and supply side-related, as well as those stemming from volatilities in the financial markets. The BSP has acted pre-emptively to ward off these inflation threats through calibrated tightening of policy stance. We have earlier raised RR and increased SDA and the policy rates. We have opted to act in this manner so that banks and other stakeholders would be guided in their own assessments of the risks they face in their transactions. We will not hesitate to make further adjustments, if these are needed, in order to keep inflation expectation well-anchored and therewith limit the occurrence of second round effects. We will also continue to work with other agencies of government to address supply bottlenecks that affect movement of good and services. We will likewise remain vigilant that none of these effects pose risk to financial stability.

We will continue to be involved in initiatives in implementing governance reforms in the country, including our initiatives for AEC 2015. Finally, we will continue to work on a more inclusive financial system that that will sustain and promote inclusive growth.

Final thoughts

Ladies and gentlemen, I have shared my assessment of our prospects and flagged some key challenges. At the end of the day, we have to nurture the gains we have achieved through time and address the pending issues which we believe can only make us better.

Markets will always evolve, just as they are changing right now. But Philippine banks, in general, have proven themselves to be resilient while remaining responsive to the needs of stakeholders. This is the mark of a strong banking industry, one which can tap growth opportunities while acting responsibly in managing the public's savings.

In the end, it boils down to choices we make. And thus far, our record in the banking system speaks for itself.

Ladies and gentlemen, thank you for your attention. Mabuhay!