Benjamin E Diokno: Continuing the legacy - key BSP reforms for sustained and more inclusive growth

Speech by Mr Benjamin E Diokno, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the 4th General Membership Meeting of the Financial Executives Institute of the Philippines (FINEX), Makati City, 29 April 2019.

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FINEX President Atty. Eusebio V. Tan, MAP President Rizalina G. Mantaring, FINEX directors and officers, distinguished guests, ladies and gentlemen, a pleasant afternoon.

I would like to thank FINEX for inviting me as your guest speaker in this year’s general membership meeting, and for the opportunity to congratulate the new members of FINEX. It is truly an honor and pleasure to be here.

When I was appointed as the new Governor, one of the things that came to my mind is which direction to navigate this strong and well-respected organization. Then, I was reminded that the BSP is backed by dependable partners, whose continuing support and confidence, enable the institution to address challenges in the pursuit of its mandate, programs, and policies. This includes the FINEX.

Truly, holding the steering gear is a tough and challenging task but I am certain that I can get through this because I am supported by highly competent workforce and by dedicated partners.

For this afternoon, I will first be providing an overview of the BSP’s strengthened mandate as the central monetary authority and supervisor of the Philippine financial system and payments system. Second, I will give an overview of the Philippine macroeconomic developments, followed by a snapshot of the condition and performance of the Philippine banking system based on the latest available data. I will also discuss the evolving banking system landscape and reform agenda. Let me conclude this presentation with some key takeaways.

For the past two and a half decades, the BSP has remained steadfast in the pursuit of its core mandates with the end goal of achieving a more globally competitive Philippine economy, and a safe, sound and stable financial system. The BSP’s mandates on price and financial stability and efficient payments system have been strengthened with the signing of Republic Act (R.A.) No. 11211.

This journey, relentlessly led by my predecessor, the late Nestor A. Espenilla, Jr., the dedicated members of the Monetary Board, and initiated by the other stewards of the institution before them, has translated in the realization of significant milestones.

First milestone is the positive macroeconomic developments.

1. ***Real GDP growth***. The Philippines remains one of the fastest growing economies in the region. Real gross domestic product (GDP) grew by 6.3 percent in the fourth quarter of 2018, leading to an average growth of 6.2 percent in 2018. The expansion in real GDP was supported by similar growths in the industry and services sectors, particularly the construction and retail trade services, as well as sustained government and household spending.
2. ***Inflation***. In March 2019, the country’s headline inflation slowed down to 3.3 percent. The resulting year-to-date average of 3.8 percent is now within the National Government’s announced inflation target range of 3.0 percent ± 1.0 percentage point for 2019.
3. ***Balance of Payments***. The country’s external position is strong as the overall balance of payments (BOP) position yielded a surplus of USD627 million in March 2019, a reversal of

the USD266 million BOP deficit recorded in the same month last year. Inflows mainly came from the BSP's foreign exchange operations and income from investments abroad as well as the National Government's net foreign currency deposits.

4. ***Gross International Reserves***. In relation to the gross international reserves (GIR) level, it registered at USD83.2 billion as of end-March 2019. At this level, the GIR represents a more than ample liquidity buffer and is equivalent to 7.3 months' worth of imports of goods and payments of services and primary income.
5. ***Exchange Rate*** – The peso averaged ₱52.34/USD1, appreciating slightly against the US dollar by 0.14 percent from the ₱52.41/USD1 average in March 2019. The peso appreciation is mainly due to risk-on sentiment following the resumption of trade talks between the United States and China. On a year-to-date basis (10 April 2019), the peso likewise appreciated against the US dollar by 1.3 percent closing at ₱51.90/USD1.

With the country's robust and uninterrupted economic growth, the per capita income has been increasing. The Philippines' per capita GDP and per capital gross national income (GNI) grew by 8.8 percent and 8.5 percent, respectively, from end-December 2017 to 2018.

The rate of poverty incidence has also improved to 16.1 percent as of the first half of 2018, from 22.2 percent in the as of the same period in 2015.

