Benjamin E Diokno: The Philippine economy - sustaining resilience amid uncertainties

Speech by Mr Benjamin E Diokno, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), to the Economic Journalists' Association of the Philippines, Manila, 27 August 2019.

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Good morning, ladies and gentlemen. First, let me thank the Economic Journalists' Association of the Philippines for inviting me to share the Bangko Sentral ng Pilipinas' view on the current and future state of the Philippine economy.

As we are all aware, the specter of slowing global economic growth looms larger than ever on the horizon as protectionist policies and geopolitical tensions continue to dominate the global growth narrative.

Greater global economic uncertainty may lead to higher risk aversion as international investors turn to safe-haven assets, resulting in volatility in our domestic financial markets. When this happens, this could have adverse consequences on our price and financial stability objectives, and ultimately on the country's growth momentum.

Nevertheless, in this presentation, I will show you how the BSP, with our purposeful and meaningful structural reforms, can help support against the impact of these external risk factors.

Risk factors identified last year, such as the escalating trade tensions between major economies and geopolitical factors, have either intensified or materialized this year and contributes to weaker global economic prospects.

Acknowledging the impact of these on world trade and investment, the IMF have several times downgraded its 2019 and 2020 global growth projections this year. Moreover, the IMF continues to view the balance of risks to the global outlook as being on the downside, with further escalation of trade tensions.

In response, central banks around the world, including the Philippines, have responded by easing their respective policy rates to stimulate their domestic economies.

In fact, some central banks have surprised the markets by reducing their rates by more than what was expected. This indicates that the global monetary policy easing cycle could gather momentum and last longer and deeper than previously anticipated.

Despite all this, we remain optimistic about the prospects of the Philippine economy. As I emphasized earlier, we are well-positioned to deal with these challenges.

We now have an encouraging mix of a manageable inflation environment alongside steady economic growth, which affords policymakers sufficient space to respond appropriately to evolving domestic and global conditions.

Overall liquidity and credit conditions remain supportive of the country's growth requirements. We likewise continue to have a fiscal target that both delivers effective government spending while remaining prudent in meeting debt obligations.

Our sound and stable banking system is aided by strong prudential regulation and supervision. Finally, our robust external payments position, underpinned by comfortable FX reserves and prudent external debt management, acts as additional cushion against external vulnerabilities.

In terms of the current state of the Philippine economy, the current manageable inflation environment bodes well for sustaining economic growth. Headline inflation slowed down further to 2.4 percent in July, the lowest inflation reading since January 2017. Thus, the year-to-date average inflation rate of 3.3 percent is now well within the Government's inflation target of 2 to 4 percent.

Price pressures eased anew in July 2019, as food inflation slowed down following the summer harvest season and amid liberalized rice importation.

Meanwhile, it is not surprising that we had a lower-than-expected GDP growth in the first two quarters of the year. To a large extent, the delay in the passage of the 2019 budget and the election ban significantly weakened government spending and public construction.

Nevertheless, we expect catch-up fiscal spending by the Government to buoy the growth momentum in the second half of 2019.

We likewise take comfort in the fact that credit and liquidity dynamics in the country remain supportive of growth.

The latest reading of credit growth is 10.5 percent as of end-June 2019 while domestic liquidity expanded by 6.4 percent during the same period.

Notwithstanding the slower growth in loans for production activities, we continue to see sustained business demand on account of favorable macroeconomic conditions in the country, particularly with the easing of inflation in 2019.

Meanwhile, the continued lending activities of Philippine banks indicate their effectiveness in facilitating a smooth flow of funds in the economy, boosting economic growth.

Banks remain sufficiently capitalized, while their past due ratios have consistently declined over the years. This enhances their capacity to manage risks and at the same time increase profitability.

We expect these improvements to continue given the positive outlook on the macroeconomy.

In addition, we continue to have sizeable international reserves to help insulate our domestic economy against external shocks. This is built from sustained remittances, robust receipts from business process outsourcing and tourism, and steady foreign investment inflows.

As of end-July 2019, gross international reserves stood at 85.2 billion dollars, equivalent to 7.4 months' worth of imports of goods and payments of services and primary income.

Meanwhile, overseas Filipinos' remittances remained robust in the first half of the year, increasing by 3.2 percent, which is equivalent to US$14.6 billion.

Taking all these into account, the Monetary Board in its most recent meeting on 8 August 2019, deemed it necessary to reduce the BSP's key policy rate by another 25 basis points to 4.25 percent. This brings the year-to-date monetary policy adjustment to 50 basis points.

In doing this, the BSP noted that price pressures have continued to dissipate, while prospects for global economic activity are likely to remain weak amid sustained trade tensions among major economies.

Domestically, the outlook for growth continues to be firm on the back of a projected recovery in household spending and the accelerated implementation of the government's infrastructure spending program.

