Amando M Tetangco, Jr: Sustaining economic growth

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the MAP Gen Membership Meeting (GMM) and First MAP Economic Briefing for 2015 with the theme “Innovative Leadership for Sustained Growth?”, Makati City, 24 February 2015.

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“Innovative Leadership for Sustained Growth”.

Strong, Simple, Spirited. It’s a confident statement and direct to the point, quite like what we have come to expect from MAP President, Popoy Del Rosario.

This theme, which MAP, has chosen for 2015 reminds me of that management principle – Innovate or Stagnate.

“Innovate or stagnate” is direct and simple to remember, and has a nice ring to it. But when you put “innovation” in the context of the broader concept of “leadership” (as MAP has done here), the resonance of that ring becomes deeper and applying it within our organizations becomes more challenging.

While it is difficult to put into practice, “Innovate or stagnate” is not impossible to do so. Think of a company like Google. Our local telcos, our local conglomerates, even our banks. They constantly reinvent themselves to gain a bigger share of the pie or create new markets where there previously were none. All these, while taking care of their people.

I have spent about two-thirds of my life as a central banker, with the last 10 years of that as the BSP governor. And I can tell you for a fact that, that mantra of innovation has never been more relevant in central banking than it has in the last eight years.

Why do I say that? Simple. The 2007/08 Global Financial Crisis (or the GFC) happened. The GFC led us to uncharted territory as it was a crisis unlike any in the recent past. Let me illustrate.

Unlike in 1997/98, when the financial crisis originated from the emerging markets in Asia, the GFC was a crisis that started from the advanced economy world. In 1997/98, central banks and economies had to fix exchange rate valuations and develop capital markets. Painful. But nothing extraordinary because contagion was localized to the region. During the GFC recession was deep in the advanced economy world. And because of highly interconnected markets, that economic weakness spread to the rest of the globe. There also was no clear way out of the room for the debt crisis in Europe. Market confidence (and in some jurisdictions, even political confidence) was very low, if not non-existent.

During the GFC, major central banks had reached the zero bound of the policy curve. Interest rates had gone so low, there was hardly any wiggle room to use interest rates for stimulating the economy. We could therefore no longer rely on the familiar channels of transmission of monetary policy. At the time, new transmission channels emerged such as the “expectations channel” and the “risk-taking channel”. So, advanced economy central banks needed to employ non-conventional monetary tools. Even central banks in some emerging market economies had to deploy non-traditional tools because of contagion.

As a result – Asset Purchase Programs in all letters of the alphabet some of which you would normally throw away in a game of Scrabble came into vogue. Q-E-1, QE2 (with operation twist) in the US, OMT [or Outright Monetary Transactions] and TLTRO [or Targetted Long-Term Refinancing Operations] in Europe, and Q-Q-E (Quantitative and Qualitative Easing – the three arrows) in Japan.

Furthermore, central banks needed to be sharper and more pointed in their communication of policy intent. As you now know, "forward guidance" has come to be a specific central bank technique for managing market expectations.

In addition, financial stability and the systemic nature of risks became the driving forces for the global financial reform agenda. "Too big to fail" was no longer going to be the bottom line. Even as we speak, ladies and gentlemen, financial reforms are being put in place so that those defined to be "systemically important institutions" would not have to be bailed out by taxpayer money. These SIFIs would instead be mandated to meet a higher capital standard. SIFIs have to have more "skin in the game", so to speak.

And the game, ladies and gentlemen, has changed.

Micro prudential regulations, while necessary, are no longer sufficient. It may be recalled that micro prudential measures are meant to improve individual institutions' resilience to risks. Central banks must now also have macroprudential measures in place. Macroprudential measures look to address the interconnected nature of the system and help ensure safety at the system level.

In truth, some have said that at the height of the GFC, Central Banking was the "only game in town". Monetary policy was made to bear the brunt of the heavy lifting in responding to the effects of the crisis because there was very little fiscal policy space, particularly in the AEs.

You may ask, eight years from the GFC, how do we see the operating environment? What is the global outlook now? How does that translate to the Philippines?

