# Amando M Tetangco: In pursuit of sustainable and inclusive growth

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the MAP General Membership Meeting and First Economic Briefing for 2017, Makati, 28 March 2017.

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Thank you for inviting me to speak at MAP's General Membership Meeting and First Economic Briefing of 2017.

*"Working Together to Achieve Inclusive Prosperity"*

This is MAP's guiding principle for 2017. It is sensitive to recent developments where we witness moves by nations to leave economic unions; when countries speak of closing off their borders to neighbors and refugees; when societies are fighting back against public institutions. All in the hope of raising their own standards of living.

The MAP therefore has to be commended for resolutely putting the themes of cooperation, social responsibility, and inclusion at the heart of its activities for this year.

The MAP could not have chosen a more appropriate theme.

I say this because the world has taken unexpected turns in the past couple of years, driven by a general sense of discontentment and a brewing distrust in public policies and institutions. How did we get to this point?

If you look closely at the trend of the Global Policy Uncertainty Index[1], two things jump out.

The first is that it has been nearly a decade since the global financial crisis broke out. And yet, we continue to live with high uncertainty and its aftermath of heightened volatility and uneven economic growth.

The second is that these are truly uncertain times. Rising inequality has given traction to anti-globalization and populist sentiment across the globe. Even as these protectionist tendencies have seen some resistance, public policy has become less certain on the whole. This tension has cast a heavy cloud over global economic prospects.

Indeed, the rise of protectionist pressures reflects a growing belief among countries that the benefits of growth need to be shared more equally and equitably. For public policymakers, this means that the goals of inclusivity and growth should always go hand in hand.

This brings us to our theme and challenge today: How do we sustain our growth momentum while also creating a more inclusive society?

Let me structure the rest of my talk as follows:

I'll continue with the world outlook, and the risks and challenges we see from these global impulses.

Then I'll discuss our own domestic market dynamics, paying particular attention to the country's sources of resilience that have allowed us to sustain positive growth and make notable headway towards greater inclusion.

Finally, I'll relate these developments to emerging challenges for policy and the role the private sector can play in promoting inclusive growth.

## Global outlook and risks

In terms of the world economic outlook, global growth is projected to improve modestly over the next two years, with upward adjustments to the projections of the IMF for the US, EU, UK and Japan for 2017. Note, however, that these forecasts are still lower than the actual growth outcomes prior to the global financial crisis.[2]

Meantime, the outlook for emerging markets is still mixed. In particular, economic activity in China has held firm, while growth projections for India and Brazil in 2017 were cut. A downside risk to this outlook, however, is potential political discord and heightened inward-oriented sentiment, both of which could undermine global trade and dampen financial market sentiment.

Meanwhile, an offshoot of the evolving upward momentum in global growth is the possibility of reflation, or that global inflation may be at a turning point.

This positive momentum is reflected in the shift in policy stances of a number of central banks. As you all know, the US Fed raised its target Fed Funds rate by 25 bps last week. Furthermore, it is widely expected to continue on this path, with at least two more hikes anticipated in 2017.

A review of recent monetary policy decisions suggests that central banks have largely turned neutral—they see less urgency for further accommodation and would rather stay on hold. This phenomenon has been described as “watchful pause”.

The prospect of higher interest rates in advanced economies could cause capital outflows from emerging market economies (EMEs) as investors search for yield. The retreat of funds away from EMEs could lead to tighter dollar funding conditions in emerging markets. For firms with significant dollar-denominated liabilities, these developments could pose a risk to their balance sheets and profitability, unless of course these exposures have been adequately hedged.

In the case of the Philippines, we have seen some incipient signs of capital flow reversals as early as last year. Fortunately, the risk to businesses was mitigated by robust domestic liquidity and credit growth and by an adequate supply of foreign exchange. Debts of nonfinancial corporations in the Philippines also remain mostly peso-denominated, which provides some measure of insulation from external shocks.

Meanwhile, with the potential for capital outflows from EMEs, some emerging-market currencies could also see depreciation pressures and volatility in the near term. We have seen that kind of depreciation effect on the Philippine peso in recent periods. However, if we take a longer-term view on the movements of the peso, we can see that the peso has been broadly stable and competitive over the medium term. Looking ahead, we expect the peso to continue to draw strength from the steady stream of remittances from overseas Filipinos and of foreign exchange receipts from tourism and the BPO sector.