Another key milestone is the fundamentally sound and stable banking system.

Key indicators show further strengthening of banks' balance sheets with positive growth in assets, loans, deposits and capital.

Alongside a growing economy, the total resources of the banking system continued to expand by 10.0 percent year-on-year to P16.7 trillion as of end-February 2019.

Consistent with the expansion in the asset base, the gross total loan portfolio of the Philippine banking system increased by 12.3 percent to P9.9 trillion as of end-February 2019, albeit slower compared to the 16.3 percent growth in the previous year. Nevertheless, loan growth remains broad-based across production sectors.

The growth in the banking system's assets was supported by the 6.3 percent growth in deposits amounting to P12.6 trillion as of end-February 2019. The deposits are mostly peso-denominated and in the form of savings account which are considered as stable funding source. Albeit slower compared to the previous year, the decline in deposit growth rate is matched by the increase in bond issuances. As a result, the U/KB-issued bonds payable jumped by 163.1 percent to P316.7 billion as of end-February 2019 from P120.4 billion as of end-February 2018.

The banking system's risk management system remains strong that is backed by capital. The average capital adequacy ratio (CAR) is well above the minimum requirement at around 14.8 percent on a solo basis and 15.4 on a consolidated basis as of end-December 2018.

Overall quality of the bank loan portfolio remains satisfactory with low non-performing loans (NPL) ratio at 2.1 percent as of end-February 2019, and average NPL coverage ratio for the past two years at 104.5 percent.

Universal and commercial banks (U/KBs) are compliant with the minimum liquidity coverage ratio requirement.

The Basel III Leverage Ratio of U/KBs stood at 9.4 percent on consolidated basis as of end-December 2018, and well above the BSP regulatory threshold of 5.0 percent and the international minimum of 3.0 percent.

The Philippine banking system also remains profitable, sustained by strong core earnings.

Banks' net profit grew by 6.9 percent to P179.7 billion for the year ended December 2018.

These figures demonstrate how banks successfully adapt to the challenging external environment and the evolving financial landscape.

Another milestone is that the Philippine banking system has become more streamlined, financially inclusive and technologically responsive reaching out to more clients across the nation and addressing their changing needs.

In particular, banks are geographically expanding through the establishment of branches and scaled-down branch-lite units.

There were also banks which capitalize on electronic solutions or financial technology (FinTech) to reach a greater scale. This move is in line with the BSP's initiative, in close coordination with industry stakeholders, on the implementation of PESONet and Instapay under the National Retail Payment System (NRPS) framework. The participation and compliance of the supervised financial institutions (BSFIs) to the NRPS requirements have been encouraging. The BSP expects more participation particularly by stand-alone thrift, rural and cooperative banks once the necessary investment in technology is completed.

Setting sights on digitalization of the financial system, we are on track with our goal to raising the share of electronic retail payments to at least 20 percent by 2020.

Given these milestones, I will continue the legacy of my predecessors with focus on financial inclusion. I am glad that a number of critical laws were passed to support sustained financial inclusion.

The enactment of republic Act (R.A.) No. 11055 or the Philippine Identification System (PhilSys) in August 2018 provides Filipinos the means to establish a verifiable digital identity. This will enable them to open accounts, use financial services more efficiently, and gainfully participate in an increasingly digital economy. The BSP sits as a member of the PhilSys Policy and Coordination Council and participates actively in the inter-agency technical working group for the successful implementation of such Law.

In the same month, R.A. No. 11057 or the Personal Property Security Act was enacted. This provides the legal and institutional framework to facilitate the use of movable property. The Law expands the range of properties which can be used as loan collateral, particularly by the micro, small and medium enterprises addressing the challenges on accessing credit because of the lack of acceptable collateral. We look forward to the operationalization of the unified collateral registry.

Equally important is R.A. No. 11127 or the National Payment Systems Act which was passed in October 2018. This formalizes the BSP's oversight on the efficiency of payments systems as channels of funds in the financial market benefiting the consumers. The proposed implementing rules and regulations are currently exposed for comments.

