

Benjamin E Diokno: Beyond conventions - harnessing the BSP multiplier amidst shifting sands

Speech by Mr Benjamin E Diokno, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the Chamber of Thrift Banks Annual Convention, Makati City, 29 March 2019.

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Introduction

Distinguished officers, members, and trustees of the Chamber of Thrift Banks (CTB), ladies and gentlemen, good morning!

Thank you for inviting me in this year's annual convention and induction of CTB's new set of officers and trustees. I am pleased to be delivering this speech before the members of the thrift bank community.

I say this because this industry has been an enabler of economic development by encouraging retail savings and extending credit to crucial sectors of the economy.

Shifting Sands

Your chosen theme for today's event – "Expanding New Markets," reflects the current economic and financial reality we are all facing.

As most of you already know, the global economy is in transition. The sands are shifting and we are once again reminded of the constantly evolving dynamics of economics and finance.

If you ask me, policymaking in this time of transition requires some rethinking. As Nobel laureate Joseph Stiglitz aptly puts it, there is a need to shift our focus from what is happening on the so-called "average," and take into account a broader spectrum of the society.

In other words, we need to bring our policies closer to the people and aim for long-term stability and inclusive growth.

Thus, in my remarks today, I wish to provide you with the BSP's perspective on these tasks. In particular, I wish to discuss the Philippine economy's recent developments, potential challenges, and the BSP's policy thrust going forward.

On Solid Footing

The good news is that, despite the challenging operating environment, we can rely on the Philippines' solid macroeconomic fundamentals to provide us with a significant headway towards a more robust and inclusive growth.

The domestic economy grew 6.2 percent last year. This extends the country's growth streak to 80 quarters or roughly 20 years of uninterrupted growth.

It should be noted that while the latest figure is relatively lower compared to a year ago, we remain on track to outpace most of our Asian peers in 2019. The economy has been growing robustly at 6.0 percent and better for the last 15 quarters since the second quarter of 2015.

Admittedly, we had to deal with a challenging inflation environment last year due to supply-side pressures. The increase in international crude oil prices, supply bottlenecks, and direct and indirect effects of the tax reforms pushed inflation beyond the government's target range of 2 – 4

percent in 2018.

The BSP's decisive action to raise its policy interest rate by a cumulative 175 basis points beginning in May 2018, coupled with the National Government's implementation of non-monetary measures to alleviate price pressures, helped rein in high inflation and ensure that it would revert back to its target path.

In fact, latest figures are encouraging as inflation declined to 3.8 percent in February this year. This is within the target range of 2-4 percent and is consistent with recent forecasts and market expectations that a manageable inflation environment could be sustained in the near term.

While the peso experienced episodes of depreciation, it should be noted that this was partly due to the strong demand for imports of capital goods, partly because of Build Build Build program, raw materials and intermediate products needed to support a growing economy.

The country's external payments position is reliably supported by strong structural foreign exchange inflows. These include remittances from overseas Filipinos, revenues from the IT-BPO industry, receipts from the vibrant tourism sector, and sustained inflows of foreign direct investments.

With these inflows, the country's Gross International Reserves (GIR) now stands at around US\$82.90 billion as of end-February 2019. This is roughly equivalent to 7.3 months' worth of imports of goods and payments of services and primary income.

All of these could provide sufficient buffer against external headwinds.

A Second Pillar of Strength

The sound and stable condition of the banking community, supported too by the thrift bank industry, has also served as a key pillar of strength of the economy.

As of end- January 2019, total resources of thrift banks (TBs) rose to P 1.2 trillion, a 7.0 percent increase compared to its level a year ago.

Bank lending meanwhile continued to expand and was channeled mostly to production sectors. Both consumer loans (CLs) and real estate loans continued to grow. As of end-December 2018, the level of CLs of TBs expanded to P 561.9 billion, higher by 6.0 percent relative to the level a year ago at P530.1 billion. Meanwhile, loans for real estate activities increased by 8.0 percent to P291.4 billion relative to last year. Sustained by core earnings mainly from lending activities, the TB industry also remained profitable as net profit stood at P15.8 billion as of end-December 2018 returning 10.3 percent to owners' equity.

Asset quality has likewise significantly improved. As of end-January 2019, the gross non-performing loans (NPL) ratio and non-performing assets (NPA) of thrift banks have significantly declined to around 5.4 percent and 5.7 percent, respectively. These figures were significantly lower compared to their end-December 2001 values of 12.0 percent and 17.0 percent, respectively. Lastly, the TB industry remains well-capitalized.

As of end-September 2018, the subsidiary thrift banks' capital adequacy ratio (CAR), on solo basis, of 15.0 percent remains well above international standards while the CAR of stand-alone TBs stood at 18.2 percent.

Ladies and gentlemen, all these numbers I just mentioned reflect, among others, the thrift banking sector's critical role in supporting the country's inclusive economic growth.

The Three Great Challenges Ahead

Even as I say this, the evolving operating environment is beset with what I refer to as the three great challenges that could potentially derail our growth trajectory.

First is the imbalance or great divergence in global growth. According to the International Monetary Fund (IMF), global growth prospects in 2019 remain fragile and uneven as recovery in advanced economies (AEs) is expected to remain steady, while activity in emerging market economies (EMEs) is projected to slow down.

This uneven growth trajectory could potentially trigger portfolio rebalancing and capital flow reversal in emerging markets (EMs), including the Philippines.

Second is the emergence of what is referred to as the great fragmentation, where policymakers tend to be less able and less willing to collaborate internationally.

Populist sentiment continues to gain traction in countries around the world. This, in turn, has fueled a greater inclination among governments towards “inward-looking,” prisoner’s dilemma type of policies.