Looking ahead, we expect inflation to remain on a target-consistent path for 2019 and 2020. The latest baseline forecasts indicate that inflation is projected to average 2.6 percent for 2019 and 2.9 percent for both 2020 and 2021.

Inflation expectations have also moderated further to levels consistent with the target based on the BSP's survey of private sector economists.

We assess the balance of risks to the inflation outlook to remain broadly balanced for 2019 and 2020, before tilting to the downside for 2021. Weaker global economic prospects continue to temper the inflation outlook.

Going forward, the BSP will continue to monitor price and output conditions to ensure that monetary policy remains appropriately supportive of sustained non-inflationary economic growth over the medium term.

In terms of financial stability safeguards, we now have a deeper policy toolkit to deal with external and domestic shocks to the system. These tools will allow the BSP to respond to the formation of imbalances and address the build-up of system risk.

First, we continue to implement a flexible exchange rate regime as our first line of defense against external shocks. Such a framework allows the BSP to intervene only if volatility in the foreign exchange market is perceived to adversely affect the inflation outlook.

Our policy toolkit now encompasses macroprudential regulations that can be targeted against specific sources of risks, contingency measures such as liquidity-enhancing facilities, and regional firewalls that boost the flexibility and effectiveness of our actions.

Aside from this, amendments to the BSP Charter allows the BSP to issue its own securities.

The BSP has also expanded its crises surveillance and monitoring toolkit. To name a few, we have the Bank Distress Index, which is used to identify potential banking crisis episodes in the country; the Philippine Composite Index of Financial Stress, which is used to measure the degree of financial stress across markets; and the Early Warning System on currency crisis and on debt sustainability.

Likewise, in terms of supervision, we continue to review and align our financial regulations and policies with international standards to enhance risk management and ensure the competitiveness of our banks in view of the ASEAN integration. We intend to further develop our macro-financial surveillance capability by improving coordination and cooperation with other government agencies and regulators.

With the rapidly evolving technology and payments landscape, our policy stance in supporting responsible fintech innovation remains anchored on three core principles:

1) Regulations must be risk-based, proportionate and fair.

2) There should be an active multi-stakeholder collaboration.

3) Regulations must ensure consumer protection.

Accordingly, please allow me to mention some key policy initiatives that we have implemented:

We updated the BSP's regulatory framework on the operation of money service business to enhance the customer due diligence expectations and re-balance the objectives of financial integrity and financial inclusion.

We also established a framework for regulating virtual currency exchanges which subject them to registration, minimum capital requirements, internal controls, and regulatory reporting, among others.

At the same time, we recognize that digital finance delivered through mobile technology alone cannot reach everyone. This is why we have also issued regulations that enable cash agents to provide improved “last mile” delivery of financial services to the unbanked and under-banked among our countrymen.

Needless to say that the BSP is committed to the effective discharge of its mandates and policy thrusts—foremost of which is maintaining price stability—to contribute to the country’s favorable growth narrative. Maintaining price and financial stability, as well as an effective and transparent payments systems, will help foster an enabling macroeconomic environment that is conducive to a sustainable economic growth.

On monetary policy, the BSP remains committed to a forward-looking approach to pre-emptively address risks to price stability. In every policy decision that we will make, we will always be guided by the evolving conditions for inflation and outlook, while being mindful of developments in the world economy.

On financial stability, the BSP will continue efforts to safeguard the domestic financial system and help manage risks attendant to financial market developments. The goal is to strengthen the regulatory regime to ensure responsible risk-taking by financial institutions.

We are also stepping up advocacy efforts to promote financial learning and microfinance to more sectors and areas across the country.

Finally, in the area of payments and settlements, we will remain proactive in ensuring the safety and timely completion of financial transactions by minimizing systemic risks and enhancing the integrity of financial processes through progressive policies on e-commerce and innovations.

The growth narrative of the Philippine economy has gone a long way. The transformation that the domestic economy underwent before achieving its current state, has been arduous, and at times, painful, but nevertheless rooted on solid structural underpinnings and macroeconomic policy discipline.

In closing, while the Philippine economy is not immune from risks in the global market, it is well insulated. In a global environment where risk sentiment is fragile and uncertainty is permanent, we are confident to say that the Philippines still provides a unique value proposition that is not fleeting, but anchored on a dynamic track record of changing for the better.

At the same time, we need to ensure that this growth performance continues over the longer term so that the next generation of Filipinos will likewise enjoy years of economic prosperity. In this regard, a sustained commitment to pursue the Government’s infrastructure and reform agenda will support high, inclusive, and sustainable growth.

For its part, the BSP remains committed to the effective pursuit of its mandates for the country’s continued, balanced, and sustainable growth which ultimately will improve the life of every Filipino people.

Thank you and mabuhay!