

Amando Tetangco: Philippine thrift banks in a changing environment

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the Annual Convention of the Chamber of Thrift Banks, Makati City, 14 March 2017.

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The officers and members of the Chamber of Thrift Banks under the leadership of President Gregorio Anonas III, distinguished colleagues from the banking industry, special guests, ladies and gentlemen, good morning! It is always a pleasure to be with the CTB for your annual convention.

Today, I will discuss macroeconomic developments, the state of the thrift banking industry and how CTB members can redefine themselves in this constantly changing environment.

Macroeconomic conditions and prospects

The good news is that in the midst of uncertain global economic conditions, our own macroeconomic fundamentals remain solid and intact. The Philippine economy continued its growth story in 2016 with a full-year GDP¹ growth of 6.8 percent, higher than the 5.8 percent growth achieved in 2015. This is also at the high end of the National Government's growth target of 6.0-7.0 percent for 2016. At this rate, the Philippines has one of the fastest-growing economies in Asia².

Our growth was generally broad-based, fuelled by investments and consumption. Strong domestic demand was underpinned by low inflation, a stable interest rate environment, and improving labor market conditions. Over the policy horizon, we see inflation remaining manageable and within the government's target range of 2 to 4 pct.

Meanwhile, our flexible exchange rate policy and adequate reserves³ continue to provide buffers against potential external shocks that can affect the domestic economy.

Sound and stable banking system

The Philippine banking system has remained a source of strength for our economy. Resources of the banking system continue to grow at a steady pace and fund economic activities, with deposits rising to record levels. This affirms sustained public confidence in our banking system.

In particular, the thrift banking sector continues to support the growth of the Philippine banking system. Consolidated assets expanded by 8.3 percent and reached P1.1 trillion as of end-December 2016. Industry assets breached the one trillion-peso mark for the first time in last year. At the same time, capitalization moved up by 6.1% while deposits increased by a robust 9.7 percent.⁴ Ladies and gentlemen, you will agree these are good numbers.

Asset quality is satisfactory with gross NPL ratio at 4.7 percent as of end-December 2016 (better than the average in the last five years) while capital adequacy ratio (CAR), as a measure of risk-based capital, remains well above the minimum BSP and international standards. For instance, the CAR of stand-alone thrift banks was at 19.7 percent as of June 2016⁵

In terms of profitability, industry figures were also better. Net income for 2016 reached P13.9 billion, higher by 17.8 percent than in 2015. Return on Equity (ROE) improved to 10.5 percent.

The Role of Thrift Banks in Countryside Development

In other words, ladies and gentlemen, the thrift banking industry is well-placed to support countryside development moving forward as reflected in your convention theme “Maximizing Opportunities in Countryside Development.”

That you have aligned your program with the Government’s 10-point socio-economic agenda of promoting countryside development is both commendable and timely. Just recently, the Government approved the Philippine Development Plan (PDP) 2017–2022⁶. The objective is to reduce overall poverty rate to 14 percent and poverty incidence in the rural areas to 20 percent by year 2022⁷ by promoting inclusive growth.

I am glad therefore that you have a special forum on the Philippine Development Plan later today. This will help you determine your roadmap moving forward.

Meeting the challenges/pushing MSMEs

There are many opportunities to help develop the countryside, particularly within your targeted niche of catering to the MSMEs. The MSME sector is a cornerstone of economic growth. We have seen how successful MSMEs liberate people from poverty by creating jobs and serving as catalysts for growth in their communities.

This is the rationale behind BSP’s continuing collaboration with the industry and other agencies of government to create an enabling regulatory environment for increased access to finance, particularly for MSMEs.

Among the challenges that we have helped address include: 1) the use of collateral and developing product lines; 2) the difficulty to expand reach, given our archipelagic configuration; 3) the competition from the “big boys” and now the advent of ASEAN integration; and 4) the changing external macroeconomic environment.

Addressing collateral

On the issue of collateral, the BSP initiated in 2008, the Credit Surety Fund (CSF) Program. This enabled cooperatives, without sufficient collateral, to access bank loans on the strength of a credit guarantee. The Program was institutionalized through the passage of Republic Act No. 10744 also known as the “Credit Surety Fund Cooperative Act of 2015.” This should further enhance MSMEs’ access to credit.

Parallel to this, the BSP strengthened credit risk management guidelines for banks. This emphasizes cash flows and the “ability to pay” of a borrower in determining creditworthiness.

Through this regulation, the BSP is signalling that collaterals should play a secondary role in credit decisions. The same regulation exempts start-up enterprises from submitting documents evidencing financial capacity and business plans; these documents are usually required from regular borrowers in the first three years of their banking relationship.

Moreover, to help channel funds to the agricultural and fisheries sector, the BSP approved the Agricultural Value Chain Financing (VCF) Framework. By encouraging linkages among various players in an agricultural value chain, the credit risk of participating farmers can be reduced and thereby facilitate their access to credit. A study is now being conducted to expand this framework to cover the MSME value chain. In particular, we are looking into potential regulatory incentives to further encourage MSME financing.

Ladies and gentlemen. All these are being laid down, so that thrift banks can help meet the financing needs of MSMEs and the agriculture sector, in support of countryside development. This could be for investments, for working capital and for business expansion.

