Nestor A Espenilla, Jr: Reflecting and acting on our immediate economic past, present and future

Speech by Mr Nestor A Espenilla, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the Joint Meeting of Rotary Club of Manila, Rotary Club of Makati West, and Rotary Club of Forbes Park, Makati City, 4 January 2018.

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A very happy and prosperous New Year to everyone!

Rotary Club of Manila (RCM) President Jimmie Policarpio, Rotary Club of Makati West (RCMW) President Dave Caldwell, Rotary Club of Forbes Park (RCFP) President Edwin Salonga, distinguished officers (past and present), members, esteemed guests, ladies and gentlemen, magandang hapon!

It has been a tradition of RCM, for the last twenty (20) years, to invite the Governor of the Bangko Sentral ng Pilipinas (BSP) to speak at its first General Assembly. As the BSP is turning twenty-five years this 2018 (your tradition is only five years shy of our Anniversary), this then makes me the fourth BSP Governor to continue this custom. This year, though, is unique, as I have the privilege of addressing not only members of Rotary Club of Manila but also Rotary Club of Makati West, and Rotary Club of Forbes Park.

Time is a curious thing. As it passes, mindful individuals would do well to reflect on one's past – taking stock of lessons learned and allowing oneself to be heartened by successes in the face of challenges... ponder on one's present, think of how it has been molded by previous years and at the same time, embrace the future with an openness to change and a willingness to adapt.

Historical and contemporary accounts have shown that engagement in reflection such as this accounts for how generations and nations have erstwhile survived and have, magnificently flourished. Sadly, the inverse is also true. We have seen how even in individual lives, a lack of reflection can result in ruin...

It is thus my distinct privilege to discuss a tiny but significant piece of the narrative with you, focusing, on what you have requested me to speak about – the Philippine economic outlook given factors in the immediate past, work we are doing in the present, and plans to face challenges of the future. Hopefully this would inspire us and aid us in thriving even more.

In doing so, I have structured my message in four (4) parts: (1) recent developments in the global economic environment and its varied effects on financial and banking stability with mention of the BSP's policy thrusts and initiatives; (2) BSP's delivery on its mandate of maintaining price stability; and (3) the challenge of digitization and how our payments and settlements system plays a role; and (4) finally, I shall share the BSP's mindset for embracing the future. It bears noting that in framing the message this way, I have touched on our mandates, and what the BSP regards as its pillars of central banking.

The global economy and domestic financial stability

2017 saw increased momentum in global economic growth. Many central banks reverted to more neutral positions, while some signalled the possibility of a tighter monetary policy stance over the horizon.

Positive US growth momentum prompted the US Federal Reserve, just last month, to raise its target fed funds rate anew. The European Central Bank continues to ponder on how and when to start tapering its own asset purchase program.

With the prospect of higher home market interest rates, some funds have moved back from emerging markets.

Last year, we saw some capital flow reversals. But despite an overall balance of payments deficit, our year ended with a very manageable external position.

In 2017, we also saw the peso's depreciation. Even as foreign direct investments flowed in, a reversal of foreign portfolio investment flows as well as loan prepayments was felt in the financial account. The BSP's first line of defense has been to maintain a flexible exchange rate while providing foreign currency liquidity from its amply supply of FX reserves to manage sharp movements.

But we also saw a recovery in our exports as major markets picked up. This bodes well for our current account in the coming year. This partially offsets the potential increase in imports of raw materials and manufactured goods due to accelerating public investment in infrastructure. Moreover, the steady inflow of remittances from overseas Filipinos, receipts from BPOs and tourism are seen to provide solid buffers to maintain a manageable balance of payments.

Despite uncertainties and volatility in the global economy and financial markets brought about by Brexit and inward-looking and populist policies of the US, domestic sources of strength have kept the Philippine economy growing strongly last year.

In the first three quarters of 2017, our economy grew by 6.7 percent due to robust production and domestic spending. Market expectations were surpassed and we remained one of the fastest-growing economies in Asia.

A sound and liquid financial system also provided support to Philippine economic activity in 2017. Banks' balance sheets expanded with a double-digit growth in assets and deposits. Credit continued to flow steadily to productive sectors and sustained efforts by the BSP and the financial sector to enhance liquidity and risk management practices kept threats to financial stability at bay.

But we are not resting on our laurels. While banks have provided resilience and support for economic growth, we also believe in developing deeper and more efficient domestic capital and money markets over the medium term. This will reduce the country's reliance on external funding and help insulate the country from external sources of risks. Diversifying the sources of funding for economic activity also allows for better distribution and management of risks in the entire financial system.

We have started this by implementing the Philippine local currency debt market development roadmap towards a more balanced financial ecosystem where the banking system is complemented by a deep and liquid capital market.

The reform agenda officially unfolded in November 2017 with the launch of the Government Securities Repo Program. This was supported by enabling policies of zero-percent reserve requirement and exemption from Documentary Tax Stamp (DST) which minimize friction costs on repo transactions under said Program. Over the year 2018, we shall be rolling out, in coordination with other government agencies, industry associations, and market participants, the remaining initiatives under the roadmap. This includes the launch of the enhanced government securities eligible dealers (GSED) program to support secondary market liquidity, enhancements in financial market infrastructure, increase in volume and consistency of treasury primary issuances, and the issuance of improved interest rate benchmark guidelines.