One other thing that we must be watchful of is the evolving dynamics of the international oil market. Oil prices rebounded right after the OPEC members agreed to cut output. However, the subsequent upswing in supply, due partly to renewed shale oil production in the US, has raised questions on the sustainability of the oil price rally.

Keeping a close eye on all these developments is crucial because they have direct implications on business costs and consumer sentiment. On the latter point, we note from the BSP’s latest Consumer Expectations Survey that consumers hold a slightly less favorable outlook for the year ahead, owing to expectations of higher prices of goods, the depreciation of the peso, as well as concerns over poor harvests and an overall slowdown in business activity.

For policymakers, tracking these dynamics closely will therefore allow for a pre-emptive response, if needed, to protect the interests of businesses and consumers. On the part of central banks, they will need to ascertain the implications on future inflation, and particularly on inflation expectations, to see if adjustments in the monetary policy stance will be warranted.

In sum, ladies and gentlemen, we see three major trends in the global environment:

1) a modest but uneven recovery in global economic activity;

2) a tentative turning point for oil prices and inflation; and

3) heightened financial market volatility, owing to a hazy outlook on potential shifts in macroeconomic policies.

## Banking on sound macroeconomic fundamentals

With these uncertainties in the external environment, we expect the year ahead to be just as challenging as the last one, if not more. The good news is that we can bank on solid macroeconomic fundamentals to keep the economy moving along on its path of robust growth.

We have a broader base for growth, a manageable inflation environment, a sound banking system, and a healthy external payments profile. How can these buffers sustain the Philippine growth engine, and how sustainable is the Philippine growth story?

Over the last two decades, the country has weathered just as many financial crises—the Asian financial crisis in the late 90s, and the global financial crisis in the late 2000s. Throughout this period, the country managed to register 72 consecutive quarters of output expansion. To put things into perspective, we are referring to a span of 18 years.

Barring any significant shock, we are on track to extending this streak, as recent indicators of activity point to a strong growth impulse.[3] The National Government expects growth to average 6.5-7.5 percent this year, higher than last year's target of 6-7 percent.

This mirrors buoyant business sentiment, as indicated in our latest Business Expectations Survey. The optimistic outlook is anchored on expectations of stronger job orders, the potential expansion of businesses and product lines, as well as the ongoing infrastructure projects of the government.

One reason for this sustained growth impulse is that growth has become more broad-based.

On the demand side, growth has historically been anchored by robust household consumption. In recent years, investments have also become a significant growth driver. In 2016, for instance, the contribution of capital investments to overall GDP growth even outstripped that of private consumption. Meanwhile, on the supply side, the shares of manufacturing and construction have also been increasing. This complements the steady contribution from services such as trade, real estate, and financial intermediation.

In short, the country now has more diversified domestic sources of growth. They should also serve as ample cushions against external shocks, particularly if protectionist sentiment continues to gain traction overseas and dampen the country's export-oriented sectors.

It also bears noting that this sustained growth in output was achieved under a stable inflation environment. Going forward, we see average inflation will be within the target range of 2-4 percent for 2017–2018. A closer scrutiny of the monthly inflation path will show that inflation imprints will be rising until sometime in Q3 2017, when the monthly rates are expected to be very close to the upper band of the target range. Even so, our forecast path suggests that monthly inflation will slow down thereafter, resulting in within-target full-year averages over the policy horizon or the next two years.

In addition, money supply remains ample. Even at double-digit growth rates, we do not see overheating in credit conditions, as credit continues to be channelled to key production sectors. More importantly, the intermediation of these funds is expected to remain safe and efficient, owing to our sound and stable banking system. Key indicators continue to reflect solid asset growth and improving quality of loans. Capitalization also remains strong and above prescribed domestic and international standards.

On the external front, the country's current account has been in surplus for 14 consecutive years,[4] due to the sustained increase in overseas Filipinos (OFs) remittances, as well as business process outsourcing (BPO) revenues and tourism receipts. We saw a narrowing of the current account surplus in recent months. This trend may continue, as imports of capital goods are seen to further pick up. Such importation, we note, is necessary to support the expansion of the economy in the medium term.

