Nestor A Espenilla, Jr: What it means – the BSP's mandates and impact on Filipino lives

Keynote speech, as prepared for the presentation of Mr Nestor A Espenilla, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), Philippine Economic Forum, National Press Club of the Philippines, Intramuros, 17 August 2018.

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Good morning. It is my pleasure and privilege to speak on the mission of the BSP and its role in the Philippine economy. I thank the National Press Club, Laurelmedia Company and DWIZ's "In the Heart of Business", for this opportunity.

I realize that to most of the public, the BSP's mandates are not known. When we first conducted our Public Perception Survey on the role of the BSP, most respondents indicated awareness of our function as issuer of currency. Some identified BSP as the supervisor of banks. Also, to many minds, the BSP's primary mandate to maintain price stability was, (and still is) largely unknown. It is, maybe, even too abstract and technical.

In fact, in conversations with the BSP Press Corps and its "graduates", invariably, there would be fond recollection of early days struggling with economic data and concepts such as Core Inflation, Gross International Reserves, Balance of Payments and the like. Some of you with such memories are here today.

And those of you here would agree that eventually once past the initial challenge of data appreciation and economic analysis is achieved, some passion for the BSP's goals follows.

Why? How does one come to such a conversion – of esoteric wondering at the BSP's role to an active advocacy for its success? I believe this happens when one realizes that the BSP's success translates to people's lives actually being improved…to inclusive and broad-based growth… to stability and to tangible economic development.

In this context, allow me to discuss our mandates.

Price Stability: What it Means

Under Section 3 of Republic Act (RA) 7653, the BSP is primarily mandated to maintain price stability conducive to a balanced and sustainable growth of the economy.

What does managed and stable inflation mean for the Philippines? Price stability supports economic growth as it allows households and businesses to plan ahead and make informed consumption, investment, saving, and production decisions. Uncertainty is lowered. Managed inflation also protects the purchasing power of the poor, which is important as the poor are vulnerable without adequate assets to hedge against high inflation.

Also, the country's strong economic fundamentals indicated (among others) by stable inflation, results in positive differentiation by global investors encouraging investments into the country.

In 2002, the BSP adopted the inflation targeting (IT) framework for monetary policy. The framework requires monetary policy decisions to be forward looking. It considers the widest set of available and relevant information about the economy. It promotes transparency through announcement of targets and the reporting of measures that the BSP will adopt to attain these targets, as well as the reasons for and outcomes of its policy decisions, increasing accountability on the part of the BSP.

In 2016, the BSP adopted the interest rate corridor (IRC) system to further enhance monetary policy effectiveness. The IRC system guides short-term market rates towards the BSP policy interest rate, enhancing the link between the BSP's monetary policy stance and financial markets. This impacts the real economy.

For six consecutive years from 2009–2014, the inflation target has been met. During episodes when inflation was above or below target, there were external or supply-side developments beyond the ambit of monetary policy.

As an inflation-targeting central bank, we are guided by data-dependent and forward-looking assessment. This disciplined and structured approach means that we refrain from reacting to short-term fluctuations or commentaries. Our focus is obtaining comprehensive information and making decisions based on inflation forecasts over a given policy horizon. Further, the BSP follows the standard approach of not reacting to supply shock episodes as these tend to be transitory or short-lived in nature, but monitor conditions for signs of second-round effects.

This was the case early this year when data indicate the inflation environment was driven by supply-side factors and our forecast continued to show inflation upticks as transitory and moderating within the target in 2019. Thus, adjustment in policy rate was not yet warranted.

Starting in Q2 2018, however, we note that forecasts have shifted higher over the policy horizon. Upside risks also continue to dominate the inflation outlook. Meanwhile, inflation expectations remain elevated. We also recognize that sustained pressures on the peso could adversely affect inflation expectations. Therefore, in response to dynamic economic and market conditions, the Monetary Board raised the policy interest rate by 25 basis points each in May and June 2018 and by 50 basis points effective 10 August 2018.

The strong policy actions recently taken by the BSP are meant to rein in inflation expectations and prevent sustained supply-side price pressures from driving further second-round effects. We expect inflation to revert to target over the policy horizon.

We enjoy resilient economic growth. While the latest GDP outturn shows a lower figure relative to last year's and last quarter's growth figures, we still remain above the long-term average trend of 5.3 percent (for 2000–2017 relative to 6.0 percent for Q2 2018). The economy has achieved uninterrupted growth for the past 78 consecutive quarters even in the midst of the global financial crisis in 2008–2009.

We have sustained fiscal discipline. The fiscal deficit is expected to be contained within 3 percent of GDP (2.3 percent of GDP as of the 1st half of 2018). This supports effective government spending and sustainability to meet debt obligations.

Our external position is strong. Our gross international reserves (GIR) remains an ample buffer. As of end-July 2018, our GIR of US$76.9 billion is equivalent to 7.4 months' worth of imports of goods, and payments of services and primary income. It is also equivalent to 4.1 times the country's external debt maturing in the short term.

Likewise, the economy's key external debt indicators are favorable. As of Q1 2018, external debt-to-GDP ratio was just 23.0 percent. Moreover, the country's external debt remained largely medium- to long-term in nature (80.5 percent of total external debt). This means that FX requirements for debt payments are well spread out and, thus, more manageable.

We are committed to maintaining a flexible and market-determined exchange rate which allows us to conduct independent monetary policy focused on assessment of domestic conditions. This likewise promotes our resilience against external shocks.

