Nestor A Espenilla, Jr: Supporting the backbone as we sprint

Speech by Mr Nestor A Espenilla, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the Philippine Chamber of Commerce and Industry's (PCCI) 43rd Philippine Business Conference and Expo, Manila, 18 October 2017.

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PCCI President George Barcelon; Philippine Business Conference and Expo Chair Joey Leviste, Undersecretary Jonas Leones, co-workers in government; PCCI officers and members, special guests, ladies and gentlemen, good afternoon.

Thank you Philippine Chamber of Commerce and Industry (PCCI) for the opportunity to speak during this 43rd Philippine Business Conference and Expo.

I am often asked how the BSP addresses wealth inequality and if we support Micro, Small and Medium Enterprises (MSMEs). While this is not directly written in our charter, we approach our mandate with precisely this as a key strategic goal.

Maintaining Price and Financial Stability Benefit All Sectors

Maintaining price and financial stability are the BSP’s primary mandates. Keeping inflation low and stable benefits everyone, especially MSMEs. A managed inflation and stable financial system allow MSMEs the best foundation to grow. Reduced uncertainty allows expansion.

In this regard, I am happy to report that amidst various challenges, the domestic economy continued to deliver on all fronts. Real GDP grew by 6.5 percent in the second quarter of 2017, making us one of the fastest growing economies in Asia. This also extends our streak of uninterrupted growth for 74 consecutive quarters.

Let me stress that beyond the nominal numbers, we also emphasize the quality of growth. Economic expansion is driven by broad-based factors with the re-emergence of the industry sector, particularly manufacturing, as another key growth driver. We are optimistic that we will be able to achieve our high growth targets of 6.5 – 7.5 percent this year and even faster beyond, fuelled by the massive infrastructure agenda of the government. Government investment spending, which picked up in Q2, confirms this important direction.

The positive alignment between growth and inflation has been a sustained narrative. Maintaining price stability amid a challenging global and domestic environment validates our inflation targeting framework. Inflation expectations continue to be well-anchored. The year-to-date average inflation rate of 3.1 percent puts us firmly on track to stay within the target range of 3.0 percent ± 1.0 percentage point for 2017. In spite of recent inflation pick-up, we project average inflation in 2017 to remain at about 3.2 percent. This is also our forecast for 2018–2019.

The sound and stable condition of Philippine banks has also been one of the anchors of sustained performance of the domestic economy. Over the medium-term, we expect the country’s banking system to continue its robust performance based on sound fundamentals. The reforms pursued by the BSP, along with banks’ commitment to improve their ability and capacity to manage risks have resulted in significant improvements in the quality of bank assets and capital.

In terms of the country’s overall external payments position, the balance of payments as of the first eight months of 2017, posted a deficit of US$1.39 billion. This is sustainable and represents less than one percent of GDP. This can be readily financed.

The balance of payments deficit can be attributed, in part, to stronger growth in imports as the economy continues to expand rapidly and ramps up investments. The deficit also reflects rebalancing of portfolio capital flows in line with potential monetary policy normalization in advanced economies. Similarly, some residents are pre-paying their foreign debt to manage their risk exposures. We are likewise seeing a pick-up in outward investments both to take advantage of regional business opportunities and to diversify investment portfolios. We look at all these as healthy developments that support economic growth and resilience.

In the meantime, we stay calm as the country's gross international reserves (GIR) remained ample as of end-September 2017 at US$81.4 billion. This is more than enough to cover 8.5 months of imports of goods and services and 5.5 times the country's short-term debt obligations.

As part of the adjustment mechanism we employ to protect our economy, we have allowed a modest and gradual depreciation of the peso. This flexibility makes us more resilient, prevents overheating, and enhances the price competitiveness of our exports of goods and services.

Supporting the Backbone

Since I began this speech, I have mentioned the word "growth" several times... As the economy grows (AND as we prepare to sprint forward) it is important to support our backbone. MSME sector is the backbone and a crucial driver of our economy.

We all know the statistics. MSMEs comprise 99.5 percent of all registered business firms nationwide and contribute the largest share of total jobs generated at 61.6 percent. However, MSMEs account for only 35.7 percent of the country's Gross Domestic Product!

MSMEs are unable to reach their full potential due to a range of barriers, including financial access, characteristic of MSMEs even in other countries. Indeed, bank lending to MSME leave much to be desired, comprising only 6.1% of total loan portfolio.[1/] 80% of SME investments are internally financed compared to only 10% that are bank financed.

Giant Leaps Bridge Gaps

At the BSP, we are troubled by these numbers and take them seriously. We have been hard at work providing the regulatory environment that will create a more inclusive financial system. We strongly believe that the deeply ingrained barriers to financial access – cost, information asymmetry, and lack of infrastructure, among others – are market frictions that can be addressed without compromising on other policy objectives.

