Benjamin E Diokno: Philippines - weaving an unprecedented growth story

Speech by Mr Benjamin E Diokno, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the Ayala Economic and Treasury Summit, Manila, 6 August 2019.

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Jaime, Fernando, other senior Ayala officials, guests, ladies and gentlemen, good morning. I am very pleased to be the keynote speaker in your annual corporate planning and budgeting conference.

As former Budget Secretary, I understand the importance of planning and budgeting to the continued growth of an institution. As head of the Bangko Sentral ng Pilipinas—a hat I've been wearing for five months now—I remain mindful of how vital forward-looking policies are to the achievement of our respective organizations' objectives and targets.

In the next few minutes, I will be discussing the current state of the Philippine economy, followed by some points on why we believe our economic growth will be sustained in the years ahead. Finally, I will also briefly talk about the BSP's role in supporting this growth narrative and some of the challenges that we may face going forward.

Let me begin with our growth story thus far in the Philippines. Our economy has experienced uninterrupted growth for over 20 years since 1999 despite challenges such as the 2004 fiscal crisis and the 2007 global financial crisis—that is 81 consecutive quarters of continuous growth, with annual growth averaging 6.4 percent in the past five years (2014–2018).

Growth in recent years has become more broad-based.

On the demand side, private consumption remained robust in the first quarter of 2019, as in the previous quarters through the years. This is further supported by rising contribution from investments from 2010 up to present.

On the supply side, services remain the main driver of growth—but the industry sector has also stepped up in recent years.

Meanwhile, the government's economic managers remain optimistic about achieving our GDP growth target of 6 to 7 percent this year despite the lower than expected 5.6 percent growth in the first quarter of this 2019.

Private consumption is expected to remain robust, aided by remittance inflows and sustained "cooling" inflation. Private capital formation, on the other hand, should likewise contribute more significantly to economic growth, with construction and investments in durable equipment expected to remain solid in light of the government's projects and other infrastructure programs.

The International Monetary Fund (IMF), World Bank (WB), and Asian Development Bank (ADB) share these expectations. In fact, all three forecast that the Philippine economy will grow by about 6.2 to 6.5 percent this year.

The bold reforms and initiatives in the past three years have prompted the government to capitalize on and sustain these gains. It is because of this that we believe the Philippine growth momentum will be sustained moving forward.

First is the government's ambitious infrastructure program—"Build, Build, Build" which aims to boost the economy's mobility and connectivity, enabling equitable growth and development. At present, there are 75 high-impact national government infrastructure, with 46 projects (61 percent) already in the implementation stage.

The government is expected to invest over PhP 4.6 trillion (or US$90 billion at PhP52:USD1) in public infrastructure from 2019 to 2022.

Second, is the recent passage of reforms aimed at strengthening our investment climate. The Ease of Doing Business and Efficient Government Service Delivery Act, the revised Corporation Code, and the Philippine Innovation Act support the government's agenda of improving competitiveness and ease of doing business in the country, promoting transparency and cutting red tape in the government for a more conducive business environment.

At present, the Philippines' current standing has improved based on different third-party assessors. For instance, the Philippines' ranking rose from 68th to 56th place under the 2018 Global Competitiveness Report.

It also received an upgrade in its sovereign credit rating from Standard & Poor's to "BBB+" from "BBB." These favorable standings are also boosted by the improved business sentiment and the stable consumer outlook based on the BSP's latest round of expectations surveys.

Finally, the continued demand for Philippine skills locally and abroad are evident in the growth of our BPO industry and strong remittance inflows. This further highlights the importance of our country's most prized resource—our labor force. Based on our estimates, production efficiency has improved over the years with the incremental capital-output ratio (ICOR) declining steadily. As you know, the higher the ICOR, the less efficient the production process is.

Recognizing the skills of our workforce, the government has invested heavily in various social programs such as the Universal Health Care Act and the Access to Quality Tertiary Education Act (RA No. 10931).

You may not know this but 40% of our budget goes to social services.

Our growth story has been supported by structural and policy reforms in the economy for around three decades. These reforms enable growth by expanding the role of market forces in key sectors of the economy; encouraging investments and private sector activity; removing bottlenecks to doing business and investments in the country; and strengthening the country's fiscal position and the financial sector. These, and other structural reforms in the pipeline, will continue to play a significant role in propelling the economy toward a balanced, sustainable, and inclusive growth.

In addition, recently approved legislation—such as the BSP Charter Amendments, Philippine Identification System (PhilSys) Act, National Payment Systems Act and the Gold Law—allow us to pursue our mandate with more vigor and in effect, enable us to espouse the interests and uplift the lives of all Filipinos.