We are focusing on the implementation of these significant pieces of legislations geared toward achieving greater and broader access to financial services by all Filipinos, especially the financially unserved and underserved population.

Parallel to this is our direction towards digital transformation recognizing the wealth of benefits that we could reap, from streamlined delivery of financial services to lower cost of services. With this in mind, the BSP always endeavors to provide a regulatory environment that encourages financial innovation for a more inclusive financial system.

While there is increased use of financial technology among financial institutions, the BSP adopts an open and flexible approach through the "regulatory sandbox", underpinned by three important principles focusing on proportionate regulation, multi-stakeholder collaboration and consumer protection.

Cognizant of the attendant risks, the BSP has issued series of regulations aimed at mitigating effects of technology-related risks, particularly cyber-security threats. These include the following issuances: (1) Circular No. 1019 further strengthens the BSP's cyber-threat surveillance capabilities by tightening the reporting regime for BSFIs on technology and cyber-risk-related incidents and disruptions; (2) Circular No. 982 sets forth enhanced guidelines covering a holistic framework on information security risk management to address the growing concerns on rapidly-evolving cyber-threats; (3) Circular No. 958 requires BSFIs to implement multi-factor authentication for fund transfers, payments, and card not-present (CNP) transactions, in response to cyber-attacks and threats; (4) Circular No. 951 incorporates cyber-resilience in the BSFIs' business continuity planning process to adequately capture the potential impact of cyber events; and (5) Circular No. 949 advocates responsible use of social media by BSFIs by instituting the necessary safeguards, governance structure and standards to effectively identify, measure, manage and monitor risks arising from social media platforms.

Add to these regulatory initiatives is our continuing market surveillance on industry developments involving crowdfunding and peer-to-peer lending. We recognize that these innovative platforms can potentially expand financial access for new businesses, particularly those belonging to the micro, small and medium enterprise sector. But we also recognize that investors and consumers are exposed to greater risk of financial abuse. We, therefore, stand ready to take regulatory action if warranted to uphold fair and healthy competition.

The BSP likewise collaborates with both local and foreign counterpart regulators to ensure consistency in the priorities, prevent regulatory arbitrage, and to promote optimization of digital innovations.

Along with digital transformation is our increased efforts towards the deepening of financial consumer protection and education. I believe that we can truly reach financial inclusiveness if Filipinos will become more aware of the varied financial products and services that are available in the system to meet their different needs.

In particular, the BSP conducts financial education expos and issues financial advisories towards this end. In 2018, we shifted our approach to financial education – from on the ground delivery of learning sessions to forging strategic partnerships. The BSP has ongoing partnerships with the Department of Education, Overseas Workers Welfare Administration, the Philippine Army, and soon with the Armed Forces of the Philippines and the Civil Service Commission. Learning tools were developed, taking into consideration the profile and learning needs of audiences, as well as institutional set-ups/training delivery mechanisms of our partners.

A measurement framework is also being developed to monitor programmatic key performance indicators and measure the impact of initiatives under each partnership.

Ladies and gentlemen, let me leave you with some key takeaways.

First, Sound and resilient Philippine banking system supports domestic economic expansion.

Second, Digitalization and financial technology are re-shaping the future landscape of the Philippine banking system.

Third, The BSP stands ready to provide an enabling regulatory environment to keep pace with the evolving developments in the financial system.

Fourth, leveraging on the implementation of new laws, the BSP is now in a stronger position to pursue its mandates and advocacy towards broad-based and inclusive growth.

Lastly, Attainment of sustained and inclusive growth of the economy as well as the banking sector is a shared responsibility among various shareholders.

It is through our harmonized efforts and partnership that we can accomplish any challenging task and be able to sustain our growth momentum.

As our staunch partner, we are always grateful to FINEX for your invaluable support in equipping banking and finance professionals with the necessary skills and knowledge to cope with the demands and challenges of today's ever changing financial landscape.

Again, thank you for your continued support to the BSP's initiatives towards a globally competitive economy and stable financial system. Mabuhay po kayo!