Expanding physical and virtual reach

On the issue of reach. Currently, of the 1,634 cities/municipalities in the country, 35.6 percent are still considered unbanked.⁸ Establishing bank branches in less urbanized areas remains a challenge due to generally low population density, geographic inaccessibility, and prevailing socio-economic situations.

These barriers pose a huge challenge to financial access. This is the reason why the BSP has set its sights on digital innovation as the primary catalyst to reaching greater scale. Part of these initiatives is the approval by the BSP of the setting up of micro-banking offices (MBOs), which as you know are low-cost banking infrastructure that can be established where it is not feasible to set up a regular branch. We have also put out regulations on e-money and mobile banking.

Recently, the BSP issued regulations allowing banks to use third party cash agents as a cost-effective service delivery channel. With cash agents, banks will be able to strategically leverage on innovative digital banking solutions and expand markets, even in the low-income and far-flung areas.

While financial innovation is revolutionizing the manner of delivering banking products and services, it has pluses and minuses. The opportunities FinTech brings come with heightened market competition and threats from cyber-attacks. These have significant implications on banks' risk management and consumer protection frameworks.

Being ready for competition

Thrift banks should also be ready for competition. Internally, from the larger banks that are expanding their networks into TBs' traditional market of consumer finance. And, also from the entry of foreign banks. If you recall, the local banking industry has been opened up to foreign competition with the enactment of RA 10641 in 2014⁹. So far, two foreign banks¹⁰ acquired existing domestic thrift banks following the passage of the said Law.

While these forces may put pressure on thrift banks, competition creates more options for the consumer, in particular, and raises economic welfare, in general. Thrift banks would therefore be served well if they would view competition such as this — as the impetus for “raising their game”. It certainly cannot be business as usual for the industry.

Indeed, there are many opportunities to better serve your chosen markets. In pursuing these opportunities, we enjoin you to remain prudent. In this increasingly integrated and globalized financial environment, it is important for thrift banks to always be guided by the tenets of effective risk management and sound governance standards.

A changing global environment

Thrift banks should fully prepare to address the risks and challenges that will come with growth opportunities in this rapidly changing business environment.

In addition, the industry should be mindful that loan exposures to particular market segments — such as consumers, MSMEs¹¹ and agriculture — are vulnerable to market shocks. This is very relevant during this period when the Fed is broadly expected to proceed with its next steps toward interest rate normalization. While you have heard me say that the BSP will not necessarily move in sync with the Fed and that our courses of action remain data dependent, we must be mindful of heightened volatility in the FX market during this transition to Fed normalization. We also need to be watchful of changes in global growth and inflation dynamics. All of these, in addition to our own domestic concerns that include exposures to natural calamities.

Careful and constant monitoring therefore of possible risk escalation from these exposures requires vigilance.

Final thoughts

Ladies and gentlemen. The CTB's role as the unifying voice among thrift banks makes you a key partner of the BSP and the National Government in achieving our medium-term development goals. Indeed, thrift banks play a crucial positive role in the transformation of our countryside as areas of growth and development.

For this reason, the BSP will continue to collaborate with the CTB to make sure that our reform initiatives will lead to a robust thrift banking sector, a dynamic countryside and a strong economy that fosters inclusive growth.

Ladies and gentlemen. Friends. This is the last time I will be addressing the CTB's annual convention in my capacity as BSP Governor. I take this opportunity therefore to thank CTB members, officers and trustees — past and present — for your steadfast support and cooperation in keeping the thrift banking industry responsive, productive and inclusive. Congratulations and thank you CTB!

Mabuhay ang ating mahal na bansang Pilipinas! Mabuhay po tayong lahat!

¹ Refers to gross domestic product in real terms

² Compared to Indonesia's 5.0 percent, Malaysia's 4.3 percent (Q3'16), Thailand's 3.2 percent (Q3'16), and Singapore's 1.1 percent (Q3'16) (Source: Central Bank websites, Bloomberg, CEIC Data Limited, and International Financial Statistics)

³ As of end-February 2017, gross international reserves (GIR) reached USD81.1 billion. This is sufficient to cover 9.2 months worth of imports (Source: Bangko Sentral ng Pilipinas).

⁴ Source: www.bsp.gov.ph/statistics/statbskrtb.asp

⁵ As of end-September 2016, the capital adequacy ratio (CAR) of subsidiary TBs registered at 15.9 percent on solo basis. On the other hand, the CAR of stand-alone TBs recorded at 19.7 percent as of end-June 2016.

⁶ The PDP was approved on 20 February 2017 during the third NEDA board meeting at the Malacañang.

⁷ Source: National Economic and Development Authority

⁸ It include the provinces in Northern Luzon, Central and Eastern Visayas, Northern Mindanao, Zamboanga Peninsula and the Autonomous Region of Muslim Mindanao (ARMM).

⁹ Refers to the Act Allowing the Full Entry of Foreign Banks in the Philippines on 15 July 2014

¹⁰ Refers to Yuanta Commercial Bank Co., Ltd. of Taiwan which acquired Tong Yang Savings Bank and Woori Bank of South Korea which acquired 51 percent of the voting stock of Wealthbank.

¹¹ Refers to micro, small and medium enterprises.