Amando M Tetangco, Jr: Sustaining relative strength in a dynamic environment

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 2016, Manila, 6 September 2016.

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It is my pleasure to join you today, and share the views of the Bangko Sentral ng Pilipinas regarding the investment landscape in the Philippines. I wish to thank Euromoney for organizing this Philippine Investment Forum, which is an annual event started in 2012.

It's always about relative value

Investing is always about weighing relative values – among asset classes, across points in a yield curve, across industries and types of credit. In our highly interconnected global environment, investment choices now also include weighing relative values across geographical markets and currencies. In other words, good investing is never done in a vacuum or in absolutes.

In making relative value judgments, prudent investors ask themselves three questions – (1) Is there upside potential? (2) Are the returns sustainable? and (3) Are the downside risks manageable?

In the case of the Philippines as an investment destination, my answer to these questions would be YES. I believe the Philippine economy continues to offer a convincing case for investment and sustained growth. I say this with confidence because the Philippines has a good solid track record!

The Philippines' macroeconomic environment has been marked by solid economic growth and low inflation. Our gross domestic product has been robust and durable, registering 70 consecutive quarters of positive growth (even through the Global Financial Crisis!). In the second quarter of this year, the country grew by 7.0 percent, its fastest since the third quarter of 2013. Quite notably also, there has been a resurgence in manufacturing in recent periods, and domestic tourism has also been on the rise, creating a broader base for economic growth. Moreover, inflation has been benign and inflation expectations continue to be well-anchored. Our latest assessment shows that inflation will be just below the lower end of the government's target range for this year, but should move to within the target range of 2–4 percent in 2017–2018.

The banking system has also been an enabler of economic growth as it continues to channel lending to the productive sectors of the economy. This, without sacrificing credit underwriting standards and the quality of their balance sheets.

In the meantime, our external liquidity position has been robust. We have been running current account surpluses for 13 years now, allowing us to beef up FX reserves to an all-time high of US$85.5 billion as of end-July 2016.

All-told, ladies and gentlemen, the Philippine economy continues to enjoy a position of relative strength. And this has not been unnoticed by global investors. We have had our share of surges in capital inflows in search of yield. And while, some of these have "come and gone", a large portion of the inflows have stayed and remain invested in our domestic assets.

But what I wish to emphasize this morning is that the Philippines is a destination not only for flighty capital. The Philippines is, more importantly, a destination for serious investment. I am able to say this with conviction because we do not only have a solid macroeconomic track record, we also have the institutions that are critical to sustaining such a strong economic performance.

Good institutions are indispensable

For more than two decades now, we have been putting in place structural reforms that have liberalized key industries, including utilities, the power sector, and the banking system. We have adopted legislation aimed at improving governance in government corporations (GCG) and public procurement (GPPB); as well as ensuring fair competition in industry and vital services (PCC). These reforms have helped raise the country's total factor productivity (TFP) and are seen to help further reduce incremental capital output ratios (ICOR). These efforts complement the ongoing reforms to further improve "ease in doing business" and lessen "frictions" for investments in the Philippine economy.

In parallel, the BSP, in collaboration with market participants and other regulators, is continuing to roll out specific market reforms under our capital market reform agenda. The reforms which include, among others, developing a benchmark governance framework and creating a repo market should further deepen our domestic capital market and align its functioning with global standards. Alongside these, the BSP has also put out banking regulations that will enhance corporate governance and credit and IT risk management among banks, in tandem with the adoption of the other components of Basel 3.

Furthermore just last month, the BSP embarked on a significant liberalization of foreign exchange rules. These measures aim to encourage the public to transact their FX needs more with banks by, among others, increasing the current limit of allowable FX purchase from banks without supporting documentation, and allowing payments in FX for certain transactions between residents.

Also, in an effort to further improve the transmission of monetary policy, the BSP adopted in June this year the Interest Rate Corridor (IRC) framework for its conduct of monetary policy.

These monetary, capital market and banking reforms are meant to further strengthen the financial markets so that they could more effectively "marry" the users and sources of funds. There is enough liquidity in the domestic financial system. What needs to happen is that more and more of this liquidity is pushed to the productive sectors of the economy more expeditiously, not only through bank lending, but also through a robust capital market.

