Benjamin E Diokno: Fueling growth of FDIs in the Philippines - The BSP as an enabler

Speech by Mr Benjamin E Diokno, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the 5th Joint Economic Briefing of the British Chamber of Commerce in the Philippines, Makati City, 19 June 2019.

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Friends, ladies and gentlemen, good morning.

It is my pleasure to address this 5th Joint Economic Briefing of the British Chamber of Commerce and the Dutch, French, German, Italian, and Spanish Chambers. The BSP always welcomes the opportunity to engage current and potential investors and to communicate BSP policy initiatives that impact the operating environment for businesses.

While fueling growth of FDIs is not the primary mandate of the BSP as a central bank, we are well-aware that achieving our core objectives of promoting price and financial stability contributes in promoting an investment-friendly Philippines.

It is from this perspective that I build on your conference topic, “Fueling the Growth of FDIs in the Philippines.”

My presentation will focus on three areas:

First, I will present developments on Foreign Direct Investments (FDIs) in the Philippines and prospects moving forward.

Second, I will discuss the factors that influenced FDI inflows during the past decade.

And third, I will present BSP initiatives that support the government’s overarching goal to further increase FDIs.

FDIs in the Philippines have been rising steadily since 2010. It reached record levels in 2017 and 2018, during which FDIs averaged US$10 billion a year on the back of robust macroeconomic fundamentals as evidenced by sustained and accelerating economic growth.

Also serving as pull factors for FDIs are the Philippines’ stable inflation, improved fiscal balance, and resilient external position.

From January to March this year, the country attracted US$1.9 billion in FDIs. This is lower than the US$2.3 billion recorded during the same period in 2018. This could be partly attributed to increased uncertainty over the US-China trade war, pre-mid-term election jitters, and the legislative proposal to rationalize tax incentives, among others.

In the early 2000s, the biggest recipients of equity capital investment have been the manufacturing, real estate and financial intermediation sectors.

During the past decade (2009–2018), however – finance and insurance as well as utilities– gained larger shares in foreign equity flows, together with manufacturing.

Moving to the first three months of 2019, the table shows that equity capital infusions were mainly invested in finance and insurance, real estate, and manufacturing, among others.

In terms of FDI sources, the top five foreign investors over the past decade have been Japan, the United States, Hong Kong, ASEAN, and the European Union.

What is notable in this table is the rising share of FDIs from our ASEAN partners—from just US$19 million in 2009 to US$990 in 2018.

While Philippine FDIs flows have substantially increased in recent years, they remain modest compared to our ASEAN peers.

This is seen in the size of FDIs relative to the size of the economy as shown in the chart at the left. The same observation applies when comparing FDIs against gross fixed capital formation, the chart on the right.

Please note, however, that in the chart at the right, the Philippines caught up with Vietnam and Malaysia in 2016.

This chart, meanwhile, shows that the average growth rate of FDIs in the Philippines from 2013–2018 averaged 22.4 percent. This is higher than the growth in other Asian countries, specifically, Malaysia, India and Vietnam—but lower compared to Thailand and Indonesia.

In any case, prospects for FDIs in the Philippines continue to be positive as shown by recent data on investment approvals.

In the first quarter of 2019, foreign investments approved by seven investment promotion agencies (IPAs)[1] amounted to PhP46.0 billion. This is more than three times higher than the PhP14.2 billion approved in the same period in 2018.

The biggest commitment was from the Netherlands, whose PhP10.1 billion investment pledge accounted for 22.0 percent of total commitments.[2]

Manufacturing, on the other hand, received the largest share among industries with 76.1 percent of the total pledges, amounting to PhP35.0 billion.[3]

Please allow me to highlight that the recent credit rating upgrade of the Philippines by S&P to BBB+ is expected to further enhance investor perception of the Philippines.

Moving forward, determining the factors that fuelled FDI growth needs an examination of trends that shaped Philippine FDIs.

While progress has been made in removing trade barriers and improving logistics, foreign ownership restrictions have been cited as an obstacle in attracting stronger investment inflows.

