Amando M Tetangco, Jr: Anchoring confidence in an era of radical uncertainty

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the 16th Bloomberg FX Summit, Makati City, 16 August 2016.

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Ladies and gentlemen, good afternoon! It is indeed a pleasure, as always, to address traders and industry experts in this 16th Bloomberg Foreign Exchange Summit.

It's interesting that Bloomberg chose for this Forum, a date in the middle of what is traditionally called the "ghost month" of August. Could it be because they thought this time would be quiet enough and we could get more of you traders and bank and corporate treasurers to participate in the Forum? Maybe, but if one were to gauge it by the price action in the markets since the beginning of August, one would need to be careful to characterize it as a "ghost" month. For the Phisix crossed the 8000 point mark again and continues to flirt very close to it; the peso changed big fig and broke the 47 level, reflecting foreign monies that have returned to our markets post Brexit, with current market buoyancy somewhat surprising given that the underlying issues remain unresolved; the TDF auctions continue to be oversubscribed even as we have already raised the auction size; and bank lending has remained brisk. In other words, it hasn't been all that quiet.

But it is precisely when something is behaving not quite the way it is expected to, that the market should be watchful and regulators even more so.

Global developments

I don't have to deal lengthily into the global events that have gripped us this year. You know the issues quite well, the list of challenges has been daunting and, in fact, has become even longer:

1. Global monetary policy divergence between a previously hawkish US Fed and accommodative advanced economies (AEs) elsewhere;
2. Growth slowdown in big emerging markets (EMs) such as China;
3. The collapse and the recent see-saw in oil prices;
4. More recently, the unfolding of Brexit; and then,
5. The global portfolio rebalancing that accompanies these challenges.

Clearly, we are all trying to divine a number of things, like: what the next move of the Fed would be; when the stimulus packages of the BOJ and ECB would finally provide traction to Japanese and European economic growth; how the heavy corporate debt levels in China would be affected by continued weak global trade prospects; when the inflection point for oil prices would come about and how would any turnaround happen; and finally, whether we have really seen the worst of Brexit and what would transpire during this two-year period of transition.

Eight years after the GFC and still a clear definition of "new normal" remains elusive. Even so, one thing is emerging – the period of global low economic growth, heightened volatility[1] and "lowflation" as the IMF calls it, seems to be quite enduring, despite massive stimulus from policymakers in many parts of the world.

[1] El-Erian, M. (2016). "The Only Game in Town: Central Banks, Instability, and Avoiding the Next Collapse."

A number of explanations have been put forward to help us understand why nothing seems to be working as fast and as effectively as we have been hoping for. From economic theory, secular stagnation (as most recently advanced by Larry Summers) – where there is an increasing propensity to save and a decreasing propensity to invest, the result of which is that excessive saving acts as a drag on demand, reducing growth and inflation, and keeping interest rates low.[2] From behavioral finance, we are taught that we must contend with animal spirits that must be appropriately incentivized to look towards long-term sustainable projects. This is important so that flighty, search-for-yield herd behavior is minimized. And from demographics, we are seeing shifts in working age population and productivity.

A position of relative strength

Fortunately, the Philippines is not in the same situation as other jurisdictions find themselves in. We had survived the GFC generally unscathed and we continue to enjoy the healthy combination of strong growth and low inflation. To cite some indicators:

- The Philippines' gross domestic product (GDP) has been resilient, registering 69 consecutive quarters of positive growth. In the first quarter of 2016, the country grew by 6.9 percent, its fastest since the third quarter of 2013.
- The sustained benign inflation environment over the past years continues to support economic growth.
- The sound and stable condition of Philippine banks and robust external sector dynamics have also been among the anchors of the robust performance of the domestic economy.

In addition, the domestic economy has sufficient buffers that help weather the external headwinds:

- The BSP's foreign exchange (FX) reserves currently stands at US$85.5 billion as of end-July 2016, more than enough to meet the country's FX liquidity requirements for trade and short-term debt obligations.
- The country's current account has been in surplus for 13 consecutive years now, supported by the sustained increase in overseas Filipino (OF) remittances, as well as business process outsourcing (BPO) revenues and tourism receipts.

Current stance of monetary policy

This position of relative strength has allowed us to keep our policy rates at 4% since September 2014 until we reduced it to 3% in June this year, following the operational adjustment when we adopted the Interest Rate Corridor.

However, even with the 100 bps adjustment in the headline rate, 3% is still over 250 basis points higher than the Fed funds target rate. That gives us significant wiggle room, in this environment where some jurisdictions have gone into negative interest rate territory.

