Nestor A Espenilla, Jr: Why the Philippines

Speech by Mr Nestor A Espenilla, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the Philippines Investment Forum, Euromoney Conferences, 27 November 2017.

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Distinguished guests; Ladies and Gentlemen: Good morning! I thank Euromoney for the invitation to speak at this annual Investment Forum. My message is simple and straightforward.

The Philippines today offers viable and strong investment opportunities. The very topics for today's panel discussions point to the key reasons. First, our economic outlook is strong and robust; Second, our capital markets are being deepened and developed; Third, massive infrastructure building gears us for increased growth and development; Fourth, we can rely on aggressive trade and industrial development and Fifth, there are untapped markets, the unserved and underserved, such as MSMEs and the agricultural sector, that present not just the opportunity to exercise social responsibility, but also to create and deliver new products and services.

First: The economic outlook

The Philippines is one of the fastest growing investment-grade rated economies in the region. We realized a better-than-market forecast GDP growth of 6.9 percent in the third quarter of 2017, our 75th consecutive quarter of uninterrupted economic growth since the Asian financial crisis. We are on track to meet this year's target GDP growth of 6.5 to 7.5 percent. Further economic growth of 7.0 to 8.0 percent over the medium term is expected.The sustained economic growth is a product of two decades of structural reforms.

Amidst this rapid economic development, we expect inflation to remain low and stable and within target. We estimate it will settle at 3.2 percent this year, 3.4 percent in 2018, and 3.2 percent in 2019.

To maintain price stability, the BSP adopted the Inflation Targeting framework in 2002. This has served us well. We continuously refine monetary policy conduct. The implementation of the interest rate corridor system in July 2016 is a manifestation of our commitment. More refinements are coming. These changes are enhancing the transmission channels of monetary policy.

The country's external payments position remains manageable and we have built up a strong liquidity buffer against external shocks. At $80.4 billion as of end-October, our GIR level can cover 8.4 months' worth of imports of goods and payments of services, even exceeding the outstanding external debt amounting to $72.5 billion as of end-June 2017. We also have in place substantial regional safety net arrangements.

The banking system is strong and stable. Banks are lending more, and to productive sectors. Outstanding loans of universal and commercial banks as of end-September 2017 are up by 21.1 percent year-on-year. But the non-performing loans (NPL) ratio stood at a mere 1.4 percent. As of end-June 2017, the capital adequacy ratio stood 16.0 percent on consolidated basis, double the international minimum.

Our comprehensive risk-based supervision approach ensure that our banks operate in a safe and sound manner and that the economy is guarded against shocks that may affect financial sector stability. Because of bold reforms, the banking system today is very different from the banking system before the Asian Financial Crisis.

Nevertheless, there are those who raise overheating concerns. Some also worry of a potential asset bubble in the real estate sector.

Our data and analysis suggest otherwise. And we are vigilant to avoid these risks. The credit-to-GDP ratio of 63.6 percent as of Q2 2017 is still one of the lowest by far in Asia, indicating relatively low overall leverage.

At any rate, regulations are in place that require banks to manage their exposures to the real estate sector. Last September, the Monetary Board approved enhancements to bank reportorial requirements on exposures to the real estate sector and to infrastructure projects. More granular information are to be submitted for the BSP to better monitor the extent of bank exposure to real estate and infrastructure projects.

We are ready to implement appropriate macro-prudential measures as the situation may require.

Another concern being raised is the country's current account balance which, after posting 13 consecutive years (2003–2015) of surplus, turned into a small deficit in 2016 (-0.3% of GDP) and in 2017 (-0.2% of GDP in Jan-June). This concern is misplaced. Indeed, IMF observed that previous current account surpluses actually reflected low levels of investment.

Behind the deficit is the economy's rapid growth, backed by rising investments. There is an increase in imports of machineries, capital goods, intermediate goods and raw materials. Eventually, we expect these to translate into higher productivity and exports, lending support to the sustainability of the current account and overall external payments position. We also expect BOP deficits to the mitigated by robust overseas Filipino remittances, BPO revenues, tourism receipts, and FDI flows.

Recent weakness of the peso is also being spotlighted. We assure that the peso's recent modest and controlled depreciation is consistent with the economy's structural shift from being consumption-led to being more investment-led. This is driven by strong imports demand, residents' increased direct and portfolio investments abroad for expansion and risk diversification; as well as public and private sector debt prepayments to manage foreign exchange risks. There is also outflow of hot money. We believe these developments are fundamentally healthy and help improve price competitiveness.

