Amando M Tetangco, Jr: The Philippine economy going forward

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the Membership Meeting of the Rotary Club of Manila, Makati City, 8 January 2015.

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On behalf of the Bangko Sentral ng Pilipinas, I wish all of you a successful, meaningful and prosperous New Year!

Now, what are the chances these wishes will come true? Well, it depends largely on the choices you will make as professionals, businessmen, as family men and as members of the community living up to the Rotary Club of Manila's brand of public service.

From the point of view of the Bangko Sentral, what do we see? As your speaker in January last year, I described 2014 as a year to be marked with "continuing growth amidst recurrent risks and uncertainty." Ladies and gentlemen, all these came to pass.

In retrospect

In retrospect, we faced national and global difficulties – we had typhoons, uneven growth in the world economy, political unrest in the Middle East and Russia, and market uncertainties from divergent moves in the global markets.

But because we have done our homework and continued to implement our reform agenda, the Philippine economy stayed the course and continued to grow above trend.

In particular, for the first three quarters of 2014 the economy grew by 5.8 percent, in an environment of low and stable price movements. Full year inflation averaged 4.1 percent, marking 2014 the 6th consecutive year that inflation was within the target range of the Government.

Ladies and gentlemen, this was achieved because we were vigilant and took timely calibrated responses to unfolding events. In mid-2014, for instance, inflation edged higher on market talk of possibly tighter monetary conditions in the US. At the same time, inflation expectations began to rise while real and financial assets continued to climb.

To forestall a situation where our inflation target could be breached and to prevent potential asset bubbles, the BSP implemented a series of pre-emptive, calibrated monetary measures to tighten monetary conditions. Among others, we raised reserve requirements, our policy rate and also our SDA rate. We did these in steps to help guide the market's inflation expectations and to help the market better appreciate the risks inherent in the shifts in the monetary policy stances of major central banks, especially the US Fed. We also carefully communicated our policy intent to the market.

At the same time, international oil prices started to drop. Subsequently, inflation started to moderate and fall to the middle of the target range of 3–5 per cent inflation. We are pleased about this outcome. Inflation management is a crucial function of the BSP as it provides the stability that our economy and its stakeholders need.

Even as uncertainties in global markets led to some capital flow reversals and depreciation pressures on the peso, we were able to maintain a strong external liquidity position. The current account sustained its surplus because remittances, receipts from the tourism and BPO industries remained strong.

As a result, our gross international reserves settled at a robust $79.8 billion in December 2014, providing us buffers from possible external shocks. The reserves are enough to cover 10.2 months' worth of imports of goods and payments of services and income; it is also equivalent to 8.4 times the country's short-term external debt based on original maturity and six times based on residual maturity.

Our strong external position continues to be a source of confidence for our creditors and investors.

Another source of strength for the Philippine economy is our sound, stable and liquid banking system as public confidence has kept deposits growing to record-high levels. Among others, this has sustained double-digit growth rates in lending, particularly to the productive sectors of the economy.

Overall, our banks have strong balance sheets, solid asset growth, low NPL ratios and above-standard Capital Adequacy Ratios as a result of good governance practices and adherence to international best practice in risk management.

Thus, our banking sector continues to be highly rated by third party assessors. In particular, the Philippines received the only positive outlook among 69 jurisdictions assessed by Moody's, a major international credit rating agency.

Indeed, our banks are fully engaged with us in our efforts to help ensure that our system is sound, that its operations are aligned with international standards, and that its reach covers more of the previously unbanked or unserved areas.

In 2014, we endorsed Republic Act 10641 that allows the full entry of Foreign Banks in the Philippines and prepared the IRR for its implementation. With the approval of the IRR, additional foreign banks can now apply to operate in the Philippines either as a branch or as a wholly-owned subsidiary.

There are clear economic benefits for us from this new law: first, foreign banks can serve as vehicles for foreign direct investments into the Philippines; transfer of technology is second; and enhancement of human resource skills is third. All these will strengthen our banking system at a time when we are gearing up for the ASEAN Banking Integration Framework.

The IRR of this law reflects enhancements in the entry criteria for foreign banks – in particular, the new law focuses on the demonstrated expertise of a potential entrant as an established, reputable and financially sound bank. In addition, foreign banks interested to enter the Philippines are required to be widely-owned and publicly-listed in their home country.

In evaluating the entry applications of foreign banks, the Monetary Board shall also consider strategic relationships and reciprocity rights. This should reassure some sectors who fear that this law opens the floodgates to foreign entry. Indeed, there are requirements foreign banks have to meet and standards they have to hurdle.

I am also pleased to share that our regulations and programs enabled us to gain more ground in our goal to develop an inclusive financial system. In this connection, we continued to widen the reach of our financial learning program. We have also started the groundwork for a formal National Financial Inclusion Strategy that will pull together the efforts of various government agencies for a holistic approach to inclusive growth.

In other words, ladies and gentlemen, against a backdrop of solid growth, stable prices and a strong banking system, the Philippine economy is entering 2015 well-placed to face challenges from both domestic and external sources and move on to sustain growth amidst new challenges.

Independent credit rating agencies affirm this. In October 2014, Moody's joined Standard and Poor's in rating the Philippines one notch above the minimum investment-grade credit rating. In raising the rating, Moody's cited the government's ongoing efforts to reduce debt, improve fiscal management, and minimize vulnerability to external developments.