At our policy meeting last week, we again kept the policy rate steady at 3%. While our assessment showed that inflation would be slightly below the NG target range for 2016, we expect that inflation would be within the target of 2–4% in 2017–2018, with an upside bias for 2017.

In addition, our credit growth suggests favorable monetary conditions, and aggregate demand remains firm. Therefore there was no strong impetus for us to move policy levers or adjust the stance of monetary policy.

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[2] Summers, L. (2016). "The Age of Secular Stagnation." Foreign Affairs. February Issue.

In other words, ladies and gentlemen, we have monetary policy space and our current monetary settings are appropriate.

Triggers to shifts in policy stance

You must have heard me say this on a number of occasions already. But you may ask, what would cause us to change the stance of policy?

My answer to that would be: our next move would be data dependent. Which then begs the question, what data are we looking at?

Data dependence sounds almost trite. Some may say this is veiled "central bank speak", given that nearly all central bankers today seem to say this in unison. But in truth, when we speak these words, we do so with great thought and much humility. For we do not know everything. It would be foolish to say otherwise. And to even be so definitive as to say which one single data point we are looking at would not be prudent at this time, given how the financial and the goods markets are so globally interconnected.

There are indeed many moving parts that we look at when we consider the stance of policy. Of course, the first is the inflation forecast relative to the target. That's the primary consideration. We would also consider any significant shift in any of the domestic macro variables I mentioned earlier. We would look at any strong misalignments in interest differentials with external trading partners. This is important to consider especially if such misalignments would significantly endanger domestic financial markets and produce knock-on effects on the real sector. We would also make a move when market confidence and expectations threaten to be forcefully dislodged.

Impulses vs policy tools

But even as I narrate those possibilities, you must be cognizant that the BSP has an array of tools. Since the GFC, our tool kit has deepened. We are no longer limited to the policy rate alone to address these impulses.

For instance, under the IRC, the auction size of the TDF is one tool that we could use. Under a financial stability framework, we can put in place macroprudential measures, as we did when we raised the capital risk weight of NDF transactions. We can consider liberalizing the foreign exchange regulatory framework, as we did last week.

And just on this last point, as you know, the Monetary Board last Friday approved a significant liberalization of foreign exchange rules. These measures aim to encourage the public to transact their FX needs more with banks. Briefly, the recent liberalization involves increasing the current limit of allowable FX purchase from banks without supporting documentation by as much as 4 times for individuals and 8 times for corporations, and allowing payments in FX for certain transactions between residents, among other measures.

Moreover, we have the flexibility to allow the exchange rate to absorb some of the shocks from capital inflows, or if the flows go the other way, we have ample reserves, to keep exchange rate volatility in check, consistent with our inflation targeting framework. Learning from our previous experience during the Asian and global financial crises, the limitation imposed by the impossible trinity[3] could actually work to our advantage. First, flexible exchange rates act as an automatic stabilizer and contain wild swings in the financial markets. Second, this also allows us to focus our monetary policy on maintaining price stability in tune with the developments in domestic demand, particularly with the considerable reduction in the exchange rate pass-through to inflation. Furthermore, during periods of

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[3] The impossible trinity states that a central bank can only pursue two of the following objectives: fixed exchange rates, independent monetary policy, and open capital account.

stress, flexible exchange rates and independent monetary policy allow us to idiosyncratically respond to shocks in line with domestic economic conditions, which is crucial in calming markets.

Not monetary policy alone

Ladies and gentlemen, we have monetary policy space to keep prices stable. But price and financial stability are but one component of a vibrant economy.

We need the other cylinders of the economy to be working, too. We would need the fiscal authorities to ramp up infrastructure spending. And we need the cooperation of the private sector to find feasible long-term projects that would help raise the absorptive capacity of the economy. In this whole process, we need you to facilitate the movement of funds from savers to users, in a safe, efficient and sound manner.

The BSP will continue to pursue its mandate of securing price and financial stability through an appropriate policy stance and relevant measures. We trust that this will help anchor your confidence, so you could in turn do your part. We need treasurers and market participants to go beyond mark-to-market gains on your financial assets. We need you to translate those financial assets to gains in the real sector that can help create jobs.

Conclusion

It is my view that in this post-GFC era, when we are in the midst of what former BOE Governor Mervyn King calls a period of "radical uncertainty", we can secure a path of sustainable growth by keeping economic confidence up. I trust that the BSP can engage you – in the financial markets – to work with us in anchoring confidence among all our economic stakeholders. In the process, we hope to be able to lay a solid bedrock of sustainable economic growth.

Thank you very much and I wish you a productive summit.