Enabling Access to MSME Credit

To promote MSME access to finance, we have pursued continuing prudential reforms to improve the overall environment for credit allocation in the economy. We implemented the comprehensive credit risk management (CRM) guidelines for banks under Circular No. 855. The rationale is that with robust credit risk management, banks can be more flexible, extend more credit, and implement innovative credit products and lending programs. The intention is for banks to focus on cash flow analysis and ability-to-pay rather than collateral when determining a borrower's creditworthiness. Collateral (particularly real estate) should only play a secondary role in credit decisions. This addresses a significant issue since MSMEs often lack collateral even if these are fundamentally good businesses.

In addition to providing an enabling regulatory environment, the BSP also initiated the Credit Surety Fund (CSF) program as convenor and promoter. The CSF is a credit enhancement scheme to improve the credit worthiness of MSMEs that experience difficulty in obtaining bank loans.

Early this month, the 50th CSF was established in Cauayan City, Isabela and the 51st CSF will be launched in two (2) weeks in Batangas City. The program already covers 31 provinces and 19 cities nationwide.

Expanding Network

Our progressive regulatory issuances have allowed a wider range of financial products, a more expanded physical and virtual reach of financial services, more competition, easier on-boarding of customers, and more protection for financial consumers.

To date, the wide range of microfinance services of banks cover nearly 1.7 million microentrepreneurs with an outstanding portfolio of P13 Billion. Bank's microbanking offices (MBOs) have allowed cities and municipalities previously with no banking presence to enjoy banking services. There are now 747 MBOs in 434 cities and municipalities all over the archipelago . We expect this to further expand with our recent issuance (Circular No. 940) allowing third party retail outlets to function as bank cash agents.

Complementing this is Circular No. 950 on the implementation of the Anti-Money Laundering Act. This allows implementation of reduced Know-Your-Customer (KYC) rules for certain low-risk accounts and the use of technology for face-to-face contact requirements. These amendments aim to facilitate frictionless customer on-boarding which is currently a major pain point for those reaching unserved and underserved markets.

The Digital Leap

Building on the gains of our policy initiatives over the years, we are setting our sights on digital innovation. Digital solutions not only present opportunities for cost savings and efficiency gains, but also provide potential break-through in reaching the unserved and underserved markets on a massive scale.

The BSP's approach has been to scale regulations according to the risks involved to ensure that beneficial innovations and efforts for financial inclusion are not hampered by unwarranted compliance burden.

Currently, the BSP is working closely with various innovators on the launch of additional digital financial services covering mobile financial services via social network, online micro-investment platform, and use of digital cash.

Moreover, the BSP has been working closely with the national government for the implementation of a biometric-based digital identity system. The initiative is envisioned to facilitate the provision of more efficient, transparent and equitable government and financial services, especially to those who have been disenfranchised due to lack of an acceptable ID.

Finally, the BSP is currently working with the industry towards enabling more Filipinos to have access to a transaction account to send and receive payments via any electronic device through the National Retail Payment System (NRPS). The NRPS, and the payment ecosystem that is envisioned to arise from it, is positioned to be a platform for fintech innovations. This can dramatically lower the cost of doing business for our MSMEs, as well as enable more e-commerce. Work has been ongoing here and we look forward to launching, next month, the Batch Electronic Fund Transfer (EFT) Credit to be called "PESO Net" and following that, the Real Time Low Value Push ACH or "InstaPay". Our MSMEs will surely benefit from these initiatives by broadening their customer reach, reducing the cost of managing cash, and providing greater access to credit.

Stepping and Leaping Together to Bridge Gaps

While much has been accomplished, the figures on MSME financing show that more needs to be done. An MSME finance ecosystem that services the needs of MSMEs at various stages of their growth path must be in place. These services are not exclusively bank credit but involve a mix of providers and products that are suited to the MSMEs needs and capacities.

There is an urgent need to develop financial infrastructure to support MSME financing. This includes a credit information system, efficient secured transaction registries and a well-run credit guarantee system. We are also very focused in pursuing ambitious reforms to deepen our domestic debt market and to further liberalize our foreign exchange regime to make doing business generally easier. The BSP is closely working with partners in government, the private sector, and international organizations on all these fronts and will stay engaged and supportive of these important initiatives.

However, coordination and collaboration of multiple players is needed. Only through our cumulative efforts will MSMEs be provided greater and affordable access to capital and finance. This will allow them to engage in more productive, innovative, and profitable activities contributing to national development.

On behalf of the Monetary Board and the BSP, I am very honored to share this vision of synergy and cooperation with you. Let us take the steps and leap forward together.

Thank you and mabuhay tayong lahat!