Amando M Tetangco, Jr: Working together towards a stronger economy

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the Security Bank Economic Forum "Economic & Business Forecast 2015", Makati City, 30 January 2015.

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The presentation this afternoon will start with a discussion on the global economic and financial developments and their possible implications for the Philippine economy. Then we will look at the growth experience of the Philippine economy and the underlying factors that form the bases for the economy's resilience.

A look back to 2014

I was looking at the new logo of Security Bank. It shows two halves – just like the yin and the yang. Two parts working and coming together. It's an interesting depiction although of course, on the "hard-court" (as in the basketball, or even in volleyball courts), it would be a stretch to say that the Greens would be above the Blues for long periods. I must have a conversation with Abet about his choice of corporate colors. The old Security Bank color was already the perfect one – Blue!

But seriously, two things coming together and being integral parts of each other. These are very similar to the themes that pervaded our global operating environment in 2014.

In 2014, there were two themes that dominated the global operating environment – 1) uneven global growth and 2) divergent monetary policies in advanced economies. As the US economic growth continued to gain traction and the US Fed subsequently ended its asset purchase program in October last year, markets began to interpret the Fed's statements to mean that it would begin "lift off" (or raise the Fed Funds target rate) sometime this year. In contrast, EU and Japan remained barely able to eke out growth. By the ECB's and the BOJ's own pronouncements, they were willing to further expand easy monetary conditions to stimulate growth in their jurisdictions. ECB President Mario Draghi even pledged to do "whatever it takes". So, in one part of the globe, you had the Fed poised to tighten monetary conditions, and in another, you had the ECB and BOJ committing to provide more liquidity as needed.

This combination ushered the shift in market sentiment – capital flowed out of EME assets (the long-standing darling of investors) toward US financial assets. This resulted in a strong appreciation of the US dollar. While this was happening, oil prices began to tumble. By year end, Brent had lost half its value, dropping from a high $115/bbl to $55/bbl.

How did the Philippines fare in all of these? Well, the Philippines stood its ground. We continued to show healthy growth in a low inflation environment. The fourth quarter GDP number was released yesterday and it showed the underlying strength of the economy. In Q4, the economy grew 6.9 percent, faster than the 6.3 pct in the same quarter in 2013 and 5.3 pct in Q3 of 2014. For full-year 2014, GDP grew by 6.1 pct. On a full-year basis, the Philippines ranked second among selected Asian economies, next to China's 7.4 pct.

In the meantime, with the right monetary policy settings and some help from lower oil prices, full-year inflation tipped at 4.1 pct, marking 2014 as the 6th consecutive year that inflation has been kept within the government's target range.

This robust performance was supported by a sound banking system that continued to be profitable, well-capitalized and able to intermediate funds to the productive sectors of the economy, while maintaining good credit standards. In addition, the country continued to sustain surpluses in its current account, enabling us to keep our GIR at about $80B at end 2014.

The outlook for 2015

Ladies and gentlemen, clearly, we have entered 2015 – as we did in 2014 -from a position of relative strength. Can we expect this strength to be sustained throughout 2015? My answer to this question is a YES.

Shortly, I will provide you four reasons why. But before that, let me give you some perspective by walking you through the operating environment that we see for 2015.

The global themes coming into 2015 were rather clear – uneven growth and divergent monetary policies and a strong USD arising from this combination. This was so until oil prices began to drop – like falling knives – as one analyst put it. It is notable that no one has yet, very definitively called the oil price decline as being "overdone". Although the IMF forecasts as of 6 January 2015 show an uptick in oil prices in the second half of this year.

The steep decline in oil prices has complicated the market appreciation of the outlook for monetary policy in 2015. Some analysts say, the Fed would be hard-pressed to hike rates by any significant measure (as in June this year) if oil prices continue to drop because inflation in the US will be soft.

In addition, low oil prices increase the risk of deflation in the EU and Japan, raising the likelihood that more easing measures would be put in place.

In other words, ladies and gentlemen, whereas markets used to have the confidence in the trend of monetary policies, this new uncertainty from oil price movements is now seen to heighten volatility in financial markets by unsettling investor risk appetite and unseating inflation expectations.

Further, a continued decline in oil price could also change the balance of global growth prospects. There will be winners and losers if low oil prices persist. While the decline in oil is a dampener to inflation and could raise purchasing power for oil importers, it could also result in a loss of revenues for oil producers and lead to weak aggregate demand. With overall global growth still fragile, the significant drop and the weak prospects in oil prices have gotten more analysts discussing the risk of deflation in recent weeks.

The Philippines in focus:

How do we see all these impacting the Philippines? For us, low oil prices represent disinflation pressures. Fuel and fuel-related items account for nearly 9 pct of our CPI basket. We have also seen transport fares being adjusted downward. In addition, the fall in oil prices could benefit us through an increase in household real income as well as the lower cost of production.