With these in mind, let me structure the rest of my presentation as follows: Since I began with the GFC, let me continue with our global outlook and the risks and challenges we see from global impulses. Then I'll move to our own domestic market dynamics, and conclude with the policy thrusts of the BSP to address these concerns.

The consensus at the moment is that global growth will continue to be uneven. If you look at the slide closely, you could see, global growth is MULTI-SPEED. In the most recent forecast of the IMF, the US was the only major economy for which the Fund raised its growth projections. The growth forecasts for EU and Japan, as well as for Emerging and Developing Asia (which includes India and China) were downgraded.

An offshoot of the growing relative strength of the US economy has been the parallel strength in the US dollar, based on the US dollar Currency Index as of 23 February 2015.

Further, due to this weak and uneven global economic growth, central banks are seen as adopting differing paths in their monetary policy stances. On one end of the spectrum, the Fed Reserve (central bank of the US) is widely expected to begin to raise its interest rates ("lift-off") this year, while on the other end, the ECB has announced its own version of quantitative easing last month and Japan had earlier further increased its monetary base.

The upshot of this divergence is that one end of the spectrum provides a counterbalance to the other, giving the market the confidence that global liquidity will not just dry up with policy normalization in the US. However, some market participants have recently begun to reassess the strength of the divergence among central bank policies, with the steep drop in oil prices.

The drop in oil prices has:

1) heightened deflation pressures in the EU and Japan,

2) led to reduction in capital expenditures in the US that now threatens to soften economic growth and inflation in the US, and,

3) caused some emerging markets to also be leery of the adverse growth effects if deflation becomes more pervasive.

With these, the Fed may not tighten as previously expected, and even other central banks may ease further.

If we add to these factors the unquenchable thirst for yield by investors, we can expect some capital flow volatility as market participants rebalance their portfolios.

In sum, ladies and gentlemen, we see three major trends in the global operating environment.

1) Multi-speed global growth,

2) Policy divergence among advanced economies, and

3) Bouts of financial market volatility as global markets rebalance positions in the face of US dollar strength and volatility in commodity markets.

Notwithstanding this fluid external backdrop, the resilience of our economy is expected to continue.

In the aftermath of the GFC, the Philippines has been tagged as "the" bright spot in Asia. For 64 successive quarters, the Philippines has been marking positive growth. In 2014, the full year growth of 6.1 put the Philippines second to China among select Asian economies. This growth performance is being underpinned by the sustained contributions of the services sector, the recent rebound in manufacturing, and favorable improvements in labor dynamics as we stand at the cusp of what the United Nations calls the "demographic sweet spot".

Indeed, the numbers reflect resiliency.

It bears noting that this sustained output growth of the Philippine economy was attained in a stable inflation environment. The 2014 full year inflation averaged 4.1 percent, marking it as the 6th consecutive year that inflation is within the target range of the Government. The latest headline inflation was posted at 2.4 percent in January 2015, well within the target range for 2015 of 2–4 percent.

Meanwhile, money supply continues to be sufficient to support the sustained demand for credit, the bulk of which continues to be channeled to the key production sectors. Intermediation of these funds has been safe and efficient owing to our sound and stable banking system.

It's worth noting that of the 69 jurisdictions rated by Moody's, it was only the Philippine banking system which Moody's gave a "positive outlook" rating to.

Indeed, our banks have strong balance sheets. Banking system CAR is above both the national and Basel standards. The quality of banks' loan portfolios (UKBs) also continues to be healthy with NPL ratio at 1.98 percent as of November 2014.

On the external front, we have been able to sustain current account surpluses since 2003, due to strong structural flows from remittances, BPO receipts and tourism. This has allowed us to build up our GIR to $80 billion, which is more than 10 months' worth of imports of goods and payment for services.

Ladies and gentlemen, with these macroeconomic indicators, it would seem that the Philippines was not severely affected by the GFC.

This is true. We believe this was because we have "kept our own house in order". Keeping one's own house in order entails putting together policies that are responsive. However, what can be considered responsive today, may not necessarily be what is responsive in the future. Keeping one's house in order, therefore, requires creativity and innovativeness.

