

Nestor A Espenilla, Jr: Optimum navigation

Speech by Mr Nestor A Espenilla, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the 9th General Membership Meeting of the Financial Executives Institute of the Philippines (FINEX), Makati City, 20 September 2017.

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When I was Deputy Governor of the BSP's Supervision and Examination Sector I had the honor of speaking at some of your membership meetings and the pleasure of participating in your golf tournaments and now, formally, one of you.

Today, I thank you for inviting me, and for the opportunity to congratulate FINEX's new members as Governor of the Bangko Sentral ng Pilipinas....

FINEX President Benedicta Du-Baladad, MBM Val Araneta, MD Jane Chiong, FINEX directors and officers, esteemed guests, ladies and gentlemen, a pleasant afternoon to you all.

In the theme, there is reference to a new BSP roadmap... As requested, I am here to talk about some of our plans, in my presentation and in our Q and A.

Since the BSP's establishment on 3 July 1993, our core mandates have remained the same. The target of making the Philippine economy more globally competitive, and its financial system more robust and stable is unchanged. Each and every Governor was focused on reaching this destination... As new BSP Governor, do I have a new roadmap?

This is an interesting question and one often asked of me... When I first became Governor, I emphasized the importance of building on my predecessors' legacies of excellence... This was summed up in the phrase, "Continuity Plus Plus."

In this sense, I can't say that there is a new roadmap... Rather, what there is, is an on-going journey... a strategic one at that... as we pursue deeper financial sector reforms.

Interactive Road Maps

Do you use Waze or Google maps?

I think these are wonderful apps... Waze relies on community and user reporting... When users report on accidents, blocked roads, weather conditions, this information is collected and immediately analysed. Wazers are then informed of the optimum route to get to their destinations...

Google Map on the other hand, is created through collaboration with Google Earth. It depends on images from third-party satellites fed into powerful computers to provide high-resolution images taken from above.

Sometimes, mid-journey, these digital maps recalculate and advise when there is a route that is several minutes faster! ... I like how technologically powered roadmaps like these are interactive... dynamic, smart, sensitive and are responsive to changing conditions!

I am not saying that the BSP is only just now adopting these mapping or planning frameworks. Even under the Governorships of my predecessors, the path of central banking has never been static... We evolve and adapt innovative ways of preserving financial stability as we deal with inter-related transactions, regionalization, globalization, the growing sophistication of interconnected markets, and developing technology.

We Are Here

Whether one uses Waze, Google Maps or an ordinary paper roadmap, the first thing one needs to determine is the start point... the “we are here mark” on the map... So where are we?

I am happy to report that the Philippines has sustained strong macroeconomic fundamentals... We continue to be one of the fastest growing economies in Asia, registering a 6.5 percent annual growth in gross domestic product (GDP) in the second quarter of 2017...

While headline inflation rose to 3.1 percent in August 2017, it is still within the Government’s target range for 2017, and also 2018–19. We have established credibility in hitting our inflation target.

Our level of gross international reserves (GIR) is healthy at \$81.72 billion as of end-August 2017, which amount can adequately cover 8.6 months’ worth of imports... In June, our foreign direct investments (FDI) have grown by 182.7 percent to \$674 million.

The banking system is sound and stable with a double-digit growth in resources at 13.5 percent to reach P14.2 trillion as of end-June 2017... Growth is fuelled by sustained inflows of deposits reaching its P11.0 trillion mark... The total loan portfolio likewise grew by 18.0 percent to P8.0 trillion.

Our financial market is deepening but domestic credit to GDP is still the second lowest among Asia Pacific countries at 63.6%...

Loan quality of the banking system is satisfactory as NPL ratios continue to decline at 1.9 percent... Banks have taken enough buffers for expected and unexpected losses arising from their expanding lending activities. Further, banks maintain ample liquidity and strong core earnings.

Recalculating for Faster Route: Deepening Markets

There are happy instances when Waze suddenly beeps and an electronic voice announces that it has found a better route... Are you familiar with this?

As we have been moving along, there are conditions that indicate room for more growth in the domestic bond market! Outstanding local currency (LCY) bonds represent just 34.2 percent of the country’s GDP. The outstanding LCY bonds amounted to P5.2 trillion (USD102 billion) as of end-June 2017. This resulted in an increase of 10.2 percent year-on-year supported by gains in both the LCY government (P4.2 trillion) and corporate bond (P1.0 trillion) segments. During the same period, outstanding LCY bonds consisted of 81.5 percent government bonds and 18.5 percent corporate bonds.

Today the bond market is still largely composed of government-issued debt, but we see a promising performance in corporate bonds given their faster annual growth rate of 18.4 percent as of end-June 2017.

In the dollar bond market, early this year, the Government issued a US\$2 billion bond with a 25-year tenor. The bond offering had a record-low yield of 3.7 percent. Corporate issuers with outstanding dollar bonds are looking to the LCY bond market to refinance foreign borrowings and to cushion the impact of exchange rate volatility. Both reflect prudent liability management amid rising foreign interest rates.

The local bourse is also upbeat. The PSE composite index is reaching all time highs. Year-to-date, the PSEi has gained something like 20 percent.

Oh... but wait... like the Waze and Googlemap apps that report possible challenges ahead, we also see downside risks such as uncertainty from monetary policy in advanced economies and geopolitical risks. Seeing these risks, we at the Bangko Sentral, have taken stock of our strengths, and remain vigilant.