So what is the role of BSP in the Philippines' growth narrative?

Our mandate is clear: "maintain price stability conducive to a balanced and sustainable growth of the economy and employment." Our objective in the BSP is to protect the real purchasing power of the peso to support conditions for long-term economic growth. With your presence in this annual corporate planning and budgeting process summit, I know you are fully aware of the importance of efficient allocation of resources.

As a central banker, I would argue that price stability is closely linked with financial efficiency. If the prices are low and stable, financial planners are better equipped to allocate resources to their most efficient use. Lesser price volatilities would also enable us to anticipate risks and plan better. And with our amended BSP Charter, we are now in a better position to implement sound policies to promote and maintain price stability, a strong financial system, and a safe and efficient payments and settlements system.

In terms of price developments, we are on track to achieving our inflation target of 2 to 4 percent for 2019.

To give you some context, our June inflation declined to 2.7 percent from 3.2 percent in May, the lowest inflation recorded in more than 20 months since August 2017.

Later this morning, the Philippine Statistics Authority (PSA) will announce the average percentage of inflation for July. My forecast is that it will settle within the range of 2.2 – 2.8 percent.

This sits comfortably within the government's target band, in line with our forecasts.

This is a stark contrast from 2018 when inflation was pushed beyond the target range to average at 5.2 percent.

Looking ahead, we expect inflation to remain on a target-consistent path for 2019 and 2020. BSP's latest baseline forecasts indicate that inflation is projected to average 2.6 percent this year and 2.9 percent next year and 2021.

The risks to the inflation outlook appear to be broadly balanced for 2019 and 2020. The main upward risks are the petitions for electricity rates and transport fare adjustments, and the proposed increase in the excise taxes of alcoholic beverages and cigarettes. The risk of a prolonged El Niño episode has gone down. On the external front, the global economic slowdown due to protectionist policies in advanced economies, as well as geopolitical tensions continue to be the main downside risks to inflation.

Inflation expectations are also starting to converge with the government's target range. Based on the BSP's latest round of expectations surveys, businesses and consumers expect inflation to remain within the 2 to 4 percent target for 2019.

Similarly, BSP's survey of private sector economists for June 2019 showed lower mean inflation forecasts for 2019 and 2021. Likewise, institutions such as the ADB and the IMF are projecting that inflation for 2019 and 2020 will be within the government's target range for this year and the next.

On June 20, the Monetary Board deemed it appropriate to maintain its monetary policy settings unchanged following the 25-basis point cut in the BSP policy rate in May 2019.

With better-behaved inflation dynamics, the Monetary Board also decided to cut the reserve requirement ratio by 200 bps phased within 3 months beginning in May up to July. This is to help ease some of the tightness in domestic liquidity.

Moving forward, monetary policy has been and always will be data-dependent. To determine whether further monetary easing is warranted, we will first have to see how macroeconomic conditions will unfold.

Two days from now (8 August 2019), the Monetary Board will be conducting its regular review of the monetary policy stance. Until then, we will continue to look at the widest possible set of available economic and financial variables. These include the recent inflation numbers to be announced today—if not yet announced, and the second quarter (Q2 2019) GDP growth set to be released on Thursday.

Meanwhile, the credit-liquidity dynamics in the country remain consistent with expanding economic activity. Bank lending continues to post double-digit, reflecting sustained demand for loans from various production sectors of the economy. Liquidity conditions, while growing at a moderate pace, remain sufficient to support economic growth requirements, with the latest ratio at 64.2 percent for Q1 2019.

The continued soundness and stability of the Philippine banking system also lend strong support to economic growth. Philippine banks remain robust, well-funded, and adequately-capitalized.

As of end-March 2019, the Philippine banking system assets expanded by 11.0 percent year-on-year (YoY) to P17.0 trillion which approximates the size of the domestic economy. The expansion in the banking system's assets was primarily due to increased lending activities.

The observed robust asset growth was supported by expansion in bank branch network to 11,933 as of end-June 2019.

Deposit liabilities continue to be the primary funding source of the banking system. These deposits are mostly peso-denominated and sourced from resident individuals and private corporations.

Meanwhile, banks' annualized net profit grew by 8.8 percent to P189.0 billion for the period ended March 2019. Annualized interest income primarily kept the bottomline robust, growing strongly by 27.7 percent for the first quarter of the year.

With respect to banks' capitalization level, the capital adequacy ratios (CARs) of U/KBs on solo and consolidated bases improved to 15.1 percent and 15.8 percent, respectively. As you know, these ratios are well-above the minimum threshold set by the BSP and BIS of 10 percent and 8 percent, respectively.