Steady foreign exchange (FX) inflows from OF remittances and BPOs, however, will continue to allow us to maintain adequate FX reserves. We expect our gross international reserves to continue to be more than sufficient to meet the country's FX liquidity requirements.

## Reaping dividends from growth

To reiterate, our macroeconomic fundamentals remain strong. On the one hand, these give us enough buffers to ward off the challenges posed by a difficult external environment. On the other hand, how secure are we against homegrown challenges?

Political noise here as well as overseas is a manifestation that the benefits of growth may not have trickled down fairly to all sectors of society. The rise in populist sentiment globally suggests that inequality in society also poses a threat to prosperity.

In essence, what we're saying is that it is not enough for growth to be just fast and sustained. For growth to be truly meaningful, It must also be inclusive.

We can take heart in knowing that the Philippines has made noteworthy progress and intends to see more headway moving forward.

For one, labor and employment conditions have shown marked improvements. The unemployment rate has declined steadily from 7.4 percent in 2010 to 5.5 percent in 2016. The government aims to reduce it further to between 3 and 5 percent by 2022 through its various social programs and sustained economic growth.

Poverty incidence and income inequality among Filipinos have also been on an appreciable downtrend, with the incidence of poor population declining from 49.5 percent in 1988 to 21.6 percent in 2015. The new Philippine Development Plan aims for this to fall further to 14.0 percent by 2022.

Also, income inequality has been reduced. The Gini coefficient inched down from 0.49 in 1997 to 0.44 in 2015.

Finally, inflation for the lowest 30 percent of households is also lower now than in prior years. From 5.1 percent in 2009, it has fallen to only 1.4 percent as of end-2016, suggesting that these households are now less vulnerable to price shocks.

## Policy thrusts

All these support the belief that with the right policies and programs in place, it is possible to achieve sustainable and inclusive growth. But for the engine of inclusive growth to keep running, both the public and private sectors must share in the responsibility of making sure that no Filipino is left behind. There is much to be done towards this end, so I reiterate the question I posed at the beginning: How do we create a more inclusive society?

In this regard, let me provide some highlights of the initiatives for public policy.

On the part of the BSP, we reaffirm our commitment to maintain price and financial stability conducive to balanced and sustainable growth. Our latest projections indicate that inflation is likely to settle within the target range of 2-4 percent for 2017–2018—at the moment, our forecasts are at 3.4 percent for 2017, and 3.0 percent for 2018. Inflation expectations also remain well-anchored. Therefore, the current stance of policy is deemed appropriate.

The balance of risks surrounding our inflation outlook is, however, tilted toward the upside. The transitory impact of the proposed tax reform program as well as possible adjustments in transportation fares and electricity rates could raise the inflation trajectory. However, uncertainty over the prospects of the global economy and potential macroeconomic policy shifts overseas continue to pose a key downside risk.

Turning to financial stability, the BSP will remain steadfast in working to strengthen the banking system, improve risk management standards, and align our financial regulations with international best practices.

Amid turbulence in the global economy, maintaining a market-determined exchange rate will help ensure the stability of the Philippine financial system and the economy as a whole. We are an inflation targeter, and therefore do not target specific exchange rates. That is why the BSP participates in the FX market only to limit volatility, or when movements are becoming misaligned with fundamentals.

Other measures include deploying liquidity provision measures to address any potential tightness in funding conditions; and enhancing macroprudential measures and other surveillance tools in targeting risks arising from capital flows and other vulnerabilities.

Let me also take a moment to highlight the BSP's ongoing campaign for greater financial inclusion, an advocacy that I hold close to my heart. As outlined in the National Strategy for Financial Inclusion (NSFI), our work will revolve around three major areas: enhancing access to financial services, promoting financial education, and upholding financial consumer protection.