Second: capital markets

Capital market development also gives more reason to invest in the Philippines. The BSP is working hand-in-hand with the Department of Finance (DOF), the Bureau of the Treasury (BTr), and the Securities and Exchange Commission (SEC) on a local currency debt market development roadmap, where reforms to deepen the market will be undertaken over an 18-month time frame. The reform agenda will officially unfold with the launch of the Government Securities Repo Program later this very afternoon (Nov 27)! Indeed exciting and transformative times!

The roadmap includes 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.

These reforms in the government securities market will translate into increased market efficiency, lower borrowing cost, more dynamic and increased participation. As the domestic debt market develops rapidly, there will be more alternative sources of funding for economic activities besides the banking sector. Risks will also be better managed.

Third: infrastructure building

We are in a period of build, build, build! This will be driven by massive key infrastructure investments.These will enhance competitiveness, support the economy's rising growth trajectory, and spread development across the country's regions.

Under the National Government's program, spending for big-ticket infrastructure projects is set between $160 billion and $170 billion in the next five (5) years. With this, government infrastructure spending as a share of GDP will rise annually from 5.4 percent in 2017 to 7.3 percent in 2022. Public investments in infrastructure and human capital development, while observing fiscal discipline, will be a major growth driver.

Sustainable funding sources must support this thrust. Deepening our domestic capital market, as earlier mentioned, will help in this regard.

BSP will continue to support infrastructure development through enabling regulations. Last month, the Monetary Board excluded loans guaranteed by multilateral financial institutions (MFIs) where the Philippine Government is a member or shareholder, from the regulatory limits on banks' loans to their subsidiaries and affiliates.This will boost available resources for the funding of big-ticket projects, including infrastructure.

While National Government builds infrastructure, we at the BSP are focused on the FINfrastructure – (this is a word I coined) referring to the financial infrastructure. We are encouraging further digitization of the financial sector.

In line with this, the BSP is closely working with the National Government to implement a biometric-based foundational ID system to broaden the reach, quality, and integrity of financial services.

We are also working with the industry so that more Filipinos can send and receive payments via any electronic device under the National Retail Payment System (NRPS). Last November 8, we launched the Batch Electronic Fund Transfer (EFT) Credit system or PESONet. With PESONet, businesses, the government, and individuals will be able to conveniently initiate electronic fund transfers and recurring payments from the sender's accounts maintained in any BSP supervised financial institution to corresponding recipient accounts in other institutions with full inter-operability. Funds will be made available to the recipient account/s within the same banking day at full value. In the first quarter of 2018, we will launch InstaPay, another automated clearinghouse allowing real time, low-value push electronic fund transfers perfect for e-commerce.

All of these initiatives will help lower the cost of doing business, enable increased e-commerce, and give wide access to credit and other vital financial services.

Fourth: trade and industrial development

The BSP supports trade and industry development through progressive liberalization of the foreign exchange market. Building on previous reforms, the BSP will soon liberalize foreign borrowings by the private sector. This will re-focus the registration process to primarily data-gathering. It will minimize documentary requirements. Down the road, further liberalization of FX regulations will support ease of doing business and help improve the country's investment climate.

The banking sector was fully liberalized earlier in 2014 to allow entry of foreign banks under Republic Act No. 10641. Since the law's enactment, the BSP has already approved the entry of 11 new foreign banks.

Fifth: the agricultural sector

Today's fifth panel discussion will revolve around the Agriculture Sector. And this sector is indeed an important driver and draw for increased investments.

Recently, the BSP issued guidelines on agricultural value chain financing (VCF) to facilitate credit to the agriculture sector. This opens up credit provision to all the players in an organized value chain and promotes VCF as an effective, organized means of channeling funds to the agri-fisheries sector, promoting their financial inclusion. By encouraging linkages among various players in an agri-value chain, the credit risk of participating smallholder farmers and fisher-folk can be reduced and facilitate their access to more credit.

But beyond this sector are other unserved, underserved and untapped markets.

To promote MSME access to finance, the BSP has issued comprehensive credit risk management (CRM) guidelines so that banks can be more flexible, extend more credit, and implement innovative credit products and lending programs. Also, a wide range of microfinance services of banks now cover nearly 1.7 million microentrepreneurs with an outstanding portfolio of P13 Billion.

Empowering these sectors are not just opportunities to exercise social responsibility, but their inclusion creates viable business propositions.

To sum up, . . .

Why the Philippines?

First, the Philippines is among the fastest growing and most resilient economies in the region. Second, coordinated efforts towards structural reforms and public sector investments in infrastructure and human capital development will make the business climate even more competitive. And Third, you can rely on the BSP's staunch commitment and effectiveness in delivering on its core mandates of price and financial stability conducive to economic growth. We are deeply committed to implementing ambitious financial sector reforms.

Let me end on this note. I wish you a very productive Investment Forum ahead!

Thank you!