Nestor A Espenilla, Jr: Invisible to joined hands

Speech by Mr Nestor A Espenilla, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the Annual Joint General Membership Meeting of MART, ACI, IHAP, TOAP, NASBI, and FMAP, Makati City, 21 September 2017.

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The spirit of unity, collaboration and optimism in this Annual Joint General Membership Meeting is palpable. That there are six (6) prestigious financial market associations here in full force in spite of a holiday of sorts is exciting. It sets the tone for our willingness to work hard together, hand-in-hand to make our financial markets stronger and better.

Historically and ideologically, there has been a divide between the private and the public sectors. There are staunch views that capitalism will take care of itself and government should leave markets alone. As early as the 18th century, Adam Smith's theory of the "invisible hand" that guides supply and demand toward equilibrium and efficiency was gospel.

In the 1930s, the idea of self-correcting markets was debunked by the Great Depression… even recently, by the Global Financial Crisis. That Government can improve market outcomes – to promote efficiency and equity, and address market failures is now accepted principle.

That you have consistently been valuable partners of the BSP emphasizes – quite happily – that we are on a higher plane of acceptance. We view each other as indispensable partners in achieving our shared vision of greater economic development … There is resounding acknowledgement that we are on the same side… and it is only when we work together that we can achieve our goals.

For this, I sincerely thank you. To the Money Market Association of the Philippines (MART), ACI Financial Markets Association Philippines (ACI Philippines), the Trust Officers Association of the Philippines (TOAP), the Fund Managers Association of the Philippines (FMAP), the Investment House Association of the Philippines (IHAP) and the National Association of Securities Broker Salesmen, Inc. (NASBI), maraming salamat…

Thank you for being partners with us in our shared vision of ensuring a more robust financial system… To everyone in this ballroom, esteemed guests, ladies and gentlemen, good evening.

Setting context

Many of us have witnessed how our country has transformed from being an economic laggard to one of the region's fastest performing economies.

For the past 74 quarters (or 18.5 years), the Philippines has posted uninterrupted GDP growth, backed by strong macroeconomic fundamentals.

Inflation today is low and stable with average headline inflation from January-August 2017 at 3.1 percent. The balance of payments is under control despite global shifts. External liquidity is secure. We benefit from prudent fiscal management with the National Government deficit at a manageable level of 2.1 percent of GDP and a relatively low debt-to-GDP ratio of 42.1 percent as of end 2016. And we protect our fiscal space to support economic gains by moving forward with an ambitious tax reform agenda.

In the first half of 2017, GDP growth was 6.4 percent. A strong domestic demand and expansive government budget for infrastructure development underpins this growth. Overseas Filipino remittances and BPO sector revenues continue to drive our economy.

Recently, the World Bank affirmed a positive growth path for the Philippines, forecasting the economy to grow even more at 6.8 percent this year, and at 6.9 percent in 2018.

Overall business sentiment remains positive as shown by the results of the BSP Business Expectation Survey for the third quarter of 2017.

Indeed, it is possible to have both strong economic growth and manageable inflation. For 2017–2019, we expect average inflation to track the target range midpoint of 2-4 percent… Ample domestic liquidity and broad-based growth in bank lending for production activities continue to support economic growth.

While there could be some transitory upside risks to inflation owing to the possible impact of the proposed tax reform program along with pending petitions to raise power rates, inflation expectations continue to be within target over the policy horizon. Over the medium term, as the infrastructure program gets underway, the resulting improvement in productivity and various safety nets are also expected to temper the impact on inflation. Based on these considerations, the Monetary Board decided during its meeting earlier today to maintain the BSP's key policy rate at 3.0 percent.

With respect to the external sector, the Philippines' current account (CA) balance narrowed during the 1st half of 2017 relative to a year earlier. This was due mainly to higher net receipts in the trade-in-services, and primary and secondary income accounts which mitigated the widening trade-in-goods deficit during the first half. In turn, the strong demand for imports such as capital goods, consumer goods, raw materials and intermediate goods is a result of the sustained and broad-based expansion in the domestic economy's capital formation, production and consumption.