Ladies and gentlemen, in the areas that are under the purview of the BSP, keeping our house in order has meant:

1. Being focused on our primary goal of keeping prices stable.

We have done this by ensuring that our monetary policy framework is well calibrated and appropriately flexible. We constantly improve our surveillance capabilities, fine-tune our econometric models, perform scenario building, and engage the market and our regional counterparts to make sure the inputs to policy are always fresh.

To illustrate, during our last policy meeting, we kept our policy rates steady, even as some in the region have lowered their policy rates. Our assessment then was that inflation would remain within the government's target range of 2 to 4 percent over the policy horizon and that the risks to this forecast are balanced.

FOR NOW, therefore, we deem the stance of monetary policy to be APPROPRIATE.

2. Being deliberate in adopting the global financial reform agenda.

While we agree with the goals of the global reforms, our adoption of these has been based on our unique domestic market conditions.

For instance, we adopted the capital requirements of Basel 3 in January 2014 because our banks were already above the new requirements anyway. Meanwhile, we have decided to phase in the adoption of the other components of Basel 3, including those related to liquidity and leverage.

Our approach to reform has always been pragmatic. But we do not subscribe to the view of others that "if it ain't broke why fix it". There is always a better way of doing things, but one needs to have a macro view in adopting change.

There will always be those who would be negatively affected by change. So, we are consultative in adopting reforms. This way, the market could understand that the short-term pain of reforms will be balanced by long-term safety for the whole system.

3. Being open to liberalizing the FX environment and keeping a flexible exchange rate system.

We have found that transparency and flexibility in FX transactions helps the market plan better. We are on our 7th wave of FX liberalization measures.

We have also allowed the exchange rate to be determined by market forces. From experience, these policies have helped us to better manage external vulnerabilities.

4. Being creative in our surveillance and monitoring

An example here is our adoption of stress testing.

We stress the bank balance sheets for extreme but plausible scenarios. One specific form of stress test is the Real Estate Stress Test (REST). Based on the results of these stress tests, our banks are seen to be able to withstand plausible stresses.

5. Finally, being strong advocates of financial inclusion.

We are firm believers that policy must translate to an improvement in the quality of life of every Filipino. I find this consistent with INNOVATIVE LEADERSHIP. As Cardinal Tagle reminded as during the last induction of MAP officers and directors, we must always consider the interest of others (our people and others who may need assistance) in our entities' corporate strategy.

While keeping inflation stable already helps the Filipino maintain his purchasing power, we believe that more can be done. Our approach to financial inclusion is three-pronged. 1) Access to reasonably-priced financial services through proportionate regulation; 2) Financial education that is targeted; and 3) Financial consumer protection that is institutionalized.

There is so much ground to cover in financial inclusion and what we do in the BSP is but part of it. This is why we have spearheaded the drafting of a National Financial Inclusion Strategy, to bring together the financial inclusion work in other government agencies, interested NGOs and the private sector into a comprehensive, holistic plan. We hope to be able to launch this year.

As a result of these initiatives, the Philippines has been recognized as having one of the most conducive regulatory environments for financial inclusion.

I hope that in the last 25 minutes or so, I have been able to paint a fair picture of the economy as we move forward in the context of the global environment we operate in. The Philippines is expected to remain resilient and grow above trend (Govt target of 7–8 pct), in a low inflation environment (Govt target of 2–4 pct), supported by a sound banking system, and able to withstand reasonable external shocks.

I also hope that you now have a better appreciation of what to expect from the BSP. The BSP can lead in the initiatives I mentioned, but we cannot do it alone. You, in the corporate world, are the ones who bring to life the policies we espouse. As you can see from the slide, the goal is to have everyone rowing in synch and towards the same goal.

In the areas under our purview, the BSP has tried to be an innovative leader.

1. We try to be unconstrained by the past, even as we learn from it
2. We always ask the relevant questions and try to find the appropriate answers, and
3. We continue to believe that, in partnership with the market and corporate world, there is always a better way of doing things.

As we push forward in 2015, I hope that the MAP and the BSP can work more closely together towards our shared goal of a stable macroeconomy and sustained economic growth.

Thank you and again, good afternoon to everyone.