Amando M Tetangco, Jr: Keeping the economy on the right track – key challenges for monetary policy

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the induction ceremony for the new officers of the Economic Journalists Association of the Philippines (EJAP), Makati City, 20 February 2015.

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Let me begin by congratulating the new set of officers of EJAP, led by its new president, Mr. Paolo Montecillo, who is a member of the BSP press corps. I wish to reaffirm the BSP's belief in the essential role of EJAP in promoting high quality economic news reporting in the country. Rest assured that your organization will continue to have the support of the BSP in your activities that help achieve the "responsible and thorough" coverage of economic events.

In the days leading up to the celebration of the Chinese New Year yesterday, we have been reading and hearing many and varied predictions concerning the Year of the Sheep or the Goat or the Ram.

Tonight, I will contribute my share – from the perspective of emerging market economy central banks, in general, and the Bangko Sentral ng Pilipinas, in particular.

The issues that confront EME central banks these days include the following: Whether disinflation pressures could lead to breaches in official inflation target bands. Whether there is a risk of domestic deflation or whether some collateral damage could be imported from deflation elsewhere. Whether there will be further monetary easing (in the AEs in one part of the globe) or whether there will be a shift in the perception of the timing of monetary tightening (at the Fed, across the other side of the globe). Whether huge dips in oil prices are a positive or a negative. Whether we will see currency wars or we will see currency peace. Whether new tools would need to emerge to ensure financial stability during this period of divergence in economic trends and monetary policy.

There are no absolutes in dealing with these issues. There are many ifs and buts. And, a number of factors and variables, including concerns related to technology and geopolitics, would need to be considered.

Friends, there is no crystal ball for these things. So, as we continue to navigate a challenging economic landscape this year, it is imperative that the intent of policies from central banks and other authorities is clearly understood by the public. Statements by the central bank and other authorities can influence people's expectations and, ultimately, their economic decisions. Sound and accurate reporting by the media therefore is necessary to help bring our message across to financial markets and the general public.

We understand that covering the economic beat is quite challenging. Unfortunately, it is also at times, thankless. Rarely would you go home to your families and see them jumping up and down to ask "so what happened in the world of economics today?" Economic news isn't riveting, unlike political news or news about crime. But what you do requires just as much vigilance, patience, and diligence, if not more.

Economic numbers rarely tell the complete story when taken at face value. Therefore, a responsible journalist who seeks to offer readers a fuller appreciation of the information will examine the figures within a broader context or against an array of other relevant indicators.

Given the facts on hand, a good reporter will know which leads to chase, and which to set aside, perhaps for another day, for another story. The objective is to understand what is happening – and why – so that the facts can be pieced together into a sensible and useful news report for their publics.

Indeed, we thank the media and, more specifically, EJAP member for playing a crucial role in helping the public understand and stay abreast of current economic issues.

With this in mind, let me briefly share two key issues in current discussions of monetary policy stance.

Disinflation

The first is disinflation pressures. The overall impact of the significant decline in international oil prices will vary in direction and scope across the globe. While there were recent upticks, oil prices remain well below their levels in mid-2014.

In general, low oil prices represent disinflation pressures for oil importing countries like the Philippines. We have already seen this in the slower inflation outturns in recent months.

Many have wondered why, given it has already lowered its own inflation forecasts for 2015 and 2016, the BSP stood pat on its policy rates and didn't follow the other central banks that had earlier eased their policy settings.

Two reasons. First, unlike in some economies, the risk of inflation falling below zero or to negative levels in the Philippines appears to be minimal. In fact, while our latest forecasts show a lower inflation path, we expect inflation to stay within the government's target range over the policy horizon.

This outlook is supported by firm domestic demand conditions. Our latest expectations surveys show that market sentiment remains broadly favorable, which should in turn drive up spending and investment. Wage levels, potential increases in utility rates and possible power shortages also lead us to expect that inflation is likely to remain positive, rather than reach or fall below zero.

Second, consistent with our symmetric approach to inflation targeting framework, we have room to wait for additional data to see if the lower end of our target range will be breached for a persistent period. We are mindful of the uncertainty over the path of oil prices moving forward. As the recent hike in fuel pump prices shows, oil prices can rise just as quickly as they have fallen. Keeping an eye on possible turning points, therefore, will help us see if there is any need to recalibrate monetary policy. As always, the key is to make the necessary adjustments in a timely and calibrated manner.