The increased demand for dollars also reflects residents' investments abroad and prepayments of foreign debt. However, continued strong inflows from overseas Filipinos' remittances, business process outsourcing receipts, and revenues from the tourism sector, are seen to support the current account. Meanwhile, we continue to watch against financial market volatility as risks emanating from normalization in advanced economies and ongoing geopolitical tensions may dampen investor sentiment.

Our financial sector has also demonstrated strength and sustained growth amidst uncertainty. Banks have stronger balance sheets and much improved asset quality. There is double-digit growth in assets, loans, deposits and capital. The banking system's resources expanded by 14.2 percent as of end-July supported by a stable deposit funding base. In line with the country's domestic growth, banks' total loan portfolio grew by 17.9 percent and is diverse across industry sectors.

Notwithstanding sustained expansion in credit, banks demonstrate prudence in lending. Banks' NPL ratios declined to 1.98 percent. Banks also maintained an adequate buffer for loan losses, registering a higher NPL coverage ratio of 113.13 percent.

Meanwhile, banks continue to build up their capital position. As of end-March 2017, the capital adequacy ratio (CAR) of universal and commercial banks (U/KBs) registered at 15.8 percent.

Continuing need for balance

We have much going for our economy that outshines seemingly inherent negativity. What is the role of the BSP and what more can it do to protect and advance our solid gains? Let me share with you some programs of the BSP key reform agenda…these embody what I describe as "Continuity Plus Plus".

The BSP remains committed to its core mandates of maintaining price and financial stability, as well as an efficient payments and settlement system. These form part of the “Continuity” agenda.

Monetary policy

To ensure inflation is kept at a manageable level, the BSP follows an established process in its periodic review of monetary policy. The BSP has been successful in keeping inflation low and stable, in this regard, we will continue with our monetary policy approach and inflation targeting mechanism.

With the introduction of the Interest Rate Corridor (IRC) last year, we continue to strengthen monetary policy transmission. We have seen some encouraging results in the form of 1) sustained Term Deposit Facility (TDF) demand, and 2) a gradual adjustment in market interest rates. As originally envisioned, we shall continue to improve the IRC system as we move towards a more market-based implementation of monetary policy.

Prudential reforms

Further, leveraging on the financial system’s current position of strength, we will continue to pursue progressive and proactive prudential reforms to maintain resilience against external shocks.

With the evolving trends and changing preferences in financial services delivery, we continue to align with international standards while engaging relevant stakeholders for our policies to remain responsive to local conditions.

Last week, our enhanced corporate governance framework took effect. It emphasizes the responsibilities and qualifications of banks’ board of directors and senior management and strengthened requirements for board composition. This essentially serves as the overarching framework that ties in risk management in functional areas of a financial institution.

Earlier, the BSP issued regulations to strengthen governance over treasury activities. The BSP expects market participants to behave ethically and with utmost integrity in all its dealings.

We recognize that the industry has developed a Code of Ethics. We understand it governs financial market activities as well as market conventions covering a range of financial products. We enjoin the industry to review these standards to ensure alignment with global best practice. We encourage the industry to operationalize arrangements to promote adherence to the Code, not only at an industry level, but down to the institution- and individual-level.

In our expanding market, integrity and accountability are vital in sustaining confidence.

Strategic financial sector reforms towards inclusive growth

Now, let me move on to what is close to my heart. While continuity is about focusing on our core mandates, the “plus plus” agenda pushes the envelope further and focuses on reforms that will foster broad-based inclusive growth. These financial sector and market infrastructure reforms are strategic, complementary, and reinforcing. They aim to 1) deepen our local currency debt and foreign exchange markets, 2) digitalize our payment system, and 3) ultimately enhance access to financial services and products.

The world has recently recognized our potential as a promising investment destination. Our capital markets are poised to serve as an important source of funding in support of the National Government’s resolve to shore up infrastructure.

A well-functioning local currency debt market, therefore, is critical to the implementation of a sustainable market-oriented debt management strategy. This will likewise support open market operations of the BSP. This will promote financial stability by diversifying funding sources to support economic growth, and increase the availability of financial products.

