Amando M Tetangco, Jr: Sustaining the economy's growth saga through the 3Ps of policymaking – proactive, pre-emptive, and prudent

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the Euromoney Philippines Investment Forum, Manila, 24 March 2015.

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I see from the conference agenda that you have already covered critical topics this morning. Our place in the ASEAN Economic Community, our prospects in the mass market and our infrastructure are certainly key issues for the Philippines today. Before you take on capital market issues and the rest of the forum topics, I thought it would help in the discussion of these sectoral issues, if I would spend the time allotted to me to speak on the broader economy that we operate in. In particular, I would like to speak briefly on the risks to the macroeconomy that the BSP sees in the horizon, and how we, from a monetary and banking policy framework, intend to address these.

First, the risks:

The risks we face come mainly from the external side. Here I mean the interplay of three key factors: (1) the uneven global economic growth; (2) the uncertainty of the oil price path and the ambiguity of the underlying drivers of the oil price decline; and (3) the resulting divergence in monetary policy stance among major advanced economies.

In the last year and a half, these factors have manifested themselves in the movement of global capital into US assets (away from core Europe and emerging markets), an appreciating trend in the US dollar and a decline in global long-term interest rates. The rebalancing in global portfolios, as funds search for better yields, has surfaced in our domestic financial markets as volatility in the peso/dollar exchange rate, and in the local bond and equity markets.

Going forward, should the uneven global growth scenario persist, we may see this translate into more pronounced changes in trade patterns.

Monetary policy thrusts:

In response, the BSP has opted to use a mix of monetary policy tools over the last year. These actions included increases in reserve requirements on bank deposits, upward adjustments in policy interest rates, a strategic presence in the FX market, alongside a clear communication plan, and other macroprudential measures. The BSP did these to allow it to: 1) better manage credit and liquidity growth, 2) anchor inflation expectations, and 3) ward off any potential build up of excesses in some segments of the market that may be overly-reliant on the historically low interest rates for their growth and exuberance.

The BSP will continue this strategy of using what it deems as appropriate from the whole range of tools available in its enhanced tool kit. I believe the domestic markets have come to understand this. They now appreciate that the BSP's approach to responding to challenges is really to be Pro-active, Pre-emptive and Prudent. Three P's.

Banking reforms:

Given the central role of banks in the transmission of monetary policy, the BSP is also strategic in ensuring the resiliency of the banking system.

We have repeatedly said that our handling of the banking system is premised on striking a balance between the needed prudential limits and the ability of banks to make sound business decisions based on the idiosyncrasies of their operations and the realities of their market. In practice, this translates into specific actions under two facets. 1) Regulatory framework, and 2) Access to financial products.

The first facet is crafting a regulatory environment that encourages innovation while adequately mitigating unwarranted financial risks. I want to be clear though that it is not just about Basel 3, although we consider Basel 3 as a primary safety net.

There was much apprehension surrounding our adoption of the capital requirements under Basel 3. In fact, I note that one of the topics for discussion in the session following my talk is whether the capital regulatory reforms are affecting banks' ability to lend. Not to preempt the later discussion, let me just share that, the initial fear over the implementation of the Basel 3 framework is unfounded. Today, our universal and commercial banks continue to have capital levels that can withstand credit stress tests of 20 to 50 percent write-offs. In addition, credit continues to grow at healthy levels. Equally worth noting is that the quality of loans has been improving, with NPLs continuing to fall. It will be interesting to find out the perspectives of the Conference on this issue.

I won't attempt to list all the regulatory reforms, but just to illustrate, let me cite a couple. We have amended the credit risk framework for banks to align this with the global best practice of highlighting the factors that go into a sound credit decision, without relying only on the collaterals pledged against the credit. We have also streamlined the minimum capital requirement for banks so that it is tiered with the extent of their branch network. At the same time, liberalization of bank branching was undertaken so that banks can better make the business decision of how and where they wish to serve their target constituents.

To round this out, we have likewise pursued the longstanding objective of developing our capital markets. Recent amendments to our regulations address gaps, particularly in arriving at market rates for purposes of marking-to-market. These new interest rate benchmarking regulations should make pricing of bonds for capital build-up more transparent.

