Transparency and stability

INTERVIEW WITH AMANDO M TETANGCO, JR
GOVERNOR, BANGKO SENTRAL NG PILIPINAS (CENTRAL BANK OF THE PHILIPPINES)

AMANDO TETANGCO is the third Governor of the Bangko Sentral ng Pilipinas (BSP). He assumed office on July 4, 2005, beginning a six-year term that will end on July 3, 2011. Governor Tetangco has been a central banker for more than three decades, with extensive experience both in the Philippines and abroad. He is recognised as one of the principal architects of the far-reaching reforms introduced by the BSP to strengthen the Philippine banking sector, foster the development of the domestic capital market and amend the BSP's charter to make it more responsive to the demands of a changing environment.

What are your key aims and objectives in terms of monetary policy in the Philippines?

The Central Bank, Bangko Sentral ng Pilipinas (BSP) has three broad objectives in terms of monetary policy in the Philippines.

First, to maintain our focus on achieving our inflation target in keeping with our Constitutional mandate to ensure stable prices. As a monetary policy framework, inflation targeting has been effective for our country as it provides us with a transparent, information-intensive and forward-looking approach and allows the use of a wide array of policy tools to achieve our objective.

Second, to maintain our market-determined exchange rate policy, while reinforcing this with further liberalisation of foreign exchange transactions to allow greater access to forex by residents for outward payments and investments. We have already put in place the first wave of forex liberalisation measures; a second wave will be implemented before the end of the year.

Third, to continue to undertake steps to strengthen the domestic financial system and to help manage risks associated with financial market developments. In the banking sector, we are focused on good governance, asset clean-up, capital build-up and industry consolidation. We want to see stronger, well-governed and better-capitalised banks that would be effective channels of monetary policy. In other words, we want stable financial institutions that efficiently perform the intermediation function and are fully cognisant of the risks related to this role. Given the changing profit dynamics from our adoption of international accounting and Basel II capital adequacy standards, we are encouraging banks to look for ways to achieve economies of scale.

Life in the fast lane: the Philippine economy grew 7.5 per cent in the second quarter of 2007

How important is foreign direct investment (FDI) to the economic development of the Philippines?

In general, FDI benefits host countries, especially developing economies like the Philippines. Capital inflows augment domestic capital, induce economic production and hasten economic development. In the Philippines, they have contributed to bridging foreign exchange gaps, providing more access to the global market, raising working standards, providing more employment opportunities, as well as transferring advanced technology, labour skills and management practices.

As a percentage of GDP, FDI in the Philippines has more than doubled in the last three and a half years, from 0.8 per cent at the end of 2004 to 1.9 per cent as of June 2007. Most of the increase in foreign investments tracked as of June 2007 went to the utility sector (electricity, gas and water), manufacturing and the mining industry. In terms of employment, foreign investments approved in 2006 are projected to generate more than 130,000 new jobs, 33 per cent more than in 2005.

What role does domestic investment play in the Philippine economy, and what policy initiatives are in place to promote this form of investment?

Domestic investments continue to play a major role in sustaining growth in the Philippines. For instance, domestic investments generated 18.5 per cent of the country's GDP in the second quarter of 2007 and contributed 1.39 per cent to our second quarter's healthy 7.5 per cent GDP growth rate.

Domestic investments sustained broad recovery after dropping in 2005, growing marginally by 0.9 per cent in 2006 and a robust 7.5 per cent in the first half of 2007. The recovery came from increased government spending for public works, particularly in the countryside; increased private investments in non-residential construction;

expansion in railway and water transport investments; and increased investments in orchard development.

To promote domestic investment, the government continues to work on providing a stable macroeconomic and financial environment, accelerating infrastructure investments, and promoting industrial competitiveness.

The Philippine banking sector has posted impressive gains in recent years. What are your plans for further liberalisation of the industry?

We continue to work on the further liberalisation of the banking sector. The key areas for liberalisation are the derivatives market and the collective investment schemes of banks. Rules on the granting of derivatives licenses are to be rationalised. We want to have an organised derivatives market with a wider range of derivative products available to support risk management and redistribute risks to those best able to bear them. Guidelines on the management of collective investment schemes are also being reviewed to safeguard the interest of investors.