The increase is due to the capital build-up being undertaken by the industry in anticipation of further expansion of the credit portfolio and investment activities.

Liquidity remains sufficient as banks maintain adequate high-quality liquid assets.

This favorable confluence of strong growth and a manageable inflation environment allows us to be optimistic. Nevertheless, there are still challenges that need to be considered.

There is the risk of sluggish global growth. In its July 2019 World Economic Outlook (WEO), the IMF revised its global growth forecast for 2019 from 3.3 percent last April to 3.2 percent. Trade tensions between the US and China continue to be at the forefront with both countries raising tariffs on different imported goods. At the same time, Brexit-related issues continue to be another source of risk.

The intensified uncertainties surrounding the external environment have led to weaker global trade. As a result, the IMF revised its growth projections for emerging and development economies downward—by 0.3 percentage point for 2019 and by 0.1 percentage point for 2020. 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.

Despite these risks, we have sufficient buffers to help cushion the country against external shocks. For example, we continue to maintain a market-driven foreign exchange (FX) rate, which we complement with FX liberalization measures to facilitate structural FX flows.

We continue to have sizeable gross international reserves, built from sustained remittances from overseas Filipinos, robust receipts from business process outsourcing and tourism, and steady foreign investment in the Philippines. As of end-June 2019, gross international reserves (GIR) stood at 85.4 billion dollars, equivalent to 7.4 months' worth of imports of goods, services and primary income. The recent passage of the Gold Bill will lower the cost of both funding for the country, as well as doing business for the private sector.

Meanwhile, remittances from overseas remained robust in the first five months of the year, increasing by 4.5 percent, which is equivalent to US$12.3 billion. We also continue to take a more cautious assessment of the narrowing current account balance.

Here, I should emphasize that this does not mean that all current account deficits should be taken adversely. In our case, strong economic expansion has fueled the need for imports, particularly of capital goods as well as raw materials and intermediate goods. Over time, as investment-led economic activities result in the expansion of the economy's potential capacity, there can be subsequent rise in goods exports, which would eventually mitigate the current account deficit.

We will also continue to initiate reforms in the financial sector. We wish to reiterate our commitment to implement measures designed to enhance and develop the domestic money and capital markets. We will continue to promote greater market efficiency and price discovery through further refinements to our interest rate corridor framework and monetary operations. We will also lower friction costs in the banking sector to foster more efficient financial intermediation, which will be further enhanced by the availability of alternatives offered by FinTech and digital innovation.

Likewise, the BSP has recently put in place various enhancements in its arsenal of macroprudential tools to ensure the stability of the financial system. These tools will allow the BSP to manage the build-up of systemic risk in the financial system by requiring banks to set aside additional capital as reserves during good times and as buffer for bad times.

All of these initiatives would be meaningless if they are not felt by all Filipinos. Thus, we emphasize the importance of financial inclusion in the country. We have set our sights on digital technology as a catalyst and strategic enabler to ensure that everyone has access to financial services. Ensuring that no one is left behind is critical for achieving inclusive growth.

Let me now highlight the priority legislative measures that the BSP will pursue under the 18th Congress. These bills seek to further enhance access to quality financial products and espouse the interests of the general public.

These include: the Amendments to the Bank Deposit Secrecy laws; the Financial Consumer Protection bill; and reforms to Agricultural Financing which seeks to amend the Agri-Agra Reform Credit Act of 2009 (Republic Act No. 10000) and allow banks to merge their loan allocation to the farm sector as a measure to improve banks' compliance rate.

We will work closely with officials of both Houses of Congress and other concerned stakeholders as we pursue the enactment of these important legislative measures.

Let me end my presentation with these key notes:

The Philippine economy has demonstrated uninterrupted economic expansion for over two decades. This growth is expected to be sustained going forward with sound macroeconomic fundamentals complemented by the government's "game-changing" reforms aimed at bridging infrastructure gaps, strengthening our investment profile, and supporting the future of, as the World Bank called it, our "globally recognized competitive workforce."

However, the external environment has become more uncertain in recent months given trade and geopolitical tensions. Nevertheless, we have a resilient external payments position as cushion against global headwinds.

The BSP will remain watchful and vigilant, ready and willing to utilize any and all its analytical and surveillance tools at its discretion for any potential risks to its monetary and financial stability objectives.

As we continue to support the government in its measures to sustain growth, create jobs, and reduce poverty, the BSP will continue to focus on fulfilling its mandate of price stability conducive to a balanced and sustainable growth of the economy.

Thank you for your attention. I hope that this presentation has given you all an additional perspective that you can use in your future corporate planning process going forward.

I look forward to an engaging discussion with you this morning.