Recent depreciation of the peso is attributed to both fundamental and non-fundamental factors. Fundamental factors include: (i) higher demand for imports of capital goods, raw materials and intermediate products in support of our growing economy; and (ii) dollar debt repayments, prepayments, and outward investments. Meanwhile, non-fundamental factors reflect various market sentiments over domestic and external developments adding more pressure on the peso.

We remain confident that the Philippine economy's solid fundamentals will lend support to our flexible peso.

Our solid macroeconomic fundamentals and growth prospects are attested to by continued favorable investor sentiment. Foreign direct investments (FDI) continue to grow. Sovereign credit ratings remain favorable. In particular, FDI-to-GDP ratio improved from 1.6 percent in 2005 to 3.2 percent in 2017. For the first five months of 2018, FDI registered growth of 49.0 percent from the comparable period in 2017.

Notwithstanding global and domestic challenges, the Philippine economy has cemented its resilience and has built buffers over the years.

Financial Stability: What it Means

As mentioned earlier, the public is aware that the BSP is supervisor and regulator of banks. The limited notion though is that we exist merely to regulate, to police… Of course, sound rules and regulations implemented by the BSP are expected to be followed to protect the public interest.

But more than this, our regulations and policies exist for a higher purpose. The idea is that a well-functioning financial system supports productive expansionary business activities and consumption spending, hence, is crucial to promoting economic growth. Our pursuit of banking and financial reforms in the areas of supervisory policy, banking supervision, financial surveillance and systemic risk, stabilizes and strengthens the domestic financial system and helps grow financial institutions into regionally competitive and economically viable players.

The BSP's role is to ensure that the financial system is able to perform its financial intermediation role despite economic shocks. Likewise, we are cognizant that financial stability is essential for monetary policy to be effective since the fragility of the financial sector can affect the transmission of monetary policy to the real economy.

Because of long-term structural reforms, the Philippine financial system, with the banking sector at its core, continues to be a source of strength and stability for our economy. As of end-June 2018, the asset base of the banking industry reached over Php 15.7 trillion, higher by 10.3 percent a year ago. Asset quality remains satisfactory. There is also continuing build-up in capitalization. The risk-based capital adequacy ratio (CAR) of U/KBs as of end-March 2018 stood at 14.48 percent on a solo basis and 15.07 percent on a consolidated basis.

We also ensure that appropriate financial products and services are accessible to a greater majority. Our regulatory framework recognizes that there are the deeply ingrained barriers to financial access such as cost, geography, information asymmetry and lack of infrastructure, among others. As such, market-based solutions, innovations and use of technology to address market frictions are encouraged. This approach has allowed the range of products and services to widen with expanded physical and virtual reach, liberalized consumer on-boarding and greater consumer protection.

Efficient Payments and Settlements System: What it Means

While we have utilized technological progress to advance financial inclusion, we recognize its great potential to also enhance the efficiency of the country's payments and settlements system.

An efficient, secure and reliable payment system reduces the cost of exchanging goods and services. It is also an essential tool for the effective implementation of monetary policy and the smooth functioning of the financial system.

Under the National Retail Payments System (NRPS), launched in 2015, we leveraged on financial technology to bring about an inter-operable, safe, affordable, and efficient real-time digital payments system. In 2017, we launched the PESONet to provide an electronic alternative to the still widely used paper-based check system and to provide an efficient channel for government and private business collections and disbursement.

Just this April, we launched InstaPay, which allows for safe and affordable retail electronic payments in real time. Moving forward, we are expecting other automated clearing houses to be transitioned into NRPS system. We are also working on adopting a national QR code standard aligned with global standards, which can accelerate the digitalization of merchants.

These initiatives should facilitate the shift from being a cash-heavy to a cash-lite economy, a trend we observe happening across the globe.

We are encouraged by the much-awaited passage of R.A. No. 11055 or the Philippine Identification System Act (Philsys). This is a significant legislation that will boost our digitalization efforts and financial inclusion agenda. With its goal of providing every Filipino a trusted and verifiable digital identity, PhilSys can be a powerful tool for on-boarding millions of Filipinos into the formal financial system and providing them access to meaningful financial services.

The power of PhilSys lies in its singular function. It only aims to do one thing: to establish and verify a person's identity, to prove that you are who you say you are whether online of offline. Accordingly, PhilSys only captures very basic demographic information and biometrics sufficient to establish an individual's unique identity.

Focus on our third mandate of an efficient payments and settlements system aims to transform the economy. We recognize that such will bring efficiency to business transactions. Substantial savings will likewise be generated from a shift from paper-based to digital instruments. An efficient payments settlements system benefits consumers and businesses in terms of affordability, convenience and speed of services, promoting financial inclusion.

Conclusion

Ladies and gentlemen, as I have shared, while the BSP's mandates are highly technical, our goals address the betterment of Filipino lives. We function to provide a macroeconomic environment conducive to economic growth. We guard against erratic and uncontrolled inflation and work vigilantly to promote confidence in the safety, soundness and strength of our banking and financial system. We are committed too to delivering an efficient payments and settlements system that promotes interoperability of payments, financial inclusion and which will allow us to transition from a cash-heavy to cash-lite economy.

At the BSP, we are foremost, public servants, committed to our mandates for the furtherance of the national and public interest. This, is what our work means.

It was my distinct pleasure to speak about our role and share our initiatives with all of you.

Maraming salamat.