A World Bank report cited the following factors as constraining investment entry into the Philippines. These include:[4]

- Infrastructure challenges;
- Inadequate investor protection;
- Laborious procedures required to open and close a business;
- Poor access to credit among small and medium-sized enterprises (SMEs).

The government is well aware of these and have pursued structural reforms over the years to address these bottlenecks. Among these are the passage of the Ease of Doing Business and Efficient Government Service Delivery Act of 2018 (R.A. No. 11032) which aims to facilitate prompt action or resolution of government transactions with efficiency.

Aside from recent reform initiatives — the country’s robust economic fundamentals, “Build Build Build” program, and credit rating upgrades are expected to continue supporting positive investor sentiment for the Philippines. This is in addition to the presence of a young, highly-educated, and English-speaking workforce in the country.

In view of these factors, what then is the BSP's contribution in promoting FDI growth?

The BSP's primary contribution to fueling FDI growth lies in the effective discharge of its mandates and policy thrusts. Fostering price stability, sound external payments position, financial stability, and an efficient payments system will minimize systemic risks as well as provide resilience to shocks to the economy.

This will help support an enabling environment that is conducive to accelerating economic growth and, in turn, investment opportunities.

Let me expound…

First, the BSP promotes a favorable investment environment by ensuring that inflation continues to be stable and that inflation expectations remain well-anchored.

Headline inflation increased to 3.2 percent year-on-year in May 2019 from 3.0 percent in the previous month. The resulting year-to-date average of 3.6 percent remains within the Government's inflation target range of 3.0 percent ± 1.0 percentage point for the year.

Looking ahead, we expect inflation to remain on a target-consistent path for 2019 and 2020. The latest baseline forecasts (as of 9 May 2019 MB policy meeting) indicate that inflation is projected to average at 2.9 percent for 2019 while inflation forecast for 2020 is slightly higher at 3.1 percent due largely to the rebound in crude oil prices.

Meanwhile, risks to the inflation outlook remain broadly balanced for 2019 amid risks of a prolonged El Niño episode and higher-than-expected increases in global oil prices. For 2020, the risks continue to lean toward the downside as weaker global economic activity could temper commodity price pressures.

Maintaining a stable inflation environment, as you know, is very important to avoid increases in operating costs (e.g., wages, utilities, locally-sourced production inputs) and maintaining the competitiveness of your operations in the Philippines.

Given these favorable inflation assessments, the Monetary Board (MB), during its last monetary policy meeting, decided to reduce its policy rate by 25 basis points (bps) to 4.50 percent, effective May 10, 2019. The MB's decision is based on its assessment that the inflation outlook continues to be manageable, with easing price pressures owing to the decline in food prices amid improved supply conditions.

In addition, the BSP also recently pre-announced the schedule of reserve requirement reduction for universal commercial banks: 100 bps by May 31 and 50-bps each on June 28 and July 26, 2019. In reducing the reserve requirement ratios, the MB recognized the continued downtrend in domestic inflation with headline inflation averaging at 3.6 percent in the first four months of 2019, which is within the target band of 3.0 percent ± 1.0 percentage point. The BSP was also guided by the benign inflation forecasts of 2.9 percent for 2019 and 3.1 percent for 2020. Inflation expectations have likewise shown increasing convergence with the BSP's inflation target. This is part of the BSP's ongoing initiative to enhance the effectiveness of monetary policy and deepen domestic money market.

Second, further enhancing BSP's monetary policy transmission is one way of promoting more efficient financial intermediation conducive for investments.

The interest rate corridor system (IRC) of the BSP has put in place incentives for active interbank trading and financial market development by reducing short-term interest rate volatility and aiding systemic liquidity management.

The IRC also helps in developing benchmark short-term market interest rates (for bank loan and deposit pricing). Encouraging market development through market-based monetary operations unlocks investment capital as it ensures market efficiency.

Third, the BSP's continuing pursuit of foreign exchange reforms is aimed at supporting investments.

The BSP is committed to continue implementing various FX liberalization reforms to make the country friendlier to investors and attract bigger and better FDIs both in value and quality.

To date, there have been ten waves of FX reforms implemented since 2007. The most recent set of reforms took into consideration the country's strong macroeconomic fundamentals as well as the increasing needs of a growing economy.

