Nestor A Espenilla, Jr: Of commitments and navigation

Speech by Mr Nestor A Espenilla, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the Reception for the Banking Community, Manila, 27 July 2018.

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Good evening everyone. On behalf of my co-hosts, members of the Monetary Board - Finance Secretary Sonny Dominguez, Phillip Medalla, Jun de Zuniga, Peter Favila, Tony Abacan and Bruce Tolentino... welcome to the Bangko Sentral ng Pilipinas.

As you know, the BSP hosts a reception for the banking community annually in January. It is a time of fellowship and networking. It is an opportunity for us to share the economic outlook for the year, and our plans, initiatives and policies moving forward.

Tonight's special event is part of our month-long 25th anniversary celebrations. We sincerely thank you for being a part of it, despite your very busy schedules, braving Friday evening traffic.

Last July 3 marked a full quarter of a century's dedication to the BSP's mandates of promoting price stability, financial stability and maintaining an efficient payments system.

Tonight, I reiterate these commitments in the context of the BSP's anniversary theme, "Navigating the Future."

Commitment to Price Stability

The BSP's commitment to price stability has supported a balanced and sustainable growth of the economy. We have enjoyed 77 quarters of uninterrupted economic growth since the 1997 Asian Financial Crisis. Our six-year consecutive growth of above 6 percent makes the Philippines one of the fastest growing economies in the world. This growth streak is projected to continue for the medium term despite challenges in the global and domestic economic landscape.

Our sound macroeconomic fundamentals and growth prospects have led to positive investor sentiment and have attracted more foreign investments. We gained our investment grade status from international rating agencies in 2013. This year, Standard & Poor's upgraded our sovereign ratings outlook from STABLE to POSITIVE while both Fitch and Moody's reaffirmed our sovereign credit ratings with a STABLE outlook.

We have record high foreign direct investments — a total of USD 8 billion and USD 10 billion in 2016 and 2017, respectively.

Our gross international reserves (GIR) continue to provide an ample external liquidity buffer. The end-June 2018 GIR of USD 77.5 billion is equivalent to 7.5 months' worth of import of goods and services.

Domestic liquidity continues to expand to meet the needs of the economy even as we have demonstrated our resolve to tighten monetary policy whenever the situation calls for it. In the face of rising threats to the inflation target, we hiked policy rates last May and June. We are ready to follow-through to secure our inflation target. The BSP remains firmly committed to its primary mandate of price stability.

We stand steadfast and undaunted by the headwinds. Rising global rates. Trade wars. Geopolitical risks. We face unpredictable currents. Distributed ledger. Artificial intelligence. Cyber-threats. We rely on the navigational skills we have honed over the years to manage the constant challenge.

Commitment to Financial Stability

Coming to the BSP's mandate of promoting financial stability, our friends from the industry know that the strong banking system we have proudly nurtured is a product of decades of hard work, commitment to reforms, and decisiveness.

Total assets of the banking system increased by 12.2 percent year-on-year (YoY) as of end-May 2018. The expansion was funded by the 12.5 percent growth in deposits mostly deployed to lending activities. Loans were broad-based across various borrower and industry types.

The banking system is healthy and profitable. Overall profitability is buoyed by the increase in core income from lending activities.

With staunch commitment and consistent dedication, capitalization of the overall banking system is now above the regulatory thresholds.

Banks continue to adhere to sound credit underwriting standards as shown by the very satisfactory quality of the banking system's loan portfolio. Moreover, banks are well prepared to bear credit losses as they have set up adequate provisions for possible defaults. They maintain an NPL coverage ratio of over 100 percent.

Moving forward, we expect further expansion of the banking system, sound asset quality, adequate liquidity and rising capital buffers. The trajectory for profit growth will continue, driven mainly by strong growth outlook, upbeat lending activities, product innovations, and more cost-efficient and technology-enabled operations.

As the main provider of credit to key production sectors, the banking system is key to the Philippine growth story.

On behalf of the Monetary Board and the Bangko Sentral ng Pilipinas, I personally commend you — leaders of the banking industry for being our staunch partners as we pursue meaningful reforms: raising risk management standards, and aligning corporate governance with international best practices.

Through the years, we have built a banking system that is resilient, robust and responsive.

Congratulations to everyone. I believe these achievements warrant a round of applause.

