Amando M Tetangco, Jr: Sound macrofundamentals – a steady anchor

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the lunch meeting of the Rotary Club of Makati West, Makati-City, 29 September 2016.

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Thank you for your kind invitation to speak at your meeting today. The Rotary Club has long been a driving force of service and goodwill in the Philippines, and your Club has always been known to be a gathering of the country's best professionals and business leaders.

When I was thinking about how to share my message with you this afternoon, my mind was drawn to an HR Ocampo painting that used to hang in the hallway on the way to my office. Many of you will recall that HR Ocampo paintings are abstract, with strong base colors (often brown and deep red), and with sprinkling of bright strokes (often yellows and oranges). I told myself, an HR Ocampo painting somehow parallels my message today. That is, just like the strong brown and red base of the painting, our resilient economy is the foundation for a solid macroeconomic outlook going forward but there are risks on the horizon that threaten to break that solid base, just like the bright oranges break the levelness of the dark browns.

The macroeconomy

Let me go directly to the heart of my message: that is, the Philippine macroeconomy remains strong.

The second quarter GDP growth rate of 7 pct brings to 70 the number of consecutive quarters of positive economic growth. Such growth dynamics is supported by solid domestic demand, underpinned by strong private consumption and investment, continued productivity growth and favorable demographics. In recent separate reports, the IMF and the ADB both raised their GDP growth outlook on the Philippines .

Inflation has been low and stable, and inflation expectations continue to be well-anchored. The banking system is characterized by strength in balance sheets and profitability, serving as an efficient intermediator of funds in the economy. Our external position is likewise robust, with current account surpluses for 13 years now and our gross international reserves reaching US$85.8 billion as of end-August.

While other emerging markets experience moderation in growth prospects and falter from the tough global headwinds, the engines of the Philippine economy are in good shape to create value.

But there are shifting sands

We do not wish to nor can we downplay these headwinds. In fact, shifting sands seem to be the "permanent" character of the global economy today.

Most of these headwinds are of external origin. For example, the subpar global recovery, and that any upside could be limited by possible spillovers during the transition to Brexit on the economies of the UK and EU area. According to the IMF, the global economy is projected to grow by 3.1 percent in 2016, which was a downward revision to earlier forecasts.

There is also high uncertainty regarding the timing when the US Fed will continue its stalled normalization of monetary policy, in contrast to the continued accommodative policies of other major central banks, namely the ECB and the Bank of Japan. Monetary policy divergence fosters an environment of volatility in capital flows, which can ultimately hamper global recovery.

Further, the instability in commodity prices, in particular crude oil, also contribute to the uncertainty and fiscal pressures on oil-producing nations, which could eventually spillover to other economies via lower demand and investment.

There are also salient non-economic risks, which further complicate the growth prospects. These include terrorism, political divisions within advanced economies, and armed strife.

In the domestic setting, we also need to contend with frequent natural disasters and climate change, as well as recent headline risks.

These headwinds continue to motivate policy makers to build buffers to shield any economic gains that have so far achieved, from being chipped.

Reforms provide anchor through shifting sands

Over the years, the efforts and actions of policymakers focused not only on making the economy work today, but also on laying down the foundation for durable and sustainable progress. Over the years, we have created buffers by building good institutions, being committed to reform, and ensuring policy is consistent.

Good institutions are essential and indispensable because they enable our macroeconomic fundamentals to be self-sustaining, allowing markets to thrive even through negative surprises. Good institutions that emphasize anti-corruption, uphold good governance and that improve the cost of doing business have helped secure the confidence of the public and other stakeholders.

Commitment to reform continually enhances and improves the way we do things. Over the years, we have liberalized important industries such as telecommunications and power as well as the banking system to seize the advantages of competitive markets and ultimately upgrade standards and the quality of living in the Philippines. The BSP has also just recently further liberalized the country's FX regulatory environment by further rationalizing the approval process for FX purchases, so that these transactions return to the formal banking system.

The reform pipeline reflects our desire to set the right and smooth conditions for business and investment, and allow the Philippine economy to achieve its growth potential. On many occasions, third party observers such as credit-rating agencies and think tanks have recognized the Philippine growth story as a narrative grounded on reform, and therefore sustainable.

Policy thrusts of the BSP

Finally, policy consistency. Markets look for this as an anchor for planning and investment. And, the BSP has endeavored to precisely provide this. In this environment where the sands are shifting, there is need for an anchor. This is similar to the role the browns and deep reds provide to HR Ocampo painting. The browns and reds define the bounds of where the occasional oranges could play.

Ladies and gentlemen, you can look to the strong macrofundamentals for this "fixed point". At the BSP, we steadily and consistently aim only to deliver on our mandate of ensuring price and financial stability in the Philippine economy. This is not to say that the BSP operates in a mechanistic manner. Instead, the BSP takes all the information and impulses and processes these in order for us to make refinements to policy as and when appropriate. All these, with our mandate clearly in mind.

Specifically, we will continue to calibrate monetary policy consistent with the outlook for inflation. At the moment, our assessment is that inflation will be manageable over the policy horizon. We forecast that for 2016, full year inflation will average 1.7 pct, slightly below the national government's target range of 2–4 pct. Nevertheless inflation is seen to rise to within target in 2017–2018. Thus, there is not a strong reason to modify the stance of monetary policy for now. Interest rates therefore could be seen to remain at current levels.

As for the exchange rate, I am sure you have seen that the peso has been under some pressure of late. And pundits attribute this to current events that hog the media. Without doubt, the FX market is driven by sentiment. But negative sentiment towards the regional currencies, including the peso, has really also been largely affected by the market views on the actions of the AE central banks, especially the Fed, so externally induced. It is difficult to precisely dissect how much of the FX movements is due to the global environment and how much is idiosyncratic. Nevertheless, the BSP policy on the exchange rate remains the same. As we have said in the past, we will allow the exchange rate to be broadly determined by the market, but we will step in when, in our view, the moves are excessive. Markets must remember that the country's underlying fundamentals are sound, and therefore it would serve market players well, if they do not allow themselves to be driven by sentiment alone.

On banking, we will continue to align our regulations to international standards and closely monitor the conduct of our banks and supervised institutions, including their credit and market operations, to make sure that in all these the financial consumer is adequately protected.

Tying it together

What do these insights tell us about moving forward? The future is not completely decipherable. But we will continue to implement policies and calibrate our actions to maintain the strength of our macroeconomic fundamentals.

Our actions will always espouse the development of sound institutions, implementation of a proactive economic reform agenda, and achievement of stability and sustainability in the economy. This also includes our continuous conversation and engagement with stakeholders like you, to help us be attuned to the reality on the ground and synergize with your own efforts to push the economy forward.

There will always be challenges, but we believe that our unrelenting collaboration and engagement will keep us achieving the best results. In the end, it is our belief that the Philippines can remain an economic strongman and the challenges ahead will be definitely conquerable.

Thank you and I wish everyone a good day!