Moreover, the BSP continues to pursue financial sector reforms needed to maintain a healthy banking system and develop a vibrant capital market. In the area of banking, efforts have focused on the asset clean-up of banks through asset disposition under the amended Special Purpose Vehicle Law, under which banks are expected to unload another Php100 billion worth of idle assets. The risk management process is also being reinforced through effective enforcement of risk-based supervision, the management of technology-based risks, and the implementation of the Basel II risk-sensitive capital adequacy framework from July 2007.

In keeping with aligning domestic regulations with international practices, the BSP adopted the prescribed International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS) in 2005. This was a major step toward firmly establishing meaningful and reliable standards for financial reporting in the banking system to make local banks' financial reports comparable with those of other countries.

Complementary to moves to strengthen the banking system, the BSP has taken initiatives to develop a deep domestic capital market by supporting the passage of new laws that should generate long-term, local financing for infrastructure development, while reducing the country's vulnerability to the vagaries of the external market. This includes the passage of the Credit Information System Bill, the Collective Investment Vehicles Bill, the Corporate Recovery and Insolvency Bill, the Pre-need Code Bill and the Personal Equity Retirement Bill.

What is your strategic vision for the Central Bank's policy over the medium term?

In the process of articulating our vision over the medium term, we match our central banking pillars – monetary policy, banking supervision, and the payments and settlements system – with what is relevant to our stakeholders.

Addressing the first pillar, we will continue to implement a forward-looking monetary policy anchored on credible forecasts and risk assessments. With inflation targeting as our framework, we will keep sharpening our forecasting capability through further enhancements of our inflation forecasting models and understanding better the transmission mechanism for monetary policy in a world marked by globalisation and financial innovation. We will continue to refine our early warning systems with regard to the macroeconomy, business cycle, financial system and the external sector. We will continue to do comprehensive surveillance of both the domestic and global economies.

For the second pillar, our thrust is proactive regulation and effective supervision of banks, as well as other supervised and regulated industries. We will continue with risk-based and consolidated supervision, while maintaining a flexible and responsive regulatory framework. We will also promote healthy competition in the delivery of banking and other financial services to have a wide array of financial products and services accessible to the public. We will foster competition among banks to reduce remittance charges and promote transparency to encourage more overseas Filipinos to use the banking system. We will continue to push for the development of the capital market, more access to microfinance, and the promotion of financial literacy.

For the third pillar, we will continue to ensure that PhilPaSS, our real-time gross settlement system, ▶

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Manila's thriving retail sector reflects the booming Philippine economy

◀ remains a safe, sound, reliable, and efficient payments system that inspires confidence.

What role does fiscal policy play in the governenment's overall economic strategy?

Fiscal consolidation is a key component of the macroeconomic agenda of the government for the medium term and this is expected to reduce the country's debt stock, help improve the country's credit ratings for sovereign issues and ultimately lower the cost of our borrowings.

Our fiscal consolidation programme is anchored on a steady increase of revenues during the medium term up to 2010, through a combination of administrative and legislative measures for a more financially viable and progressive Philippines. The policy objectives of our country's Medium-Term Fiscal Programme are as follows: to have a balanced budget by end-2008, and to reduce the ratio of national governmental debt-to-GDP from 63.8 per cent in 2006 to 54.2 per cent by 2008.

On the expenditure side, the government is pursuing an efficient expenditure management programme to ensure prudent management of expenses and to provide resources for key infrastructure initiatives.

On the other hand, the primary goal of reforms in the domestic financial system is to ensure that we have a sound, responsive, efficient, and competitive financial sector that supports our country's development objectives. Key reforms in the financial market are directed at ensuring macroeconomic stability through prudent monetary and fiscal policy; promoting a stronger, stable, and deeper financial system; reforming the pension system; and providing easier access to funds by SMEs.

What are the key challenges to sustaining the current high economic growth rates in the ASEAN countries, and what steps are you and your ASEAN counterparts taking to achieve this?

With the recent global financial turmoil, ASEAN countries are faced with certain challenges in sustaining the current high economic growth in the region.

First, Asia's decoupling from the US economy remains a key challenge for the region. The increased global integration has meant that the real economy and financial market cycles of the US and Asia-Ex-Japan (AXJ) has tended to move in sync. The increasing cross-border financial linkages, as evidenced by the rise in the gross external assets of emerging market countries and the highly correlated price volatility across countries, suggest that AXJ will likely have a 'soft' decoupling and decelerate at a slower rate following a US economic slowdown. This prognosis is based on the strengthening of AXJ's balance sheet; increasing surplus liquidity stock; and strengthening demand from its domestic market and from its non-US trade partners.