Many of you were at the BSP last month when the BSP, in collaboration with the Department of Finance (DOF), Bureau of the Treasury (BTr), and the Securities and Exchange Commission (SEC), unveiled the local currency debt market development roadmap.

As you know, the capital market reform agenda will initially focus on benchmark markets. The reforms will be undertaken over an 18-month time frame from launch in November with specific targets for regulatory and institutional milestones. Deliberately, we sequenced and calibrated the roadmap to ensure that urgent and foundational issues are prioritized.

These include initiatives to 1) increase the volume of treasury bills, 2) provide stable, predictable and transparent issuance of government securities, 3) develop a systematic set of obligations, rights and incentives for market-makers, 4) establish a reliable yield curve, 5) introduce a repo program, and 6) strengthen regulatory oversight over the repo and fixed income market.

Even as we pursue efforts to deepen the local debt market, the BSP actively worked on improving access to investment products. For instance, the Personal Equity Retirement Account (PERA) was launched late last year. This was done with the strong support of the industry. The program provides an opportunity for capital market gains to be enjoyed by a wider retail base. Further, we continue to pursue a related legislative agenda such as the Collective Investment Schemes Law (CISL) to provide a harmonized legal framework for pooled vehicles of investments.

Given the Philippines' young demographic profile, these efforts can also translate to the mobilization of a sizeable and sustainable amount of savings towards financing the country's long-term infrastructure requirements and developmental programs.

As part of our holistic financial sector reform agenda, we are pursuing ambitious foreign exchange (FX) reforms. The objectives are to deepen the FX market, increase its efficiency and reduce the cost of doing business. Reforms include removing prior BSP approval for certain FX transactions, simplifying registration processes, further reducing documentary requirements, and enhancing data capture for effective policy decision-making.

While the idea is to establish a framework that relaxes FX rules and regulations, we wish to stress that authorized agent banks (AABs) are responsible and are held accountable for faithfully complying with these rules.

With these efforts, we hope to encourage FX flows from the parallel market to the formal market. Even as we strengthen regulations over Money Service Businesses (MSBs) to maintain financial integrity and enhance consumer protection, we will streamline FX requirements for the banking system to reduce market fragmentation and increase FX liquidity.

The amendments to FX regulations is part of a broader thrust for an organized FX market. The intention is to increase transparency, improve price discovery, and increase availability of FX instruments, including hedging products, to improve risk management capabilities of banks and clients.

Finally, we are setting our sight on digital innovations as a catalyst to reach greater scale. Creating an efficient digital infrastructure reinforces our capital and FX markets and financial inclusion agenda. It provides an enabling platform that can transform the way financial services are efficiently delivered and consumed.

In this regard, the BSP is committed to drive modernization of the country's retail payment system, promote electronic retail payments, and facilitate inter-operability for faster settlement of transactions. The launch of the National Retail Payment System, in partnership with industry stakeholders, will help us achieve this vision of a “cash-lite” economy.

From invisible to helping hands

At the onset, I expressed how the role of Government in economic markets has shifted from exclusion, to regulation, to cooperation. Adam Smith’s invisible hand, while potent with respect to forces of supply and demand, is now complemented by the helping, collaborating and joined hands of the Government and the private sector. Joining hands is essential for long-term success.

This is so as goals must be shared and not merely cascaded. For sustainability, interests of the regulator and regulated must converge.

Our objectives are the same but our expertise and experiences are varied… these differences may be harnessed so that we can come up with viable and mutually beneficial outcomes. I have faith that ACI, MART, IHAP, TOAP, NASBI, and FMAP will remain our trusted partners in this regard. I trust that all of you will remain committed to playing a big role in growing our respective markets, in developing professional standards, in delivering value to your organizations and clients, and in forging strong partnerships with regulators such as the BSP. Today is a day of protest. Join me in protest against inefficient and undeveloped financial markets. Tama na! Panahon na! Sama sama tayo sa pagunlad. Mabuhay tayong lahat.

Thank you and I wish everyone a pleasant evening.