Philippines: Toward Soaring New Heights

Date: May 16, 2022
Occasion: Citi Virtual Macro Forum
Speaker: BSP Governor Benjamin E. Diokno

Good day, everyone. Thank you for inviting me to the Citi Virtual Macro Forum to share updates on the Philippine economy.

Two years ago, in this same virtual roundtable discussion organized by Citi, I expressed my confidence in the Philippine economy's strengths on three critical factors—pre-crisis fundamentals, emergency response, and structural/development reforms.

Now, I can tell you that we have weathered the unprecedented crisis during the past two years because of the country's strong fundamentals, which were built through decades of continued implementation of structural reforms and sound macroeconomic management.

The Philippines is well on its way to full recovery. After the pandemic-driven recession in 2020, the economy grew by 5.7 percent last year and sustained its robust momentum with an 8.3 percent growth in the first quarter of 2022. Now, our original growth target of 7-9 percent this year appears to be doable.

The relaxation of mobility and activity restrictions for most of the country sustained growth as we are able to better control the spread of COVID-19.

Growth in the first quarter was broad-based.

On the supply side, all sectors expanded, driven by industry at 10.4 percent, followed by services at 8.6 percent.

On the expenditure side, growth was driven by private consumption which grew by 10.1 percent, a stark reversal from the -4.8 percent in the same quarter a year ago, owing to much relaxed quarantine restrictions.

Investments and external trade performed well, too.

The employment picture is close to its pre-pandemic level. From a peak of 17.6 percent in April 2020, the unemployment rate is down to just 5.8 percent in March this year.

Moreover, foreign direct investments reached an all-time high last year, growing by 54.2 per
the first two months of the year, FDIs were up by 8.0 percent to USD1.7 billion.

Manufacturing activity has strongly rebounded, with the purchasing managers' index hit 54.3 in April - the highest in four years.

Both business sentiment and consumer outlook have improved.

Our business expectation survey shows broad improvements in outlook in the next quarter and year.

All these came on the back of a whole-of-government approach to recovery.

In tandem with the national government's efforts, the Bangko Sentral ng Pilipinas implemented its own list of COVID-response measures.

First, we cut policy rate by a cumulative 200 basis points to a record low of two percent. This move helped stimulate provision of credit to productive activities.

We reduced the reserve requirement against deposit and deposit substitute liabilities.

For universal-commercial banks and non-bank financial institutions with quasi-banking functions, we cut the reserve requirement from 14 percent to 12 percent effective April 3, 2020.

For thrift Banks and rural-cooperative banks, we reduced it from 4 percent to 3 percent effective July 31, 2020.

Second, we extended short-term provisional advances to the national government and purchased government securities in the secondary market to help finance its COVID-19-response programs.

In sum, the BSP has injected over PhP2.2 trillion or approximately USD 41.9 billion into the financial system. This is equivalent to about 11.2 percent of the GDP.

And third, the BSP put in place key regulatory and operational relief measures for banks. These measures helped calm down the market, maintain the financial system's stability, and ensure the public's continued access to financial services.

Even as the country transitions from one administration to another, the Bangko Sentral ng Pilipinas will continue to fulfill its mandate of ensuring sound macroeconomic management.

On the whole, there are clear signs that the new administration will continue the key reforms and programs of the outgoing administration.

As the economy recovers, the BSP recognizes the need to scale back its extraordinary measures.

The timing and conditions of the BSP's exit strategy will continue to be guided by the inflation and growth outlook over the medium term, the state of public health, and domestic and global risks to the economy.

Economies with strong fundamentals tend to handle crises better.

As such, it pays to strengthen fundamentals during good times so that the economy has buffers against shocks in bad times.

In the case of the Philippines, it entered the pandemic with strong macroeconomic fundamentals.

Its healthy external accounts and hefty gross international reserves served as buffer during the pandemic.

The government's fiscal space allowed it to finance its huge COVID-19 response without incurring unmanageable public sector debts.

The government's Comprehensive Tax Reform Program strengthened the country's fiscal house. The CTRP, which simplified the tax system; increased tax on automobiles, petroleum and tobacco products; expanded the value added tax base; introduced excise tax on sugar-sweetened beverage and cosmetic procedures; and simplified estate and donor's tax.

At the same time, the stable banking system—which benefitted from regulatory reforms over the years—was able to extend credit to consumers and businesses.

As a result, credit activity has picked up since August last year.

In addition, prudent lending standards of banks helped to keep the rise in bad debts within manageable levels while ample capitalization enables them to absorb shocks. The banks' capital adequacy ratio (CAR) on a consolidated basis was 17.4 percent in September 2021, much higher than the BSP's requirement of 10 percent, and the Bank for International Settlements' 8 percent.

On digital transformation, the BSP's policy agenda include digitalization of the country's payments system. As the economy gradually reopens, we seek to further promote innovative contactless payment technology and onboard more Filipinos into the formal financial system.

By 2023, we aim to digitalize at least 50 percent of retail payments and at least 70 percent of Filipino adults should have transaction accounts.