The country's external payments position remains resilient and sustainable as it enjoys support from different fronts. These include remittances from overseas Filipinos (OFs), revenues from the IT-BPO industry, receipts from the robust tourism sector, and sustained inflows of foreign direct investments.

For 2019, the BSP sees a BOP surplus of $3.7 billion equivalent to 1 percent of GDP.

The current account deficit, on the other hand, has been revised upward to USD 10 billion, equivalent to 2.8 percent of GDP. We continue to see this as financeable given support from structural inflows.

The country's Gross International Reserves (GIR) now stands at around US$85 billion as of end-May 2019. This is roughly equivalent to 7.5 months' worth of imports of goods and payments of services and primary income.

In addition, the passage of R.A. No. 11256 or the Gold Law would allow the BSP to increase its purchases of domestic gold to further build up the level of the Philippines' GIR, which serves as the country's primary buffer against external economic shocks. The law exempts from excise and income tax the sale to the BSP of gold sourced from small-scale mining activities.

Fourth, the BSP's implementation of capital market reforms facilitates easier funding access.

The BSP is a long-standing advocate of reforms to further deepen the country's capital market. Capital market development helps finance infrastructure projects and limits concentration risks in the banking system, thereby facilitating investment in long-term government bonds, lowering borrowing costs, and improving monetary policy transmission. At the same time, this allows the private sector to tap into a broader market or avail themselves of alternative financing opportunities for infrastructure projects.

The BSP continues to enhance the regulatory environment (e.g., refinement of benchmarks and trading rules) by allowing banks to offer instruments that help hedge risks and provide ways of portfolio diversification.

On the other hand, the liberalization of the banking system, which allowed the entry of new foreign banks into the country, enhances the quality of competition in the banking system, expands the array of financial products and services at competitive rates, encourages more foreign direct investments (FDI), and opens alternative financing opportunities to fund infrastructure projects.

Before I end my presentation today, I would like to highlight key structural reforms that will help the BSP to more effectively perform its mandates.

Under my watch, the BSP shall have strict and prompt implementation of recently enacted laws namely:

1. Amendments to the BSP Charter

2. National Payment Systems Act,

3. National ID System, and

4. The Gold Law

The BSP also advocates these bills that have been passed in Congress, which needless to say, we shall strictly implement upon their passage.

5. Islamic Banking Bill and the

6. Anti-Bank Hacking System Bill which places harsher penalties for hacking of bank systems and skimming of ATMs or the Anti-Bank Hacking legislation.

Taken together, these laws will help enhance the macroeconomic environment, promote growth, and improve investment prospects in the country.

As we all know, investments are fundamental to economic growth and development, especially amid an increasingly integrated global economy.

It is for this reason that we are glad to engage the British Chamber to share our views on "Fueling the Growth of FDIs in the Philippines." This is in line with the goal of strengthening the position of the country as one of the favored destinations for FDIs.

On the part of BSP, please rest assured that we stand ready to support efforts to fuel further FDI growth in the Philippines within the bounds of our mandate.

It is my view that pursuing business opportunities in the Philippines will indeed be mutually beneficial for both foreign investors and the domestic economy.

Thank you very much and a pleasant day to all.

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[1] i.e., Board of Investments (BOI), Clark Development Corporation (CDC), Philippine Economic Zone Authority (PEZA), Subic Bay Metropolitan Authority (SBMA), Authority of the Freeport Area of Bataan (AFAB), BOI-Autonomous Region of Muslim Mindanao (BOI-ARMM), and Cagayan Economic Zone Authority (CEZA)

[2] Japan came in second pledging PhP9.4 billion or 20.5 percent of the total and Thailand taking the third spot with pledges amounting to PhP8.5 billion or 18.4 percent of the total approved FIs.

[3] Administrative and Support Service Activities came in second with investment commitments valued at PhP3.5 billion or 7.7 percent of the total FI. Accommodation and Food Service Activities followed with PhP2.9 billion or 6.4 percent of total FI commitments.

[4] World Bank "Philippines – Discussion Notes: Challenges and Options for 2010 and Beyond." June 2011.