Benjamin E Diokno: The Philippine economy - bright prospects ahead

Speech by Mr Benjamin E Diokno, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at The Asset Philippine Forum, Manila, 8 October 2019.

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Friends from The Asset, stakeholders from the financial sector and investment community, members of the media, ladies and gentlemen, good afternoon.

I would like to thank The Asset for always inviting us to take part in its annual forum, which provides the audience relevant updates on the Philippine economy.

In keeping with the theme "Seizing the Opportunity," my presentation will talk about the bright prospects ahead for the Philippine economy, which I hope would prompt investors to do business here so they can "seize opportunities."

The Philippines is among the fastest growing and most resilient economies in the world. In fact, it grew by 6.2 percent last year and, based on forecasts by the IMF, it is poised to maintain growth in the 6.0-percent territory this year and next.

The government is even more bullish, with the official growth targets set at 6.0 to 7.0 percent this year, 6.5 to 7.5 percent next year, and 7.5 to 8.0 percent in 2021.

The inflation environment is also favorable.

While the economy experienced elevated inflation last year, it was fixed through the prompt implementation of monetary and non-monetary actions.

BSP raised policy rates by a total of 175 basis points to arrest brewing second-round effects and to anchor inflation expectations.

Other concerned government agencies also implemented measures to boost food supply, including streamlining of processes for food importation. Congress passed, and the President approved, a game-changing law that liberalizes rice importation.

As such, after peaking at 6.7 percent in September 2018, inflation continued its downward trend, settling at 0.9 percent in September, the lowest in over three years.

Based on these developments, BSP estimates that inflation will settle at 2.5 percent this year, and 2.9 percent in 2020 and 2021, well within the official target of 2.0 to 4.0 percent.

Third-party institutions agree that inflation will be within target range up to 2021.

With this benign policy environment, the BSP, so far this year has been able to:

1) Cut the key policy rate by a total of 75 basis points and

2) Cut the reserve requirement ratio (RRR) by a total of 300 basis points, 100 basis points of which will be effective at the start of November

The favorable growth and inflation dynamics also helped boost business confidence and investments in the country. This is evident in part by the increase in importation of capital and intermediate goods to support an expanding economy.

The increase in imports has led to a manageable deficit in the current account (CA). In fact, the current account deficit is financeable, with robust foreign exchange inflows in the capital and financial account expected to keep the overall balance of payments (BOP) in surplus this year.

The country's balance of payments position is driven primarily by steady inflows of business process outsourcing (BPO) revenues, overseas Filipinos' cash remittances, and tourism receipts.

Combined, these three items recorded an amount equivalent to 17.2 percent of the country's gross domestic product (GDP) in 2018.

Another solid source of foreign exchange is foreign direct investments (FDIs), which amounted to about US$10 billion both in 2017 and 2018. In 2010 and earlier years, FDIs hovered at only less than US$2 billion. Improvements in the macroeconomic and business climate are credited for the rise in FDIs.

Looking ahead, we expect FDIs to remain robust, as shown by hefty amounts of investment pledges approved by the country's investment promotion agencies (IPAs).

In the first half of this year, foreign investment applications approved by the IPAs amounted to P95.6 billion, more than twice the P45.2 billion recorded in the same period last year.

The economy also enjoys sufficient buffers against external headwinds. Its gross international reserves (GIR) are high while external debt burden is low.

As of end-September, the GIR amounted to US$86.2 billion. This is enough to cover 7.5 months' worth of imports of goods and payments for services and primary income. The received doctrine is that 3 months worth of imports is enough.

The country's external debt is manageable. It is a mere 23.8 percent of GDP as of end-June 2019. Manageability of external debt has improved significantly over the years, with the amount recorded at nearly 60 percent of GDP in 2005.

The country's banking system remains sound and stable.

With healthy indicators, including more-than-adequate capitalization and low exposure to bad debts, banks are able to help fund the growing investment requirements in the economy.

Credit growth, which has settled in the double-digit territory over the last few years, has benefited the productive sectors of the economy. This bodes well for sustained growth.

Robust lending growth has consistently come along maintenance of good quality of loans, reflecting observance of prudent lending standards.

We expect lending growth to continue, especially with the BSP's intention to continue slashing the reserve requirement ratio (RRR).

Should the inflation outlook continue to improve, we will further cut the RRR until it reaches single digit by the end of my term in 2023.

As you know, we have room and reason to reduce the RRR as it is currently the highest among select peer countries. RRR is a friction cost, and lowering it is consistent with the aim of further enhancing financial intermediation.

In the past, the high RRR had served as an important tool to mop up excess liquidity. But now that the BSP, under its amended charter, has the mandate to issue its own debt securities, we can rely less on the RRR for liquidity management.

With lower RRR, the banking sector can then lend more support to the economy’s growth prospects.

It is also important to note that economic growth in the Philippines is happening not only in the National Capital Region (NCR) but throughout the country.

In fact, growth rates of other regions are outpacing that of the NCR. Growth in the regions is expected to remain robust, driven in part by infrastructure development across regions.

This pattern of growth is consistent with the aim to make economic growth more inclusive.

Nevertheless, the BSP will continue to adopt measures that will improve the regulatory and operational environment so that banks will be able to support robust and inclusive economic growth.

