Amando M Tetangco, Jr: Adapting to change – creating advantages from challenges

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the FINEX 6th General Membership Meeting, Manila, 17 June 2015.

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I am pleased to join you during your 6th General Membership Meeting for this year to speak on the near-term prospects and challenges of ASEAN integration in particular, as these relate to the Philippine banking system. I am sure questions about our readiness for ASEAN integration are in the back of your minds. And rightfully so. Serious market players must ask these important questions. Are we equipped to take full advantage of the benefits of integration? Can our banks and our domestic markets face up to the challenges of greater competition? I am hoping that at the end of my remarks, you and I will come to the same conclusion.

Positive third party assessments

In preparing for my remarks, it was tempting to simply enumerate the positive reviews that the country has been given in recent periods. The latest of these is from the IMF Article IV Mission which observed in their concluding report that the country "continued to perform strongly, despite weather-related disruptions to agricultural production". In the same Mission report, the IMF team noted that "the banking industry is sound, with capital ratios well in excess of prudential norms, low nonperforming loans, and abundant liquidity." The economic numbers do tell a positive story. We have built buffers against external shocks through more than ten consecutive years of current account surpluses and our gross international reserves are ample by most traditional yardsticks.

Governance of monetary policy is clear

Moreover, the governance of our monetary policy is clear. And this, together with improved policy communication and engagement with stakeholders, has helped to keep annual average inflation within-target over the last six consecutive years.

A number of central banks in the region have adjusted their policy settings in the past few months. Some have asked me why the BSP hasn't yet followed suit. The answer quite simply is that the conditions that have compelled other central banks to ease monetary policy are not exactly present in the Philippines. First, inflation expectations continue to be well-anchored. Second, while we are cognizant of expectations of global slowdown in economic growth and volatile asset prices arising from the asynchronous monetary policies in advanced economies, our assessment is that domestic demand conditions remain robust. Solid private demand and buoyant business sentiment support this view. Moreover, notwithstanding the lower-than-expected Q1 GDP report, we see that in the months ahead, ample domestic liquidity and higher public spending are expected to support domestic economic activity and sustain the economy's momentum.

We do feel some heat, however, quite literally from Mother Nature. This is not just about the discomfort of the daily heat permeating through our office windows. Rather, there is the looming threat of another El Niño phenomenon. As temperatures rise, supply chains may become disrupted and create ripples through inflation.

All things considered, however, we see the balance of risks still point to inflation settling within the target range of 3±1 percent in 2015–2016.

Vision for the banking industry

In making these assessments, however, we are aware that markets are constantly evolving. In light of this, the BSP has repeatedly espoused "3Rs" for the banking industry. Banks must be Responsive to the needs of their stakeholders, act in a Responsible manner and stand Resilient to the volatilities that frequently come their way.

Responsiveness requires that banks are inclusive. The market that banks serve must not be limited to those who can already invest. Instead, banks must reach out to those who desire and can be made better off by the products that they offer. Acting Responsibly stems from adherence to the entire spectrum of governance. While Resilience to volatilities necessitates effective management of risks.

The lay of the challenges ahead

These 3 R's must figure prominently in our banking system if it is to continue to be welfare-enhancing to its stakeholders. This is true whether we consider only our own domestic operating environment or whether we consider the broader market of ASEAN integration.

If it is brought to its expected conclusion, the integration of the ASEAN financial markets would reshape the global market landscape. To better appreciate how this may come about, it will help to step back and identify the different facets of this integration initiative.

The ASEAN Economic Community (AEC) is slated to commence by year's end. The objective is to consolidate ASEAN into a single economic base that is integrated into the global markets. In short, we expect to achieve free movement of goods, services, investment, skilled labour, and the freer flow of capital.

The parallel initiative is the integration of the ASEAN financial markets under the ASEAN Financial Integration Framework or AFIF. This has a very broad coverage which includes banking, insurance and capital markets as well as the payment systems.

The banking component of AFIF is the ASEAN Banking Integration Framework or ABIF. Under ABIF, so-called Qualified ASEAN Banks or QABs will be allowed to establish operations within ASEAN. These QABs, as endorsed by the home jurisdiction regulator, must meet established global standards for banking supervision. In addition, the framework provides for bilateral agreement between the respective home and host banking authorities which will govern the execution of ABIF and the operation of QABs in the respective jurisdictions.

An easy way to imagine how the ABIF will play out is this. Picture a single multi-jurisdiction archipelago called ASEAN. Goods and services, as well as labour and capital, can move freely within the archipelago with as little friction cost as possible. QABs extend the reach of one jurisdiction by having "outposts" outside its own jurisdiction's borders but still within the larger archipelago.