- On enhancing access: Only about 64 percent of cities and municipalities nationwide have banking presence[5]. By allowing micro-banking offices (or MBOs) and alternative financial service providers such as pawnshops to enter underserved markets, 88 percent of municipalities and cities would have access to financial services. We have also put in place regulations that leverage on financial technology ("fintech") such as e-money transactions, as well as programs aimed at improving access to financing for our small entrepreneurs[6].
- On promoting financial education: We will continue with our Economic and Financial Learning Programs targeting OF families, the youth, and entrepreneurs. To date, we have conducted EFLPs in 79 of the 81 provinces in the country.
- On financial consumer protection: We enacted BSP Circular No. 857 to ensure that BSP-supervised financial institutions (BSFIs) adhere to the highest service standards. We will continue to promote regulations that will encourage BSFIs to embrace a culture of fair and responsible dealings with the public.

Finally, we recognize that to enable the country to springboard toward a higher and sustainable growth path, it needs more infrastructure to increase the economy's productive capacity and to redistribute the benefits of faster growth. Road networks, air and sea transport systems, facilities for health and other social services—all these should help address the congestion in Metro Manila and other urban areas, and in the process help distribute opportunities for employment and access to other public services to the rest of the regions. There is fiscal space to do all these, and the National Government has committed to capitalize on that space and ramp up infrastructure spending.

## Concluding remarks

Ladies and gentlemen, I hope that in the last half hour or so, I have been able to paint a fair picture of the outlook for the Philippine economy. All told, domestic sources of resilience will allow us to weather a difficult global environment and sustain growth amid a manageable inflation environment.

We owe this resilience largely to our continued investment in reform. The Philippines has made significant strides in strengthening its institutions and enhancing its competitiveness over the past years, and our efforts have not gone unnoticed.

Beyond the recognition, these reforms have also begun to yield dividends for more Filipinos by encouraging private-sector participation and investments; ensuring fiscal sustainability; and promoting innovation and competition—all of which, in turn, have helped reduce poverty and income inequality. But this is not to say that the job is done. Far from it. What it means is that we have a big job ahead of us.

However, as recent global events have shown us, there is no guarantee that these benefits of growth will be shared fairly.

The challenge, therefore, remains. Promoting sustainable and inclusive growth will require much work and the concerted efforts of both the public and the private sector.

As a final remark, let me say that the private sector remains a vital cog in the country's growth engine through investments, financing, and knowledge transfer. Your role in pursuing sustainable and inclusive growth is to provide opportunities for employment, and access to finance and expertise, especially to the sectors and regions where they are most needed.

The MAP, in particular, is moving in the right direction. You have your Top Five Priority Programs for 2017: Traffic Management, Ease of Doing Business, Entrepreneurship, Employment Generation, and Women Empowerment. All these initiatives should provide a solid springboard towards your goal of promoting inclusive prosperity.

As we push forward in 2017, I hope that the MAP and BSP can work more closely together in this shared responsibility of pursuing sustainable and inclusive growth. Let me also wish the MAP continued success in its endeavors in the year ahead.

Thank you, and good afternoon.

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[1] The Global Economic Policy Uncertainty index measures policy-related economic uncertainty using media coverage and professionals' forecasts of macroeconomic variables. The index peaked in January following the anti-immigration policy pronouncements of the Trump administration in the US. The rising acceptance of populism in Europe also continues to cause unease, with upcoming major elections in Germany and France remaining a source of uncertainty.

[2] Compare these to their respective average annual growth rates prior to the global financial crisis (i.e., 1998–2007: US (3.0 percent); Euro Area (2.4 percent); UK (2.9 percent); and China (9.9 percent). (Source: IMF World Economic Outlook, October 2016).

[3] The average capacity utilization rate of the manufacturing sector stood at 83.8 percent in January 2017.

[4] Following the BPM6 format, the current account has been in surplus from 2005–2016. (Current account surpluses were also recorded in 2003 and 2004, following the BPM5 concept)

[5] As of 2016, 88.2 percent of cities and municipalities have at least one financial service access point, up from 87 percent in 2015. Of this number, 63.8 percent have banking presence in 2016 (63% in 2015). (Source: BSP Financial Inclusion Initiatives 2016 Report)

[6] Republic Act No. 10744 (“Credit Surety Fund Cooperative Act of 2015”) was passed into law on 6 February 2016.