We are in the midst of protracted trade tensions between the US and China. While talks have recently begun between the two countries to potentially outline the exit from the trade tension, unwinding of the tariffs already imposed would still take some time.

Third, there is also the risk of great disruption stemming from the so-called rise of the Fourth Industrial Revolution. While technological innovation in itself is not bad, and indeed often brings benefits, the velocity and depth of transformation could have potentially disruptive effects, especially in the short term.

Consider for example the impact of financial technology on key areas of central banking such as monetary policy and banking regulation. Digital currencies can potentially alter the organic composition and evolution of money supply and affect how central banks can influence aggregate demand.

On top of these external risks, we also have risks emanating from the domestic sphere. These include important challenges such as the impact of adverse weather disturbances- La Nina, El Nino-, infrastructure gaps, implementation bottlenecks, and delay in the passage of the 2019 budget of the National Government, among others.

BSP’s Policy Thrust

How do we respond to these challenges?

To my mind, successfully navigating this time of uncertainty entails a three-pronged approach.

Building on Strengths

First, there is a need to continue building our strengths.

In this regard, I am fortunate to inherit an institution that has a legacy of excellence, credibility, and independence.

Rest assured, price and financial stability will remain the BSP’s top priority. On that note, you can rely on the BSP to remain independent and steadfast in safeguarding our primary mandates and implement timely and appropriate policies that are evidenced based.

Let me just say a few words about monetary operations. The BSP will continue to use market-based monetary instruments in its operations.

In particular, the BSP will work to further fine-tune our monetary operations with refinements in our Interest Rate Corridor (IRC) framework. The adoption of the IRC framework in June 2016, has allowed the reduction of reserve requirements by 200 basis points in 2018, from 20 percent to 18 percent, without sacrificing monetary control.

The goal of reducing the Reserve Requirement Ratio (RRR) can therefore resume provided that domestic inflation and monetary conditions would allow it.

This commitment to a gradual reduction in deposit reserves will lower friction costs in the banking sector, create more efficient financial intermediation, and help curb shadow banking given the rise of strong alternatives offered by fintech and digital innovation.

Enhancing Policy Agility

This brings me to the second approach. There clearly is a need to make our policies more responsive to the changing environment.

Just recently, the amendments to the BSP's Charter was enacted into law. The new charter amendments restore the BSP's authority to issue debt papers, providing us greater flexibility in determining the timing and size of our monetary operations.

The BSP is also given the authority to obtain information from private individuals and entities for its policy formulation. The law also widens the coverage of BSP-supervised financial institutions to include money service businesses, credit granting businesses and payment system operators. These reforms put the BSP in a stronger position to pursue our price and financial stability mandates amid a rapidly evolving environment.

In terms of financial stability, the BSP continues to foster a regulatory environment that is both enabling to emerging trends and effective in managing new risks.

The BSP's policy reform agenda aims to strengthen risk governance in banks by setting out standards that promote continued enhancement of banks' risk management systems. The BSP is guided by the principle of proportionality while pursuing international best practice in its strategic policy objectives.

For instance, the Monetary Board recently approved the extension of the observation period for the Basel III Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) compliance of thrift banks, that are subsidiaries of universal and commercial banks, up to end-December 2019, moving the effectivity date of said ratios to 1 January 2020. This provides covered banks and quasi-banks sufficient time to build up their liquidity position given the combined impact of these liquidity measures. Moreover, enhancements to the LCR and Minimum Liquidity Ratio (MLR) methodologies were also approved as a result of the BSP's continuing discussions with the CTB and the rest of the banking industry. Starting 1 January 2019, stand-alone thrift banks are already subject to the 20 percent MLR which aims to ensure that covered institutions set aside a liquidity buffer that will enable them to withstand liquidity stress events.

To cope with the rapid advances of Fintech, we have upped our "RegTech" game by adopting a regulatory sandbox approach. This allows the BSP to observe and study new products and create appropriate regulations in response.

Harnessing the BSP Multiplier

Third and the last approach is something I am very passionate about. The magnitude and severity of today's challenges also call for the BSP to go beyond convention and embark on goals outside the ambit of traditional monetary policy.

I am talking about the need to support inclusive growth.

The BSP's effective pursuit of our primary mandate of maintaining price stability puts the country in a better position to attain inclusive growth. We foster a macroeconomic environment conducive for investments and supportive of job generation and employment.

However, maximizing the impact of the BSP's policies on the lives of Filipinos entails that we tackle the inclusive growth advocacy directly. I am heartened by the thought that the recent Banking Sector Outlook Survey showed that most thrift banks believe that business growth may be maintained by developing new capabilities and by expanding market reach, digitally or through new products and services.

This is what I refer to as the BSP Multiplier or the BSP's ability to improve every single Juan and Maria's quality of life.

Towards this end, you can expect the BSP to continue to focus on this goal and integrate our financial inclusion advocacy with our traditional objectives.

The BSP is working hard to bring central banking operations to the people, of course with your help. We are committed to advancing our financial inclusion, financial education, and consumer protection agenda to ensure that everybody is given the opportunity to ride in this economic growth.

ABSP that is Closer to the People

For us to be able to succeed in a transitioning global environment, we need to build our strengths, be more responsive, and sometimes go beyond conventions.

The BSP is aware that our efforts cannot stand alone. To keep the engine running, both the public and private sectors must share in the responsibility of making sure that no Filipino is left behind.

I therefore thank the CTB and the thrift bank community for supporting the BSP and its thrust on financial inclusion.

Rest assured, you can count on the BSP to walk closely with you in our country's journey towards inclusive growth.

Thank you and mabuhay tayong lahat!