As banks, these QABs compete with other banks in the host jurisdiction. They are covered by the same regulations as a "local" in a host jurisdiction, subject to refinements agreed bilaterally by the home and host regulator. This increases competition in the market of the host jurisdiction but it also provides financial consumers with a wider array of financial products and services.

As illustrated, ABIF provides a financial highway for the raw potential of ASEAN. Instead of using US correspondent banks, intra-ASEAN trade and investments can be cleared and settled as inter-branch transactions of QABs. This is not only convenient but specifically highlights the nature of ASEAN itself: a regional cluster that has a record of growth, defined by a retail market with high disposable income and unparalleled saving potential.

But, ASEAN integration is not just the banking side. It also covers the development of both the capital market and the payment systems. Achieving both the AEC and AFIF means that

Filipino entrepreneurs can seamlessly tap the capital markets in any of the 10 ASEAN jurisdictions. Local investors would also have more options on securities, with the added convenience of not having to open accounts in other ASEAN jurisdictions.

To enforce this vision, payment systems would be linked such that cross-border obligations will be settled with finality in the investor's own jurisdiction. Central counterparties are established to reduce liquidity flows while central depositories are in place in behalf of investors with all trades duly reported to designated repositories.

Taking the changes and creating opportunities

All these, ladies and gentlemen, represent the vision of economic integration.

For FINEX members who are banks, you will be faced with increased competition. It is imperative therefore that you define/carve out your comparative advantage in our local market, which has one of the youngest populations in ASEAN and in the bigger ASEAN market, which is home to over 600 million individuals. This necessitates perhaps a different thinking cap, given that you will be making the hard decisions on positioning yourself in the market a time when global reforms and regional agreements are reshaping the market landscape. If you have not done so, you will need to make those tough decisions now to give yourselves time to execute your strategic goals.

Broker-dealers must now take an even broader view of what and how you define your "market". I know many of you have leveraged on technology to extend your reach throughout our archipelago. But you may wish to also go beyond the bounds of our 7,100 islands and partake of ASEAN's saving which in 2013 alone was over USD700 billion. A portion of that has been deployed outside ASEAN, so, re-directing this back to ASEAN is certainly going to have positive effects.

And to the CFOs in FINEX, the sheer thought of transforming 10 separate jurisdictions, that generated about USD2.4 trillion worth of output in 2013 alone, into a single base of freely flowing economic resources ought to lead you to review the way you prioritize portfolios.

With ASEAN banking integration on the horizon, new opportunities arise. But we also recognize the possibility of the increased volatility of capital flows and additional risks attendant to cross-border transactions. The complexity of regional bank operations highlights the need for vigilance among supervisory authorities and continued focus on risk management among financial institutions.

Ladies and gentlemen, our finance executives must adapt quickly to our rapidly changing environment. Unparalleled opportunities are unfolding and potential pitfalls as well if we do not watch out. It is soon going to be a very different world out there for the financial executive. The sooner we take cognizance of what may be, the better we can prepare. Change is upon us. Are we ready for ASEAN banking integration?

For ABIF, the groundwork has been prepared with the liberalization of foreign bank entry. The BSP is gearing banks up to "step to the regional plate" by adopting higher capital requirements, enhancing credit risk management rules and raising governance standards, among others. From a macro point of view, the BSP has continued to create a stable macroeconomic environment. The rest of the story lies now with each of you in how you will adapt and move forward.

This reminds me of that little best-selling book: "Who Moved My Cheese?" by Spencer Johnson. The book has been in print for over a decade now. But its lessons are always fresh. The book is a parable about 4 characters – "Sniff" and "Scurry", and "Hem" and "Haw". In the parable, these 4 characters found "cheese" in the same spot at Cheese Station "C" each day. Hem and Haw assumed that the cheese would always be there because so far, the cheese had been there without fail. They were not paying attention to the small changes that had been taking place. In the meantime, Sniff and Scurry noticed that each day the cheese was getting smaller. Not unexpectedly, therefore, their reactions were different when one day, there was no longer any cheese at Station C. Sniff and Scurry were prepared. My question to you, ladies and gentlemen, is this – when change comes upon you, would you be heard shouting petulantly like Hem and Haw did: "Who moved my cheese"?

While there are still parts of ASEAN integration that are being finalized, the principles have been set. The lessons from the book on anticipating, monitoring and being quick to adapt to change are therefore lessons we would need to apply even today. Together, we have travelled far in re-shaping and re-energizing our financial system. Let us, further solidify that partnership to position our country in a more integrated ASEAN.

Thank you very much for your attention and good afternoon.