I have been asked whether we are worried about deflation (due to the substantial decline in oil prices). Well, deflation effects in the AEs can spillover to our economy through lower trade. However, trade as a percentage of GDP is still relatively lower than those of our peers in the region.[1] So the risk here is probably only of a relatively small magnitude.

As for deflation materializing in the Philippines, the risk is not significant. For one, our demand conditions are firm. Services and industry remain strong. And on the demand side, consumption is seen remaining robust. We heard Sec. Balisacan say yesterday that "the worst is over on underspending" and that the government is committed to ramping up spending. There are other factors that lead us to say that deflation is remote – or that

[1] Note: Trade value (exports plus imports) relative to GDP is low for the Philippines as compared to most of our regional peers. Average (2005–2012): Philippines – 52.2; Malaysia – 144.6; Singapore – 290.6; Thailand – 123.6; Indonesia – 44.3; Taiwan (PRC) – 118.7; South Korea – 84.6.

inflation would remain positive. These are wage rigidities and the upside risks from pending petitions for utility rate adjustments (electricity) and potential power shortages.

Given this scenario, what would the monetary response of the BSP be? Our initial projections using lower oil prices show that inflation would still be within the target range for 2015, which is now lower at 2–4 percent compared to the previous year's target of 3–5 percent. Indications of easing inflationary pressures owing in part to the decline in international oil prices as well as signs of robust domestic economic growth allow the BSP some room to maintain its current monetary policy stance. Even so, we do not pre-commit to a set course of action. As I have always said, the stance of monetary policy will remain data-dependent.

One thing we keep in the back of our minds is that prices can reverse and often very quickly. If you have been in this market long enough – as I believe some in the audience have – you know that markets tend to get ahead of themselves. So, we continue to watch developments in the oil market carefully and how these affect inflation and growth dynamics, to see if there is any need to make adjustments in the stance of policy.

While volatilities in oil prices have complicated the balance of growth prospects, there are the other underlying other risks that we see in the horizon. These include a bumpy growth path for China, delays in the needed structural reforms in the EU and Japan, and geopolitical risks that could arise from a worsening of the situation in Russia or the Middle East – all of which can heighten financial market volatilities.

Can we remain steadfast in 2015?

Going back to the earlier question of whether we will be able to sustain our position of strength in 2015. Let me share that, in the areas under the purview of the BSP, we believe we will be able to withstand headwinds in the global economy. And I have four reasons.

One, our monetary policy is focused. While we are mindful of developments externally, we will always adjust policy in consideration of domestic demand and supply dynamics as reflected in our forecasted inflation path. The focus has served us well throughout the period of the Great Moderation through the Global Financial Crisis and in the aftermath of the GFC. So you should not expect that we will necessarily move in synch with and in the same magnitude as the Fed or other central banks.

Two, we have maintained a strong external position. We expect current account surplus to be sustained by remittances, receipts from the tourism and BPO industries. We will continue with our policy of a market-determined exchange rate, while allowing for some scope for official action given that the exchange rate can be an effective tool for absorbing shocks from external sources.

Three, we have a sound, stable and liquid banking system. The Philippine banking system is the only one, out of the 69 jurisdiction that it rates, which Moody's judged as having a positive outlook. This sound performance of the banks was due to progressive implementation of deep reforms and prudent risk-taking activities of banks despite the ample liquidity in the global economy.

Over the years we pursued reforms to enable our banks to respond to the evolving requirements of their stakeholders, just as it has to adapt to a changing market environment. We do not anticipate a specific market scenario. Rather, we want our banks to be in a strong position regardless of how markets swing or stakeholder needs evolve. In effect, we envision a banking community that is not just resilient but one that is fundamentally responsive to stakeholder needs and where banks act responsibly.

So in 2014, for instance, we raised the minimum required level of bank capital, recognizing that the new normal of banking treats conventional risks more aggressively while constantly identifying newer forms of risks. We also achieved fairly significant milestones, for example, in re-writing our credit risk framework, in crafting the implementing guidelines for Republic Act 10641 and introducing a Financial Consumer Protection Framework.

Four, we are unrelenting in our commitment towards a more inclusive financial market and an empowered economic and financial consumer. This is not just about providing access but having the wherewithal to make markets where there are none yet, investing in the future rather than be content with the limitations of today.

Our commitment

Going forward, the BSP will remain on the lookout for potential risks to price and financial stability. We will be vigilant to be able to provide timely and calibrated responses to unfolding events.

But just as in the Security Bank logo, you have the yin and the yang, the BSP needs your partnership. For only as we come together and work towards the same goal, can we preserve what we have achieved and ensure that our economy sustains its position of strength.