Benjamin E Diokno: The Philippine economy - a story of cautious optimism

Speech by Mr Benjamin E Diokno, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the Wallace Business Forum, Makati City, 19 June 2019.

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Wallace Business Forum (WBF) Managing Director Gary Teves, distinguished officers and members of WBF, esteemed guests, ladies and gentlemen, good morning.

I am pleased to address you in this forum organized by the Wallace Business Forum. Your continued interest in the Philippine economy has greatly helped in shaping the quality of information provided to the international community. Events such as this offer the BSP an excellent opportunity to engage with various stakeholders in policy dialogue and discuss the developments in our core mandate of promoting price stability and financial stability as well as our views on the current challenges we are facing.

Let me begin my speech with the concept of a Goldilocks economy, a state of having a “just right” mix of high growth and low inflation. Has the Philippines entered this state? The answer is DEFINITELY YES.

Allow me to clarify. There has been an encouraging development in the decelerating trend in inflation. This has allowed us to reduce the interest rate on the BSP’s overnight reverse repurchase (RRP) facility by 25 basis points to 4.5 percent in our latest policy meeting held last May 2019. This decision was aimed at helping inflation move towards the middle of the target range and give due consideration to growth, in line with the BSP’s flexible approach to inflation targeting.

In addition, although the country experienced lower-than-expected growth for Q1 2019 at 5.6 percent, growth is expected to pick up in the second half of 2019 with the catch-up government spending plan. Let me emphasize that the country’s economic expansion streak is now 81 quarters, which translates to more than 20 years of uninterrupted growth.

In terms of the BSP’s outlook for inflation, our latest baseline projections in May indicate that inflation will likely settle within the target range of 3.0 percent ± 1.0 percentage point for both 2019 and 2020. This positive alignment between growth and inflation has been a constant narrative and is expected to further lend support to the country’s long-run growth momentum.

Both liquidity and credit conditions in the country continue to be in line with the country’s overall economic growth. As of end-April 2019, bank lending and liquidity grew by 12.7 percent and 7.0 percent, respectively.

Other aspects of the economy offer a sound basis for optimism. The country’s external payments position remains manageable and sustainable as it enjoys support from different fronts. These include remittances from one, overseas Filipinos (OFs); two, revenues from the information technology – business process outsourcing (IT-BPO) industry; three, receipts from the robust tourism sector; and four, sustained inflows of foreign direct investments.

As a result, the country’s Gross International Reserves (GIR) now stands at around US$85.0 billion as of end-May 2019—the heftiest level of GIR ever. It is roughly equivalent to 7.5 months’ worth of imports of goods and payments of services and primary income.

In other words ladies and gentlemen, the Philippine economy continues to fire on all cylinders and is expected to see steady economic growth without possible risks of overheating.

In terms of financial stability, we want to maintain a “Goldilocks economy” by not allowing markets to create new risks and vulnerabilities. This means that we do not only concern ourselves with growth and price stability, but also take into account resiliency. Implementing measures that would further enhance the existence of flexible systems and develop financial markets remains a policy imperative.

Toward this end, the BSP’s policy agenda has endeavored to promote greater market efficiency and transparency by relying on market-based instruments in our operations.

For instance, the BSP continues to refine its Interest Rate Corridor (IRC) framework. The IRC is expected to support capital market development by fostering more active liquidity management by individual financial institutions. This, in turn, could strengthen the price discovery process and facilitate the effective and efficient pricing of financial products in the domestic market.

This operational reduction in reserve requirement (RR) is also part of the BSP’s broad financial sector reform agenda to promote efficiency in the system by lowering intermediation costs. This is in line with the BSP’s medium-term objectives of enhancing the effectiveness of monetary policy and deepening the domestic money market.

Over time, the IRC system will also help reduce the country’s reliance on RR for sterilization purposes, shift to market based instruments, and allow the BSP in the future to bring the RR in line with regional norms.

The BSP is also committed to foreign exchange (FX) reforms toward a more organized FX market that supports a flexible and market-determined exchange rate. This includes further liberalizing FX rules to reduce the cost of doing business and to improve data capture for FX transactions.

Overall, our commitment to lowering friction costs in the banking sector will foster more efficient financial intermediation, which will be further enhanced by the availability of alternatives offered by fintech and digital innovation.

Towards a more internationally integrated financial sector, BSP has been supportive of the ASEAN financial integration process and has actively cooperated and collaborated with ASEAN central banks through responsive regulations and measures to support regional financial integration and capital market development.

Likewise, the BSP has recently put in place various enhancements in its arsenal of macroprudential tools. These include the recent approval to impose counter-cyclical buffers (CCyB) and the approval of the extension of the observation period for the Basel III Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR), among others. These tools allow the BSP to manage the build-up of systemic risk in the financial system by setting aside additional capital as reserves during good times and as insurance or buffers for bad times.

Despite all these positive developments, there are still challenges on the horizon. As International Monetary Fund (IMF) Chief Christine Lagarde aptly puts it, “the global economy is at a delicate moment”—as we see uncertainty as well as lack of trust and confidence by the business community as to what the global economic landscape is going to be. Under such condition, markets and economies, including the Philippines could possibly become more susceptible to risks. Allow me to identify some of the key challenges that we need to address.

First is the risk of a sharper-than-expected global economic slowdown. In its most recent World Economic Outlook (WEO), the IMF revised its global growth forecast for 2019 downward from 3.7 percent last October 2018 to 3.3 percent this April 2019.

Second, with global growth slowing, advanced economies have shifted from a restrictive to a more accommodative stance of monetary policy. While this could be beneficial for emerging economies like the Philippines, it could also potentially provide the impetus to a cycle of capital flow surge and sudden stop.

Third, we are observing the tendency in some economies to move away from globalization towards the rise of protectionist policies such as the protracted trade tensions between the US and China. While the Philippines is not directly affected with the tariff impositions, the continued trade friction could take its toll on the country's external sector.

Fourth, there is also 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. In fact, rapid technological innovation has already ushered in broad structural economic changes that policymakers are only just beginning to understand. Certainly, this would have significant impact in the conduct of economic policy and the way we do business.

On top of these global risks, we also have to deal with the infrastructure gap on the domestic front.

Nonetheless, despite these risks, we are cautiously optimistic that the Philippine economy is poised to sustain its growth momentum amid lingering global headwinds.

Let me close by assuring everyone that the BSP will continue to adhere to sound policies and remain focused on its mandate. You can continue to count on us to remain steadfast in our primary objective of price and financial stability, factors that reinforce the vibrant investment environment.

Having said all these, I am looking forward to a productive, open, and stimulating discussion with you and will be receptive to your insights.

Thank you and mabuhay.