Risks moving forward in 2015

Moving forward, what do we see in 2015? What I can tell you with certainty is that 2015 will be a year of challenges and opportunities.

Externally, we see global growth continuing to be uneven – strong in some countries and fragile in other economies. As a consequence, monetary policies across the globe will continue to diverge as their economies move into opposite directions.

We see, on one hand, the US Federal Reserve and the Bank of England taking steps toward monetary policy normalization, as growth in their jurisdictions gain traction. On the other hand, the European Central Bank and the Bank of Japan are weighed down by their struggling economies and therefore anticipated to continue or accelerate their unconventional monetary policies or stimulus measures. China is in the same boat, as it is anticipated to go through a process of reforms in its financial sector, to prop its slowing economy.

To us, having protracted uneven global growth is a cause for concern as this could have significant implications for our own growth dynamics and impact trade and the service industry.

At the same time, policy divergence among advanced economies would also have an impact on our own domestic financial markets. Should the US economy continue to strengthen, yields on US dollar assets could also continue to rise. The growing difference in policy stances among major economies could result in polar destinations of capital flows and in the process…heighten volatilities in our own financial markets – including the peso, equity prices and yields on bonds.

BSP's policy thrusts

Given this scenario, we at the BSP, will continue to be watchful and ready to deploy appropriate policy actions in a timely manner to minimize potential adverse impact of volatile capital flow movements.

In the meantime, our earlier decisions to act preemptively to address potential risks to price and financial stability have given the BSP sufficient policy space to consider measures that may be required by emerging monetary conditions.

Ladies and gentlemen. What I have given you so far is the big picture.

At this point, I wish to share the process we go through in operationalizing our policies. This should reassure you that the BSP does NOT rely on a crystal ball nor does it craft policy in a vacuum.

We coordinate with various government agencies. For instance, the BSP is a resource agency of the Development and Budget Coordination Committee (DBCC). With the inputs of the DBCC members and the BSP, the DBCC formulates growth projections and approves inflation targets for the country.

The BSP then incorporates the growth targets into our own inflation forecasts, and makes appropriate adjustments to our policy rates to ensure that inflation would be within the approved target over the policy horizon. For 2015, the DBCC is projecting that the economy would grow 7–8 percent within an inflation target range of 2 to 4 percent.

The way we see it, the risks to inflation in 2015 are broadly balanced. Higher utility rates and LRT fares will be counterbalanced by lower international oil prices, which fell to around $50 per barrel this week, the lowest since 2009. For 2015, therefore, we expect inflation would be well-within the target range. This should provide the BSP the flexibility to keep policy rates at low and stable levels in support of economic growth.

On the exchange rate, another metric the BSP is always asked about, I can tell you that our policy remains the same. This means we will allow the exchange rate to be essentially determined by market forces.

As I mentioned earlier, we expect some volatility in the market in the near-term because of the growing consensus for a strong US dollar. But as in previous episodes of volatility and portfolio outflows, there will be core investors who will remain invested in the Philippines because of our positive growth prospects and sound fundamentals.

During these periods of volatility, you can expect the BSP to maintain a presence in the forex market to keep the movements aligned with fundamentals and with those of our peers in the region.

Aside from working on monetary stability, the BSP will continue its banking reform agenda appropriate to our own operating environment. These reforms will impact on the way banks do business with you, but these are calibrated to enhance the protection of bank clients and to ensure the stability of the financial and the economic system as a whole.

Conclusion

Ladies and gentlemen of the Rotary Club of Manila, whatever the Philippines has achieved in the past years is a result of close coordination between the public sector and the private sector.

As the monetary policymaker, the BSP will continue to promote an enabling environment for business and develop a more inclusive financial system that supports sustained and inclusive growth.

You will be happy to know therefore that from 2009 to 2013, the Philippines was consistently ranked as the best in the world in terms of the regulatory environment for microfinance.

In 2014, the Economist Intelligence Unit (EIU) named the Philippines as the top country in East and South Asia and the third in the world, with the most conducive environment for financial inclusion.

But beyond these recognitions, what we value is the impact of our gains in improving the lives of millions of Filipinos through financial inclusion, and particularly through microfinance. Nevertheless, we are mindful that there are so many more that we need to reach out to.

This is where successful professionals such as yourselves and organizations such as the Rotary Club of Manila can help make a difference.

The actual use of financial resources to create jobs and generate production for our country's economic growth are in your hands.

We at the BSP also look forward to working with you on financial inclusion programs that will attract more Filipinos to be part of the financial mainstream where money would be more widely available at prevailing commercial rates. Rates that are significantly lower than the 1,000% a year rate in the informal sector.

Imagine the beneficial impact this can bring to millions of our microentrepreneurs.

Let us therefore continue to work together to keep the Philippine economy growing and make lives better for Filipinos.

This is very much in keeping with the Rotary Club's two mottos: "Service Above Self" and "He Profits Most… Who Serves Best."

Ladies and gentlemen of the Rotary Club of Manila, together, may we have a successful, meaningful and prosperous New Year!

Thank you for your attention.

Mabuhay ang Pilipinas! Mabuhay po tayong lahat!