Amando Tetangco: Marking time - anchoring strengths amidst uncertainties

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the Joint Meeting of Rotary Club of Manila (RCM) and Rotary Club of Forbes Park (RCFP), Manila, 5 January 2017.

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I am pleased to join you today as speaker for your first general assembly of the year. It's become a tradition of sorts between the BSP and the Rotary Club of Manila. And today marks the 12th consecutive year that we are doing this together. We are, as they say in a game of sport, 12 for 12.

For the Rotary Club of Forbes Park, on the other hand, our relationship is somewhat younger. Nevertheless this does not detract from the significance that we put on engagements with stakeholders such as yourselves.

As I have done in my past appearances in your meetings, I shall share with you today the BSP's views on the economic landscape going forward and what you may expect from the BSP in terms of policy thrusts. I hope you will find this time well spent and the information I will share useful.

A surreal 2016 in a nutshell

Last year, I opened my remarks by saying that if we were to use the first seven days of the year as an indicator, 2016 was going to be "far from boring". In particular, I said that it could be "riveting and challenging". Well, that was just what had come to pass. In fact, Merriam-Webster Dictionary suggested that surreal is a word that describes the events of last year.

Webster defines "surreal" as being "marked by intense irrational reality of a dream"[1], also "unbelievable" or "fantastic". Being the most searched word, surreal was declared the "word of the year" for 2016. The dictionary publisher further explained that word searches surge around specific news events.

For many market observers, surreal aptly captures the occurrence of the unexpected and seemingly irrational extreme events of 2016. While there were risks and uncertainties that persisted throughout the year, such as the worry over the possibility of a hard economic landing in China; the anxiety over the direction of oil prices, and commodity prices in general; and the market meandering due to the uncertainty in the timing, pace, and magnitude of the US Fed's policy rate normalization, there were specific events that shocked the market. These include the unexpected outcome of the Brexit referendum in June, and the upset in the close race in US Presidential election in November. Financial markets did not get both of these right. Trading positions betted on the other side of the table, so to speak, and underestimated the underlying political sentiment. The surprise resulted in episodes of elevated financial market volatility.

We are mindful of these global market volatilities because the Philippines is not immune to the repercussions of global headwinds. In addition, we also have home-grown risks and "noise" to deal with. Indeed, the evolving nature of uncertainty in both the global and local environments requires that we be vigilant.

Vigilance: mapping the risks for 2017

For this afternoon therefore, let me highlight three risks and describe how the BSP sees these panning out in 2017:

First, the global economy is seen to remain tentative. Growth prospects for advanced economies continue to be weak. Among emerging economies, the growth outlook in China is also a concern. As you know, China has moved away from dependence on exports to more domestically-oriented sources of growth such as services and consumption. While this move has helped stave off a hard landing for China, it remains to be seen whether this rebalancing is sustainable over the medium term.

In the meantime, we are seeing the rise of populist sentiment around the globe. Brexit and the Trump win are manifestations of this trend. In addition, both of these events reflect a preference for protectionist policies. Some analysts have called the latter a “retreat from multilateralism”. With continued global growth weakness, this retreat from multilateralism is encouraging countries to also look more towards domestic sources of growth.

If the shift to “inward-looking policies” gains traction, this can potentially further shrink global trade, which could lead to even lower global growth. In economics, this is a classic case of the Prisoner’s Dilemma, wherein because of the absence of cooperation, the simultaneous actions of economic agents lead to sub-optimal outcomes.

Closer to home, the “retreat from multilateralism” could dampen the country’s OF deployment and remittances, as well as cause slowdown in the BPO sector, thereby hurting domestic consumption.

Before I move on to the next risk, let me just say that on the more specific issue of Brexit, the direct exposure of the Philippines to the UK is relatively limited. The bigger concern, however, is whether the other EU economies will follow the UK’s lead; given that our trade exposure to the EU is larger at around 12pct.

As for the Trump election, we will need to see how his campaign rhetoric translates to actual policy. Our eyes and ears are tuned to January 20, when he actually takes over the White House.

The second risk comes from the US Fed’s future policy rate actions. At its meeting in December 2016, when the Fed raised its target rate for the first time for the year, the Fed indicated that it would raise rates three more times in 2017. If the Fed veers from this, volatility in both the global and domestic FX and fixed income markets could rise.

A steeper than expected hike in US interest rates could lead to a faster rise in domestic commercial and government securities interest rates also, as well as stronger depreciation pressures on EME currencies, including the peso. Such price movements may adversely affect the balance sheets of domestic corporates and banks, especially of those that have FX and floating-interest rate obligations. This adverse result would be magnified if the markets panic, overreact, and thus amplify the initial increases in interest rates and weakness of the peso. Moreover, a tightening in domestic financial market conditions could also dampen domestic credit activities in the near-term.

However, if the reason for Fed tightness is that the underlying US economic growth has become stronger, then that may offset some of the near-term negative impact of the Fed tightening and lead to over-all support for global growth in the medium-term.