Navigating the Future with Progressive and Proactive Financial Sector Reforms

Truly, there is reason for celebration.

But, from experience - and I dare say, out of habit - we shall not rest on our laurels. We are ever mindful of the need to improve to level up. Last 19 January, during the reception for the banking community, I said that market development and efficiency is a theme that will underlie our reform agenda. I said you should expect this. Continuity ++. In my message that evening, I underlined the importance for financial markets to discover prices efficiently and for self-correction mechanisms to be encouraged.

We have started to deliver. A total of 200 bps reduction in reserve requirements ratio (RRR) this year is consistent with our strategy of the phased and gradual reduction of RRR from 20 percent to single-digit level over a six-year period. At the same time, we were able to neutralize the liquidity impact through our open market and FX operations. Indeed, reducing the RRR to single digit by the end of my term is attainable without compromising effective monetary control. We are ready to resume this initiative next year just as inflation returns to target based on our forecast. We remain firm in our pursuit of structural reforms so that the banking industry remains guided even as you develop your long term strategic plans.

As challenges evolve globally and domestically, we continue to improve our open market operations and expand our policy toolkit. We are currently studying and conducting consultation with the industry for operational refinements meant to further strengthen our ability to guide short-term market interest rates to move closely with the BSP policy rate and strengthen the transmission of monetary policy to the rest of the economy. We are tying this closely to the broader capital market reforms especially in developing the domestic debt market.

Another integral part of our policy toolkit is the flexibility of the exchange rate. Deepening the FX market is therefore another key priority agenda. Our ambitious FX reforms have three core elements: (1) FX liberalization; (2) stronger oversight over non-bank financial institutions; (3) clearer governance arrangements towards a more organized FX trading market.

With these efforts, we hope to encourage FX flows from the parallel market to the formal market. We have streamlined FX requirements for the banking system to reduce market fragmentation and increase FX liquidity.

We expect responsible behavior among market players. We have a collective responsibility to consistently build our markets to rise above the desire for short-term gains.

On the regulatory front, we are pursuing continuous improvement aligned with global standards and best practices.

The BSP is rolling-out the enhanced liquidity risk management framework.

We are prescribing guidelines on the adoption of accounting standards to promote transparency and fairness in both financial and prudential reporting.

The BSP is also continuously working to ensure that financial industry participants are sensitive to, and proactive in, addressing emerging cyber threats. We are enhancing as well our AML-CFT compliance posture.

The BSP continues to create a supportive policy environment for financial inclusion. Banks are now allowed to use third party cash agents for increased on-boarding of the unbanked. We allow reduced Know-Your-Customer (KYC) rules for certain low-risk accounts and use technology for face-to-face contact requirements to promote bank account ownership. We have created the framework for opening basic bank accounts. The BSP is also working closely with the national government for the implementation of a biometric-based national identity system to facilitate maximum access to financial services.

We are also making big leaps in developing the country's payment system even as we continuously improve the existing arrangements. Today, we are capable of producing 43 million pieces of high quality currency notes per month, up from just 6.5 million pieces 25 years ago. We also produce 200 million pieces of coins per month.

Our real time gross settlement system, Philpass, processes 6,000 transaction valued at Php 1.4 trillion per day. But we are upgrading it further to do more as we roll out the National Retail Payment System that will pave the way for the digitalization of our financial system. Already, we have together launched PesoNet and Instapay. More inter-operable and cooperative payment schemes will follow soon.

Closing Remarks

As I close, I remind that as market stakeholders, to better navigate a more interconnected and sophisticated financial market system, we must be mindful of changes that are reshaping it. We must embrace the work that needs to be done, to stay ... not only abreast, but ahead of developments.

This task of navigation is, and has, never been an easy task. But with collaboration, constant communication, coordination and cooperation, the challenges we face will be easier to hurdle.

We at the BSP thank you — our valued stakeholders for ensuring the continuity of policy reforms to guide the economy and shape our banking and financial system into being among the world's most resilient.

Let us now offer a toast^.

Dear pillars of the financial system, fellow public servants, honored guests, friends from the private sector, media and the academe, we at the BSP re-affirm our commitment to our mandates. To Continuity ++. We reiterate our gratitude for your partnership and look forward – jointly and collectively – to navigating the future together.

Cheers!