The financial sector can help spur a more inclusive growth through financial inclusion. We have achieved milestones on financial inclusion as far as regulations are concerned. In fact, the Philippines is recognized as having one of the best regulatory environments in the world for financial inclusion.

However, many municipalities still do not have banks operating in their areas. A big part of the country’s adult population still do not use formal channels to save or borrow money.

To enhance financial inclusion, the BSP has implemented several initiatives and are further strengthening its efforts.

For instance, we have issued regulations allowing other entities to serve as cash agents or to perform financial services on behalf of banks, as well as regulations that make it easier for people to open bank accounts.

The BSP also spearheads the Credit Surety Fund (CSF) program, wherein pooled funds from various institutions – such as state-owned banks, local governments, and cooperatives – serve as collateral for loans applied for by micro entrepreneurs.

We have also implemented the National Retail Payment System (NRPS), which is a framework for interoperable, secure, efficient, and affordable fund transfers.

Our regulatory environment also enables the promotion of financial technology (fintech). In a country like the Philippines where mobile phone penetration is high, it is prudent for financial regulators to recognize the potential of fintech to hasten financial inclusion.

In fulfillment of the NRPS, two interoperable payment systems have been launched—InstaPay for low-value fund transfers credited real time, and the PESONet for bigger-value fund transfers credited within the same banking day.

These payment systems allow funds to be transferred electronically from one financial institution to another. Most of the big banks are already participating in PESONet and InstaPay. Soon, we expect more banks, particularly the smaller ones, to participate and further boost electronic payments.

We expect e-payments to hit 20 percent of total financial transactions in the country by next year.

We are also keen on hitting the targets of reducing the number of unbanked municipalities from about a third a few years back to only 20 percent by the end of next year, and to have the estimated 20 million unbanked or under-served Filipinos access the formal financial system also by the end of next year.

We can imagine the Philippines becoming a cash-light economy, with e-payments accounting for at least half of total financial transactions in five years.

The law amending the BSP charter was signed into law last February. With it, the BSP's ability to fulfill its mandates of price and financial stability is enhanced.

Some highlights of the law include

(1) increase in capitalization;

(2) authority to issue our own debt instruments;

(3) wider supervision to include not only banks but also money service institutions, credit granting businesses, and payment system operators;

(4) authority to prescribe minimum risk-based capital adequacy ratios; and

(5) protection of concerned BSP personnel against lawsuits arising from the conduct of the BSP's financial regulation duties.

Other important laws concerning the BSP have also been enacted recently, including

(1) Islamic Banking law, which provides the framework for regulation and development of Islamic banking in the country;

(2) Gold law, which exempts from taxes the sale of gold from small-scale mining to the BSP;

(3) the National Payment Systems Act, which formally recognizes the BSP as supervisor of the country's payments and settlements system;

(4) Personal Property Securities Act, which allows use of other assets besides real properties to serve as collateral for loans to boost micro lending;

(5) Philippine ID system, which will ensure all Filipinos have proper identification, thus allowing banks to comply with know-your-customer (KYC) rules when they offer financial services to the poor; and

(6) Anti-hacking law, which imposes stiffer penalties on hacking, thus better protecting the financial services industry and their customers from IT-related fraud.

With my appointment as BSP Governor coming shortly before and after the enactment of these new laws, I consider it my personal mission to oversee the prompt and effective implementation of these game-changing reforms.

We are not stopping here. More legislative reforms are in the pipeline, and we are keen to see them being implemented soon. These include

(1) amendments to bank secrecy laws, which will support efforts versus money laundering and tax evasion;

(2) amendments to the Agri-Agra law, which will relax provisions of mandated lending to the agriculture sector;

(3) Financial Consumer Protection bill, which seeks to require financial institutions to have mechanisms in place to protect financial consumers; and

(4) amendments to the Warehouse receipts law, which seeks to modernize the warehouse receipts system to better account for assets that can serve as collateral for loans.

Besides the legislative agenda, we are also pushing for a wide range of other reforms, including in the areas of risk governance, fintech, integrity of financial system and safeguarding of public interest; and capital market development.

The newly enacted laws and those in the pipeline are a continuation of the Philippines' long history of structural reforms, which have strengthened the country's macroeconomic environment over the years.

Rest assured that the BSP will be one with the government in continuing the reform agenda to push the Philippines to its next stage of development.

At the moment, the Philippines enjoys investment grade credit ratings and is on the cusp of becoming an upper middle income economy.

With the reform momentum, we expect the Philippines to become an A-rated economy in the next two years or so, and to become a high income economy by 2040.

In closing, allow me to give the following take-away points:

First, the Philippines will remain among the fastest growing economies in the region and the world;

Second, amid external headwinds, sustained growth will be supported by healthy external payments position and strong domestic demand;

Third, robust, sustainable, and more inclusive economic growth will be supported both by “soft” or policy reforms and “hard” or physical infrastructure reforms; and

Fourth, the reform momentum will push the Philippines to its next stage of development where it enjoys Single A credit ratings in the next two years or so, and where it becomes a high-income economy in two decades.

Amid this favorable backdrop, we invite everyone to seize the growth opportunities that this economy offers.

Thank you very much and mabuhay!