On the other hand, if the Fed turns dovish (i.e., fewer or no further hikes in 2017), then that could encourage “risk on” market behavior, stall domestic interest rate increases and dampen depreciation pressures in emerging markets. But such result is unlikely, as Trumponomics, which is reported to focus on increased fiscal spending, is widely expected to be inflationary.

Third. In addition to these external risks, we also have risks emanating from the domestic front such as political noise and adverse weather disturbances. Moreover, while the administration has committed to ramp infrastructure spending, they could be forced to cut back on this, should revenues from the proposed tax reform package fall short of expectation as indicated by the Secretary of Finance. If critical infrastructures are not built in time, this could hold back the country's current economic growth momentum.

A sound basis for optimism

Given this outlook, how do we expect the Philippine economy to fare in 2017? For the reasons I will share shortly, our view is that the economy should be able to weather 2017 relatively well barring surprises that are more surreal than those in 2016.

Economic growth remains impressive. Q3 GDP growth was reported at 7.1 percent, making the Philippines the fastest-growing among major South East Asian emerging economies. We clocked in 71 consecutive quarters of positive economic growth, and we are upbeat about Q4 outcomes given the boost from holiday spending.

We also emphasize the quality of growth. Economic expansion is driven by broad-based factors. On the supply side, while services has remained the key driver of growth of the Philippine economy, the share of industry output has been expanding. On the demand side, growth has been historically buoyed by robust private consumption. This is complemented by strong capital formation as contribution of investments to overall GDP has been increasing.

Moreover, the positive alignment between growth and inflation has been a sustained narrative. Headline inflation stands at 1.8 percent for full-year 2016. While average inflation is below the Government's target range, inflation is projected to rise toward the midpoint of the target range in 2017 and 2018. In other words, inflation is seen to be manageable.

The sound and stable condition of Philippine banks has also been one of the anchors of the sustained robust performance of the domestic economy. Moreover, we have put in place reforms to further strengthen governance and risk management in banks.

Given the external headwinds, our defense system is reliable. Our flexible exchange rate policy provides us with a tested tool to shield the economy from temporary gyrations, while our adequate reserves and sustained current account surplus fundamentally anchor our external position.

Each of these strengths is a cornerstone that we stand upon. We can therefore conclude that the economy continues to enjoy a position of strength.

An arsenal to manage the risks

Indeed, the economy performed well in 2016 even amidst evolving economic and financial conditions. But having strong fundamentals is just the first step, we also need to implement the structural reforms already in the pipeline, including capital markets reforms, to unleash further productivity and enhance the efficiency of intermediation.

Should the risks I mentioned earlier materialize, we have ample policy space to respond. There is enough room for monetary policy to support the economy. Consider, for example, the prospects of monetary policy in the midst of US Fed normalization. The present and future stance of domestic monetary policy remain data-dependent. We will therefore act on (global) developments only to the extent that it alters the domestic inflation path. Our assessment now is that the current policy settings remain appropriate. Thus, we do not need to adjust in sync with the Fed's rate hikes.

The BSP also has a deeper policy toolkit now. This includes: (i) macroprudential regulations that can be targeted to specific sources of risks, (ii) contingency measures such as liquidity-enhancing facilities, and (iii) rediscounting windows and regional firewalls that boost the flexibility and effectiveness of our actions. We intend to further refine these tools as appropriate.

In terms of supervision, we continue to review and align our financial regulations and policies with international standards to improve risk management as well as ensure the competitiveness of our banks in view of ASEAN integration. We intend to further enhance our macro-financial surveillance capability by, among others, improving coordination and cooperation with other government agencies and regulators.

There is also elbowroom for fiscal authorities to further boost public spending and accelerate aggregate demand and productivity growth.

Concluding remarks: strength in cooperation

In sum, ladies and gentlemen, the global operating environment today is certainly challenging. But we have built buffers over time. In addition, the BSP remains committed to its mandate of price and financial stability.

I am sure that with a good appreciation of risks and the right amount of vigilance, the partnership between the public sector and private stakeholders (such as yourselves) would push the economy upward and forward even in the face of the downside risks.

At the beginning of my remarks I mentioned that this is the 12th consecutive year we are doing this together. The number 12 has different meanings in various cultures and religions. But more universally, 12 is a number that is used to mark time. There are 12 hours on a traditional clock, and there are 12 months in a traditional calendar year. As we begin a new year, I wish to encourage everyone to mark time judiciously. Time is an equalizer. Whether you are rich or poor, in public or private sector, each of us has been given the same 24 hours each day. What we do with it, is up to us. Time is precious. You cannot take it back, if you have spent it. And you cannot recover it, if you waste it. Furthermore, if you simply stand idly by, time will also just pass you by. As you prepare for 2017, I hope that the time that we just spent together this afternoon has been useful.

Once again, on behalf of the Bangko Sentral ng Pilipinas, I wish Rotary Club of Manila and the Rotary Club of Forbes Park, a prosperous, successful and hope-filled 2017! Mabuhay po tayong lahat! Maraming salamat po!

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[1] "Surreal named Word of the Year." An article in Washington Post dated 20 December 2016.