Divergence

This ties in closely with our second key issue: divergence in economic prospects across economies, and consequently, divergence in monetary policies. We have been talking about this topic since early last year, and it has retained its relevance to the present. In fact, the disinflationary effect of the steep decline in oil prices has served to complicate our own views of the outlook for 2015, especially with regard to overseas monetary policies and their potential implications for financial stability.

More specifically, a robust recovery is underway in the US. As a consequence, financial markets largely expect the Federal Reserve Bank to raise its policy rates sometime in 2015 as it moves to normalize its monetary policy settings. However, if inflation in the US softens considerably, then the increase in interest rates may come later than anticipated, keeping in mind the Fed's forward guidance on its inflation objective.

By contrast, low oil prices increase the risk of deflation in the Euro area and Japan, which could further stall their economic recovery. At the moment, even with substantial monetary easing measures already in place, economic activity in these two jurisdictions continues to struggle for traction. This raises the likelihood of an extended period of monetary accommodation by their respective central banks.

There is a benefit to this, as this could provide some counterbalance to the potential decline in global liquidity and increase in interest rates resulting from tighter monetary policy in the US moving forward.

On balance, these contrasting prospects underpin the risk of capital flow volatility and financial market turbulence. Market volatility could be fuelled by a prolonged period of low interest rates and liquidity enhancement measures, as investors continue to search for higher yield.

Fortunately, even amid the volatility, investors tend to go back to assessing the merits of individual economies. For the Philippines, these merits include ample fiscal policy space, a sound and responsive banking system, an increasingly inclusive financial system, and a healthy external position, all of which contribute to a solid outlook for growth.

Indeed, the country's solid macroeconomic fundamentals continue to give confidence to investors and creditors. Moving forward, we will continue to invest in sound and prudent policies to ensure both price and financial stability. With our wide menu of policy tools and options, we stand ready to deploy appropriate measures as needed to ensure that liquidity stays adequate and that our financial system remains resilient against volatility in capital flows.

For instance, will continue to pursue reforms in the banking sector. Our objective is to enable our banks to better withstand stresses of external origin and to compete in a more integrated regional arena. To this end, we have already adopted several measures – including raising the minimum capital requirements for banks and implementing a comprehensive credit risk management framework. Other measures in the pipeline include those related to Basel 3 reforms.

The BSP will also remain alert to possible threats to financial stability, including those associated with the build-up of leverage among households and firms, as well as banks' exposure to the real estate sector. To mitigate these risks, the BSP will continue to its mix of micro- and macro-prudential tools as well as surveillance mechanisms, taking in consideration their potential impact on liquidity and overall financial conditions.

Concluding remarks

Ladies and gentlemen, disinflationary pressures and divergence are just two of the key economic issues that are likely to pose challenges for central bank like the BSP. I have discussed some of the main factors that we have considered and will continue to look into in the formulation of our monetary policy stance. I hope this provides additional guidance as you continue your coverage of Philippine economic developments.

In closing, I wish to reiterate that while other emerging markets have begun to ease their monetary policy settings in view of their own domestic considerations, we believe that our prevailing monetary policy stance remains appropriate.

Supported by robust credit growth and ample liquidity, current inflation and output growth dynamics in our country do not at this time warrant a reversal of the preemptive tightening measures we did in 2014. Moreover, there is still some measure of uncertainty hanging over global markets, the implications of which have to be continuously monitored closely. Nevertheless, should the need arise, we have ample fiscal headroom to provide further stimulus to the economy.

In other words, ladies and gentlemen, while 2015 is likely to bring continued economic challenges for the Philippines, our country appears to be well-placed to deal with them. The economy's manageable inflation environment and firm growth momentum provide policymakers ample space to respond appropriately to evolving domestic and global conditions.

Once again, I congratulate EJAP and its new set of officers under the leadership of President Paolo Montecillo. On behalf of the Bangko Sentral ng Pilipinas, I wish EJAP continuing success in all its undertakings, particularly its programs concerning professional development, sports, cultural activities, and health protection.

We have seen how EJAP has evolved as a professional organization in its first 29 years. Many of its members have moved on to assume greater responsibilities as senior journalists and editors, here and overseas. Indeed, EJAP has set the bar for covering the economic beat with depth, discipline, fairness and responsibility. Congratulations and thank you EJAP!

On our part, you can be assured that the BSP will continue to engage economic journalists with professionalism and respect.

Mabuhay ang EJAP! Mabuhay ang ating mahal na bansang Pilipinas! Maraming salamat sa inyong lahat!