The national government for its part, under the new administration, has committed to a 10-point Economic Agenda that aims to continue the factors that led growth in the Philippines: maintaining an orderly fiscal house, investing in human resources and capital development, among others.

Ladies and gentlemen, we put these institutions in place because our operating environment is not static. We know that the macrofinancial stability we now enjoy can only be sustained if we have sound institutions on which to anchor any further reform efforts.

Conditions are never static

To complete therefore the discussion of the Philippine investment landscape, allow me now to briefly speak on the risks that could possibly unsettle us. These risks impact us in the short-term through financial market volatility and in the long-term possibly through aggregate demand dynamics.

Externally, we are affected by the policy actions of advanced economies. The most pressing of these are 1) the timing of the next hike of the Fed and 2) the magnitude of any further easing from the BOJ and ECB. As the markets digest any pronouncements from AE policy makers, we will continue to experience a toggling between "risk on" and "risk off" market behavior, which always creates "noise" in financial markets.

The BSP has the tools to address such "noise" in our onshore markets, to calm our participants and keep market behavior in check. Specifically, we have room to allow the exchange rates to absorb some of these near-term shocks or provide FX liquidity under our flexible exchange rate policy. Moreover, we could also adopt targeted macroprudential tools to bring about a more fundamental change in market behavior. In addition, given the current benign inflation outlook, the BSP has room to keep its policy rates steady to provide a further anchor for stability.

A second potential source of vulnerability are shifts in Chinese economic policies – 1) from a growth model that relies on exports and fixed investments to one which is driven by domestic demand, and 2) to a more market-oriented (and weaker) RMB. Early expectations were that the shift to domestic demand would result in significant slowing in Chinese growth, which could dampen exports of its trading partners, such as the Philippines. More recent forecasts, however, show a somewhat less dire outlook on China due to fiscal and monetary support from the authorities, easing risks of knock-on effects on trading partners and demand for international commodity prices. On the other hand, the policy of a weaker RMB is not expected to lead to stronger competition against our exports because we have a relatively low degree of export similarity with China.[1] Should the policies of the Chinese authorities indeed bring about more sustainable growth, this should be overall positive for us as it reduces global tail risks.

A third risk is Brexit. The direct impact to us of a slowdown in the UK would be minimal, given that our exports to the UK account for only 0.8 pct. of total exports. It is the possibility of second round effects on the EU, however, that is more concerning because exports to EU account for 11.5 percent of total exports. We therefore need to remain watchful of developments in the UK, particularly during the transition to "exit."

On the domestic front, we have to contend with natural calamities. While no one can fully prepare for the wrath of nature, the country has put in place policies that will help ensure we have adequate supply of staple foods, particularly rice.

In short, ladies and gentlemen, the Philippines is not immune to risks but our view is that these risks right now are manageable.

The balance – short vs. long-term dynamics

On balance, the Philippines continues to forge an economic growth story that puts emphasis not only on strength but also on long-term stability and resilience. The fact that the Philippines has just entered the "demographic window", in contrast to the aging population of some neighboring economies, undergirds our long-term resilience. We have a young and vibrant population that is both a steady employment and consumer base, that opens up a lot of possibilities for investment. Many industries are already burgeoning and seizing the opportunities the demographics present.

There is fiscal space to pursue infrastructure investments geared towards increasing the productive capacity of the economy. And the new administration has promised to ramp up infrastructure spending.

On the part of the BSP, we will continue to be steadfast in delivering on our mandates of maintaining price and financial stability in the economy, thereby serving as the wind at the back of our stakeholders, including investors like you.

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[1] Based on the UNCTAD's Export Similarity Index.

The Philippines presents excellent relative value

Ladies and gentlemen, the Philippines means business. While the challenges to the investment environment appear formidable, our collective vigilance and prudence will help us achieve our objectives of sustainable growth, as well as stability. I trust that the BSP can further engage you in pursuing the economic agenda of the Philippines.

At the top of my remarks, I said investing is all about relative values. I hope that in the time that had been given to me, I have been able to show you that the Philippines presents excellent relative value, an investment choice that will allow you to achieve your target risk/return and more.

Thank you very much and I wish everyone a productive Forum.