Complementing this reform is the recently passed Financial Consumer Protection Act. The legislation provides regulators more power to act on, and improves the resolution mechanisms for, financial consumer complaints, including those involving cybercrimes.

In line with our Digital Payments Transformation Roadmap, the BSP has also issued six digital banking licenses.

On sustainability, the BSP is at the forefront of promoting sustainability principles in the financial sector.

We have issued regulations requiring banks to incorporate such principles into their operations.

We are also among the early investors in the Bank for International Settlements' Green Bon
and the Asian Green Bond Fund.

The Duterte administration did not let the unprecedented crisis go to waste. It did not sit idly by and wait for the coronavirus to subside; instead, it continued to pursue game-changing reforms which would make the Philippines a preferred investment destination by investors.

The government sustained the reform momentum in consonance with its pandemic response.

For instance, it pursued the passage of the Corporate Recovery and Tax Incentives for Enterprises or CREATE law, which cut corporate income tax and rationalizes the fiscal incentives system.

In addition, three landmark laws further open the Philippines to foreign investors. These include the amended Retail Trade Liberalization Act, the Foreign Investments Act, and Public Services Act—all of which bode well for job creation.

These game-changing reforms will help stimulate the economy, generate more jobs, improve basic services to Filipino consumers and allow for the exchange of skills and technology with the country's foreign partners.

The Duterte administration invested massively in infrastructure under the "Build, Build, Build" program, which I originally called the Golden Age of Infrastructure in the Philippines.

The goal is to make up for past neglect which earned the Philippines the distinction of having one of the poorest public infrastructure in the ASEAN region.

From 2016 to 2020, infrastructure spending as percent of GDP averaged 4.6 percent. In 2021, actual infrastructure spending reached PHP1.12 trillion or 5.8 percent of GDP.

One thing is certain: the incoming administration will inherit a better state of infrastructure to help in its socioeconomic agenda. The next administration will inherit a robust pipeline of implementation-ready infrastructure projects. A total of 88 infrastructure flagship projects for completion in 2023 and beyond will be up to the next administration to continue.

Taking all these into consideration, we are optimistic that the Philippine economy will do better this year. With the economy growing at 8.3 percent in Q1, we expect it to grow by 7.0 to 9.0 percent this year, and by 6.0 to 7.0 percent next year.

That said, like the rest of the world, the Philippines faces risks to its growth outlook. Among the risks are the resurgence of the COVID-19 virus and a prolonged Russia-Ukraine conflict.

On COVID-19, the Philippines is managing risks of potentially new variants emerging through sentinel surveillance and protecting the vulnerable population through accelerated vaccination.

As of last May 10, 68.4 million out of the target 90 million Filipino population have already been fully vaccinated.

The impact of the Russia-Ukraine conflict will be mainly through higher energy and oil prices we expect this to be manageable. Based on latest estimates of the BSP, inflation could aver slightly above the 2.0- to 4.0-percent target range this year and then move back to within the target band next year.

As such, the BSP supports timely implementation of targeted non-monetary measures by the government to prevent price pressures from broadening. These include direct financial transfers to vulnerable sectors (transport workers, farmers, and fisher folks), and efforts to boost domestic production and importation of certain food commodities.

For its part, the BSP is prepared to take preemptive action when there are stronger indications of a possible dis-anchoring of inflation expectations.

Before the pandemic hit, the Philippines was on its way to A-level credit rating.

While the virus set us back, the Philippine economy is strong, and the Duterte administration carried on its game-changing reforms. Not surprisingly, the international and regional rating agencies unanimously affirmed their investment grade ratings of the Philippines throughout the pandemic despite a wave of ratings downgrades of many advanced and emerging economies..

The next administration has to continue the country's pursuit of A-level rating. This can be done by crafting, among others, a well thought out fiscal consolidation framework, which is prepared by the Executive Department and ratified by Congress.

The framework should include:

(a) timely and efficient implementation of the amended tax laws and the recent amendments to the Retail Trade Act, Foreign investments Act, and Public Service Act;

(b) efficient allocation of budgetary resources by higher investment in public infrastructure and human resources;

(c) improving the tax-spending mix of local government units; and

(d) rationalizing the pension benefits of retired military personnel.

In order to ensure full economic recovery and to sustain the Philippines' long-term growth trajectory, the government has to pursue game changing reforms with vigor and resoluteness.

Before I end, allow me to share some key takeaways:

• The Philippines' macroeconomic fundamentals remain sound and solid.

• The Philippines was set to attain upper middle-income status before the pandemic. This remains doable within the year provided the current favorable economic performance is sustained.

• The BSP's withdrawal of policy accommodation will be done as recovery becomes fully underway, while remaining strongly focused on maintaining price stability; and

• Consistent with its price stability mandate, the BSP is prepared to respond to a sustained build-up of inflation pressures and second-round effects that can disanchor inflation expectations.

In closing, let me stress the importance of harnessing bright spots to respond and overcome the current challenges that we face.

Despite growing uncertainties, here and abroad, may we cover more grounds and soar to new heights—for the country and the Filipino people.

Thank you for your attention.