

Nestor A Espenilla, Jr: Moving the capital markets dialogue forward

Speech by Mr Nestor A Espenilla, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the 120th Anniversary of the Bureau of the Treasury, Manila, 27 November 2017.

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Finance Secretary Carlos G. Dominguez III, SEC Chair Teresita J. Herbosa, PDIC President Roberto B. Tan, National Treasurer Rosalia V. de Leon, Commissioner Ephyro Luis B. Amatong, BAP Senior Associate Director Pinky S. Padronia, MART President Michael Joseph M. Delfino, colleagues from government agencies, friends from industry associations and media, good afternoon.

Today is a joyous occasion marked by significant milestones. My heartfelt congratulations to the Bureau of the Treasury (BTr) as you celebrate your 120th anniversary. It is also apt that today, we witness the launch of several initiatives that will deepen the local currency debt market, including especially infrastructure support to facilitate market transactions. ...there are so many occasions of significance on this day!

Looking back

In a 2006 paper I wrote, I described the corporate bond market as “expanding but nascent”¹. While our local currency bond market has grown substantially over the last decade, it still remains one of the smallest in the region. The numbers show that the outstanding local currency bonds represent only 34.2 percent of the country’s GDP, largely composed of government-issued debt.

As market participants, you are very familiar with the challenges we face in our local currency debt market. Irregular supply and market fragmentation ... Imperfections of pricing methodologies that lead to problems related to an unreliable yield curve... Limited ability of the market to offer hedging instruments... We have seen how these long-outstanding issues limit the growth and development of our debt market.

Three months ago at a kick-off event at the Bangko Sentral ng Pilipinas (BSP), we began, what I called then, “a meaningful conversation” among market participants – prime movers and stakeholders in our debt market, from both the government and private sectors. Understanding the importance of a deeper and more active capital market, to complement bank lending and serve as an alternative source of industry financing and to manage risks, we made a bold commitment, and unveiled the Philippine roadmap for developing the local debt market.

The roadmap

The roadmap was deliberately designed to adopt a sequential approach, where urgent reforms and foundational issues are prioritized over an 18-month time frame. These include increasing the volume and consistency of treasury issuances across the key benchmark posts, organizing the repo market for government securities, and enhancing the government securities eligible dealers (GSED) program to support secondary market liquidity, developing the yield curve, and strengthening the market oversight framework.

Moving the dialogue forward

Since August, we have been working closely with you to implement the outlined initiatives. Following the endorsement by BTr of the implementation of the Government Securities Repo Program and the grant by the Securities and Exchange Commission (SEC) of a provisional license to MART as a self-regulatory organization (SRO), the Monetary Board approved last

November 23, 2017, the assignment of a zero-percent reserve requirement (RR) on the repo transactions under the Program, issued through BSP Circular No. 983. The zero-percent RR together with the exemption from DST minimize friction costs on repo transactions that conform to international best practices.

During last August's workshop, I remarked that a meaningful conversation is only as good as the actions and changes that follow it. Today, we have a clearer understanding and fulfillment of our respective roles in the capital market reform agenda.

Reform agenda operationalized

Our capital market reform agenda officially unfolds with the inaugural repo trade under the Government Securities Repo Program. We also anticipate the announcement of the GSED market-makers later on. Our roadmap is being operationalized! Today's inaugural launch of the organized repo market is a clear manifestation that we have, indeed, moved beyond conversations and plans, and have taken concrete actions to achieve our common objectives.

The Government Securities Repo Program

The Government Securities Repo Program is a key initiative under the Local Currency Debt Market Development Reform package. The BSP strongly believes that the establishment of an organized repo market is a key element in developing and deepening the domestic financial market.

In particular, the organized interdealer repo market is expected to boost market liquidity and enhance price discovery as it gives GSEDs the ability to quote two-way prices. Further, the "deliver-out, true sale basis" feature of this instrument is expected to provide market makers the ability to take positions and provide them greater flexibility in managing their portfolios.

We recognize, however, that the reuse of underlying government securities without appropriate safeguards can contribute to increased counterparty and settlement risks, as well as the build-up of excessive leverage in the financial system. The establishment of an organized repo market therefore addresses these concerns through appropriate financial market infrastructure, regulatory oversight, and prudent governance standards.

Initiatives of the Bangko Sentral

On the part of BSP, last year, we issued reporting requirements on repo transactions designed to capture timely and comprehensive transaction-level data. This will strengthen our financial surveillance, particularly in monitoring market trends and vulnerabilities in the repo market. In turn, this will enable the BSP to formulate effective policy responses to ensure continued stability of the financial system.

Strategic financial sector reforms, such as the development of the local currency debt market, are high priority. The foreign exchange market reforms and digitization of the financial system are other critical and complementary reforms.

Forward together

The task of implementing reforms is fraught with challenges. It is a long journey but we are taking purposeful strides forward, together. To be sure, there is still much work to be done. There are further refinements in operational rules, data access, and monitoring processes. Other aspects of the roadmap need to be implemented. These are challenges that cannot be taken on or addressed by any one regulatory agency, institution, or industry association alone. Our partnership must endure.

Congratulations everyone!

Happy 120th Anniversary again to the Bureau of the Treasury!

Thank you and good afternoon!

¹ The corporate bond market in the Philippines, BIS Papers No. 26, February 2006