All of these are done with the objective of making the regulatory environment more open to the business decisions of service and product providers. They broaden what can be achieved within the banking industry without unduly compromising the regulatory oversight for risks and conflicts of interest.

This dovetails with the second facet of how we strike the balance between prudential limits and banks' decision-making ability. This is – liberalized access to the banking market. It is critical that our market is "financially inclusive" given the structure of the Philippine archipelago. This means that access, products and policy have to generate the desired synergies so that we can equally respond to the needs of those traditionally underserved or underbanked. This is a key advocacy of the BSP, for which we could easily devote another forum.

Even if I limit myself today to the traditional banking market, so much has already happened of late.

With the enactment of Republic Act 10641, we have increased the ownership ceiling of foreign banks to 100 percent from 60 percent, liberalized branching requirements and allowed foreign banks to participate in foreclosure proceedings of real estate properties. With capital infusion and market presence, the expectation is that the Law would bolster the local banking industry through greater competition, and the benefits from the transfer of skills and technology.

This liberalization of the entry of foreign financial institutions positions us well for the ASEAN Banking Integration Framework. But more than just ABIF, we have pursued and supported these legislative initiatives because a competitive globally-oriented banking industry is an essential portal for foreign investments. This, in turn, feeds off the investment grade rating we have obtained from international credit rating agencies.

While liberalization has its advantages, we recognize that there may be potential issues such as the relaxation of credit standards in the pursuit of larger market share, the risk of contagion and volatile capital flows.

Financial stability lens:

Ladies and gentlemen, when the BSP considers the effects of potential risks, we do not merely look at the impact on individual firms. Rather, through the lens of financial stability, our concern becomes the bigger picture, examining the interaction among institutions, transactions, products and markets. It is through this new prudential norm that we address the contagion of risks, including those that may potentially arise from any liberalization initiative.

Outlook:

Against this monetary and banking sector policy backdrop and in light of the risks we anticipate, how do we see the operating environment going forward?

Very broadly, we see the country continuing to grow in a stable inflationary environment. We believe liquidity is sufficiently calibrated and that it would support broad-based growth without fuelling inflation which we monitor particularly in view of policy normalization in the US. More specifically, the government's target of 7–8 percent is attainable as domestic demand conditions remain firm and supported by improving production efficiency and robust labor market dynamics. Meantime, inflation expectations will remain well-anchored. Latest inflation forecasts, based on surveys by the BSP and the Consensus Economics, remain close to the mid-point of the target band of 2–4 percent for 2015–2016.

On the banking side, we see that this will remain a reliable intermediator of funds. Given the reform agenda, the system will continue to be characterized by solid asset growth, improved quality of loans and assets, strong capitalization, and better risk management practices.

We see the external current account remaining in surplus as exchange inflows from overseas Filipinos (OFs) remittances, business process outsourcing (BPO) revenues, as well as tourism receipts are seen to continue to grow.

Finally, ladies and gentlemen, given the positive alignment between inflation and growth, and augmented government resources as a result of fiscal consolidation, both the monetary and financial sectors have sufficient room to make policy adjustments, as may be warranted.

Conclusion:

You may ask, will the Philippine economy be able to sustain its successive years of strong growth performance over the medium term? I believe so. Apart from the country's strong fundamentals, the government's commitment toward sustaining its structural reform agenda would lend critical support to achieving our growth potential.

The BSP shares the same commitment. After all, we follow the framework of the Three P's. I am confident that we will be able to attain our goal of an upward economic growth trajectory, in an environment of price and financial stability because we will remain Proactive in policy dialogue with stakeholders such as yourselves. Pre-emptive in putting in place forward looking policies, and Prudent in adopting reforms.

Ladies and gentlemen, even as the outlook remains favorable, now is not the time for complacency. As the genius behind Intel, Andy Grove, once said, "Only the paranoid survive." I wish therefore that your conference would be peppered with just the right amount of paranoia and balanced with enough openness for finding suitable solutions. Good afternoon and thank you for your attention.