Reinforcing our efforts to further build resilience of our domestic economy are complementary foreign exchange (FX) reforms. Maintaining a flexible and market-determined exchange rate can better insulate our economy from external shocks that could disrupt the pace of economic growth. In this regard, we have embarked on more ambitious FX reforms to achieve more efficiency and ease of doing business. Over the medium term, the FX reform agenda aims to encourage innovation, improve transparency, facilitate price discovery and enhance market conduct, towards a deeper and better organized FX market.

The reforms are undertaken in well-calibrated and carefully sequenced phases, considering prevailing conditions in the local and global economy, and ensuring that measures are in place to allow the BSP to continue to capture data on these transactions for analysis of developments, policy review and crafting of appropriate measures. This started with further liberalization of FX rules covering foreign loans which the Monetary Board approved last December 21, 2017. It features the lifting of prior BSP approval for purely private sector foreign loans that can be serviced from the banking system. Further, registration processes were streamlined, registration fees were waived, and documentary requirements were further reduced. A window was likewise opened for six months providing an amnesty period during which private sector loans previously obtained without prior BSP approval can register and be eligible for servicing from the banking system. These changes commence on January 15, 2018.

We are currently drafting further amendments to adopt similar measures on trade and non-trade transactions, and on foreign investments.

The BSP also closely monitors for signs of excessive credit and leverage. We stand prepared to deploy appropriate measures such as macroprudential policies to prevent economic overheating. In this regard, the BSP intends to build on its existing frameworks for market surveillance and risk management to help identify and mitigate the build-up of systemic risks at an early stage.

We have remained vigilant and proactive as we launch new and ambitious reform initiatives.

These provide the solid foundation for confidence in our prospects for 2018 and beyond.

Just this December, Fitch Ratings upgraded the country's credit rating anew, noting that sound policies and strong investor sentiment continue to underpin the country's growth momentum.

Price stability: targets and results

In 2017, consistent with market expectations and projections, inflation slightly rose due mainly to higher international crude oil prices. Nonetheless, average inflation stayed firmly within the National Government's target range of 2-4 percent.

We expect inflation to remain within target range until 2019. However, further increases in global crude oil prices may result in inflation trending in the upper bracket of the target range.

Once the National Government's tax reforms take effect, there could be some transitory pressures on prices. On the whole, these reforms will result in productivity gains over the medium term. Also with these tax changes in mind, BSP looks out for possible price spirals. You can count on us to timely adjust the monetary policy stance to ward off any threat to our inflation target.

Meanwhile, further refinements to the interest rate corridor (IRC) framework, which we introduced in 2016, should ensure more effective transmission of any monetary policy adjustments to the real economy.

Payments and settlements system and digitization

An efficient, secure, and reliable payments and settlements system reduces the cost of exchanging goods and services. It is essential for the smooth functioning of money and capital markets. The development of accessible payment systems is also crucial towards promoting financial inclusion.

This is why the BSP continues to champion the development of the country's backbone for payments and settlements. Two years since its launch in December 2015, the National Retail Payments System (NRPS) initiative reached critical milestones in 2017. An industry-driven self-governing body was established to drive the responsible development and operations of the retail payment system. Further, the BSP adopted the NRPS framework through the issuance recently of Circular No. 980 which requires BSP-supervised financial institutions (BSFIs) to ensure that the retail payment systems they participate in demonstrate sound risk management and efficient interoperability. One of the two priority multi-lateral Automated Clearing Houses (ACHs) was launched. This is PESONet. Through PESONet, the government, private businesses, as well as individuals will be able to conveniently initiate electronic fund transfers and recurring payments to each other's transaction account.

These are all part of the initiatives for the Philippines to transition from a cash-heavy to a cash-lite economy. Other automated clearing houses will also be launched this year, including "InstaPay", which enables 24/7, real-time low-value electronic fund transfers that will support e-commerce.

The BSP has also set its sights on digital innovation to reach the financially unserved and underserved. For this reason, we support the inter-agency initiative to establish a biometric National Identification system to improve the accessibility and delivery of financial services.

We realize this will require a responsive security management framework to help guard our financial system against cyber-threats. In this regard, we have upgraded our preparedness.

2018 and beyond: taking on challenges

Characteristics of strength, resilience and the capability to innovate will come in most handy as we navigate through the challenges this year. An alarmist mindset is not necessary as we draw from our experience.

At the BSP, we try very hard to be pro-active. We carefully survey the landscape for potential threats. We ensure that our tools to deal with them remain sharp. We strive to stay on top of developments, and to always be prepared, so that we can address risks appropriately and in a timely manner.

This mindset motivates much of the BSP's policy thrusts not just in 2018 but beyond. Our intention is to continue laying down foundations for the economy to withstand potential shocks.

In closing, while the coming year is likely to bring continued challenges for the Philippines, we are well-placed to deal with these challenges.

The country's firm growth momentum and manageable inflation environment provide ample space to respond appropriately to evolving domestic and global conditions. On the part of the BSP, we have enough instruments in our expanded toolkit to address the challenges that could arise.

On this note, mindful of the past, vigilant in the present and excited for the future, let me wish everyone a happy and fruitful New Year. Thank you, and good afternoon.