Medium Term Philippine Development Plan on Capital Market Development

This optimum route towards economic development is consistent with the Government's medium term development plan. In this plan, the administration's initiative to foster capital market development by promoting efficiency in trading, settlement and delivery of securities is outlined. This underscores the vital role of the capital market to complement bank lending for purposes of supporting long-term financing requirements of corporates and the Government, particularly for its "Build, Build, Build" program.

In deepening the capital market, there is need to secure reliability, quality, and integrity in the pricing and valuation of financial instruments. There is also need to establish an integrated financial market infrastructure. These initiatives are significant in promoting price discovery, transparency, orderly trading, clearing, and settlement of the full range of financial transactions.

BSP Support for the Capital Market Reform Program

The BSP is highly supportive of a capital market reform program. We desire a more balanced financial ecosystem where a well-functioning banking system is complemented by deep and liquid debt and equity markets and where there are viable alternative sources of financing for long-term investments, including the development of necessary financial market infrastructures (FMI).

Recently, the BSP in collaboration with the Securities and Exchange Commission (SEC), Department of Finance (DOF), and the Bureau of the Treasury (BTr) unveiled a package of joint and coordinated initiatives to spur domestic debt market development to be undertaken over an 18-month timeframe once we get going.

The capital market reform agenda will initially focus on benchmark markets (the money market and the treasury bond market). Improving discovery of benchmark yields is critical in pricing risk assets.

Strengthening these foundational elements will facilitate development of the broader capital market.

The BSP, on its part, has already implemented various reforms in expanding the depth and breadth of capital market transactions as well as enhancing market conduct. For instance, we have already started the groundwork for project financing under Circular No. 914 last year in support of the Government's "Golden Age of Infrastructure".

The BSP's fine-tuning of the Interest Rate Corridor (IRC) system to make it even more market-oriented is also aligned with this purpose. The IRC system will guide market interest rates closer to the BSP's policy rate. We see this as a contribution to capital market development through better price discovery for very short term interest rates.

There is also an initiative to further liberalize foreign exchange (FX) regulations to achieve more efficiency and to facilitate ease of doing business. This includes higher standards of governance and conduct for market participants in the FX market. These elements, in turn, will also support the deepening of the domestic capital market.

Equally important is the digitalization of the financial system. Creating an efficient digital platform is complementary to capital and FX market reforms.

In this area, the BSP together with industry stakeholders, launched the National Retail Payment System (NRPS) Framework to facilitate a safe, efficient, and reliable electronic retail payment system that is interconnected and interoperable. The NRPS aims to promote a “cash-lite” economy and ultimately improve the country’s economic competitiveness.

While the BSP pursues these reforms, we also stress the value of good corporate governance and the promotion of a risk management culture. As markets continue to evolve, it is important that risks are fully priced to generate reasonable and sustainable returns to the investor.

Moreover, we are also working closely with both houses of Congress for the enactment of some critical financial sector reforms. Allow me to provide you a brief overview:

- ♦ *Critical Legislative Amendments.* These include the amendment of the BSP Charter, Anti-Money Laundering Act (AMLA), and the Deposit Secrecy Law. As a financial supervisor, it is paramount that BSP’s supervisory powers are well-enshrined in the law. This will further enable the BSP to effectively discharge its mandate.
- ♦ *Other Legislative Reforms.* Other important pieces of legislation in our reform agenda are the Payment System Act (PSA) and Collective Investment Schemes Law (CISL). The PSA intends to formalize BSP’s oversight of the national payment system while the CISL intends to provide a harmonized legal framework for the pooled vehicles of investments.

Optimum Navigation – Evolving Roadmaps

The interesting thing about the apps I mentioned – Waze and Google Maps – is that they are interactive. When you open Waze, your smart phone automatically shares information with the other Waze users on the road and you are rerouted around potential traffic jams, stalled cars and are even warned of traffic police!

Google Maps is similar. It uses other smartphones, which if these have Google Maps open and location services turned on, send anonymous data back to Google to determine how traffic is flowing. In effect, people send information to other people so that they would not make the same mistakes they have made, and also to watch out for hazards they have seen. I have read that Google also combines this new information with historical data from satellites built up through the years!

I think this is wonderful! In effect, people help each other make evolving roadmaps!

This is what we have been doing as we, the BSP collaborate and cooperate with you, ladies and gentlemen of FINEX. This ensures our continued success.

Indeed, together along with various stakeholders: such as the SEC, DOF, BTr, private corporations and other market participants, we have achieved significant inroads in capital market development.

Recent financial markets indicators and upbeat investor sentiment validate the point that we are moving and are making progress toward our intended destination.

While much remains to be done, we rely on your continued support for our reform initiatives moving forward. These collaboration and cooperation are needed for optimum navigation.

On behalf of the Monetary Board and the BSP, I thank FINEX for its invaluable partnership in working towards the development of a fully functioning, deep and vibrant local capital market that can effectively provide another robust source of financing to the domestic economy. Let us continue writing the evolving roadmap together as journey towards our shared desired destination.

Mabuhay ang FINEX, mabuhay ang ating bansang Pilipinas. Magandang hapon sa inyong lahat.
I thank you for your kind attention.