

Amando M Tetangco, Jr: Strengthening the monetary transmission mechanism through the BSP's Interest Rate Corridor System

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the MOA Signing for the BSP's Interest Rate Corridor System, Manila, 16 May 2016.

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Magandang hapon sa inyong lahat! I am pleased to see all of you here at the signing of the Memorandum of Agreement on the Monetary Operations System (MOS). Today's simple signing ceremony is a milestone that ushers in a new framework for the way that the BSP conducts its monetary operations.

Since we first broached the idea to the public in 2013, we carefully laid down the groundwork for the adoption of the Interest Rate Corridor or the IRC this year. This included drawing up an operational framework through consultations with the banking community; establishing the MOS as an IT platform for auction-based monetary operations; and developing a model for domestic liquidity forecasting to guide our daily monetary operations. In other words, years of preparation culminate in today's MOA signing. And in a few weeks' time, on June 3, 2016,¹ we will bring these operational elements together to implement the IRC system.

Our motivation is simple. We would like to further strengthen the relationship between the BSP's policy rates and money market interest rates. This, in turn, will enable the BSP to better manage inflation and promote long-term sustainable growth. By providing an operating framework for money market rates to move more closely with the BSP's policy rate, the IRC will help enhance the link between the stance of BSP monetary policy and the real economy.

In order to establish the interest rate corridor, the BSP interest rates will be re-calibrated as follows:

First, the current overnight RP rate of 6.0 percent will be reduced to 3.5 percent when the RP window is converted to the overnight lending facility.

Second, the overnight RRP rate of 4.0 percent will be adjusted to 3.0 percent.

And third, the SDA rate of 2.5 percent will be kept steady when it is transformed to the overnight deposit facility.

The new configuration effectively sets a ± 50 basis-point width around the BSP's policy interest rate. While there is no international consensus on the appropriate width of the corridor, a narrow corridor provides clearer guidance for the market and also helps to limit volatility in short-term interest rates.

By introducing auction-type instruments, the IRC system is intended to ensure more equitable access for all participants. In addition, we hope to ultimately aid in the development and deepening of the country's capital and money markets. Over time, as more liquidity is absorbed by the BSP, market participants will be encouraged to be more active and more prudent in managing their own day-to-day and short-term liquidity positions. It is our hope that, in the process, we will encourage counterparties to reduce their reliance on central bank facilities and instead transact more with each other through interbank markets, in order to meet liquidity requirements.

The more immediate benefit of the new auction-type instruments under the IRC is that the price discovery process will be facilitated by the bids we receive from market participants, which will

¹ By June 3, all RRPs under the current facility would have matured and all term placements under SDA would have been wound down to give way to the new facilities under the IRC.

provide information for the BSP and for the market on the prevailing cost of and demand for liquidity. In turn, better price discovery will allow the industry to establish more accurate interest rate benchmarks in the future.

Ladies and gentlemen, let me emphasize that the new IRC system is not a departure from the BSP's current monetary policy framework. In fact, the IRC system is envisioned to further support the inflation targeting framework by reinforcing the BSP's policy stance as represented by the overnight reverse repurchase rate that will remain our key policy rate.

More importantly, the shift to the IRC system does not represent a change in the BSP's stance of monetary policy. The IRC reforms are primarily operational in nature and will not materially affect prevailing monetary policy settings upon implementation. At the same time, short-term liquidity conditions are expected to remain broadly unchanged, as funds will continue to be absorbed through monetary operations under the new IRC system.

Moreover, the rate adjustments in the BSP's instruments under the IRC system remain consistent with the outlook for inflation and growth. Our current domestic environment of manageable inflation, a stable financial sector and firm economic growth prospects affords us the flexibility to implement these IRC-related reforms at this time.

The successful implementation over time of the IRC system will also allow for recalibrations in other monetary policy tools, including possible adjustments in reserve requirements in line with international norms.

Ladies and gentlemen, I have often said that while our mandate remains the same, the environment in which we operate in remains dynamic and continues to evolve. We therefore continue to rise up to the challenge of rethinking the status quo and finding ways to further improve as a central monetary authority – a central monetary authority that promotes stability and fosters sustained economic growth.

As we strive to constantly be better and to build on our strengths, we hope to be able to count on the continuing support of the banking and financial sectors. Indeed, for our IRC system to succeed, it is important that we move forward together and cooperate in making it work as envisioned.

I am pleased therefore that we have with us today the Bankers Association of the Philippines represented by its President Nestor Tan; the Money Market Association of the Philippines with its President Raul Martin Pedro; the Investment House Association of the Philippines with its President Manuel Tordesillas; the Trust Officers Association of the Philippines with its President Angel Maria Pacis; the ACI Philippines, the Financial Markets Association represented by its Treasurer Anthony Paul Yap; and the Chamber of Thrift Banks with its President Rommel Latinazo.

I would challenge our industry associations to undertake your day-to-day liquidity management more actively, to strive for greater participation in the interbank market and reduce reliance on central bank facilities, and to continue efforts towards establishing appropriate price benchmarks for financial markets.

Finally, we also thank the media for their continuing coverage that keeps us connected with our stakeholders and our people.

Maraming salamat sa inyo.

Mabuhay ang ating mahal na bansang Pilipinas!

Mabuhay po tayong lahat!