Second, the development of the region's financial and capital market remains a priority among member countries. As strong macroeconomic fundamentals continue to attract large capital flows, the development of the region's financial and capital markets enables member countries to cope better with potential capital flow volatility. The objective is to have deep and liquid capital markets within a well-regulated system and strong institutional quality across a broad range of indicators including corporate governance, accounting standards, the rule of law, and control of corruption.

The launching of Asian Bond Fund 2 supported these objectives with the listing of exchange traded financial instruments and the creation of a well structured Asian index. It created a benchmark against which all investment vehicles can evaluate their performance in Asian bonds. This has also opened the markets to a wider class of investors.

Likewise, the Asian Bond Markets initiative has been focusing on strengthening national and regional market infrastructure. The region will also benefit from more effective regional reserve pooling, comprehensive economic surveillance, and greater policy coordination, all of which would enhance financial stability and reduce the risks of future crises.

Finally, deepening economic integration through trade relations is a good strategy for achieving sustained economic growth. There is a need to facilitate cross-border movement of goods and services, capital and people. If left unattended, issues concerning inadequate transport and communication infrastructure; uncompetitive transport and logistics services; and restrictive policies will escalate the cost of doing business in the region and weaken its competitive edge. It is also important to foster cooperation in areas that will help ASEAN countries effectively manage other cross-border risks such as environmental degradation, communicable diseases, and natural disasters, to strengthen the provision of regional public goods.

To what extent has macro-economic stability been achieved in the Philippines?

Our macro economic fundamentals today are the best in two decades, as we reap the benefits of continuing structural and market reforms.

The Philippine economy expanded at an average rate of 5.6 per cent during the last three years and indications are that in 2007 we would surpass our target growth rate of 6.1-6.7 per cent. GDP expanded by a robust 7.3 per cent in the first semester of 2007 on the back of strong performance from the industry and services sectors, sustained capital formation as well as household and government consumption.

It is noteworthy that economic expansion was sustained without fuelling inflation, even as oil prices ▶

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The Philippines is the fourth largest remittance-receiving country in the world, next to India, Mexico and China

◀ reached record high levels. Supported by stable food prices and a strengthening peso, inflation has been easing. Between January and October 2007, headline inflation averaged 2.6 per cent.

Meanwhile, strong forex inflows from record-high remittances of overseas Filipinos, investments, and exports, continue to boost the peso against the US dollar. Our gross international reserves are at an all-time high, we have a balance of payments surplus, and the consolidated resources of our banking system are at record levels. Indeed, our key indicators are pointing toward the right direction.

Real interest rates remain low given the ample liquidity in the system and low inflation rate. They averaged 0.67 per cent during the first eight months of 2007. Improved revenue collection from key tax measures further improved business confidence and allowed the government to increase spending on infrastructure and social services.

Sustained structural reforms should ensure a more long-lasting economic growth in the years to come.

However, risks to inflation remain on account of record high oil prices and relatively high liquidity growth. The BSP continues to monitor these risks to ensure that inflation remains within the target of 4-5 per cent in 2007.

What are the key challenges to ensuring the kind of sustained economic growth we have seen over the past three years?

Stable macroeconomic conditions and continued structural measures supported the economy's strong performance in recent years. Growth for the first semester of 2007 averaged 7.3 per cent, well above the full year growth target of 6.2-7.0 per cent. A key challenge to this outlook includes a surge in liquidity. In response to the double-digit growth in domestic liquidity, the BSP adopted new liquidity management measures that effectively stemmed inflationary pressures.On the external front, volatility in oil prices, sudden reversal in investor risk appetite and the adverse impact of the US subprime meltdown pose downside risks to growth.

To pursue further capital account openness as a way of reducing upward pressures on the peso as well as increase efficiency in capital flows, the BSP further liberalised its foreign exchange regulations. The BSP will remain focused on managing risks to inflation expectations and closely monitor demand-pull and cost push factors to inflation. Furthermore, financial reform measures, such as improvements in the payment systems and standardisation of approaches to risks, are continuously being pursued to strengthen the financial sector against external shocks.

While a strong peso has generated net benefits to our economy, addressing the impact of a strong peso on exporters and overseas workers remain a key challenge.

How effective is the tax collection system and what challenges lie ahead in this area?

We are now reaping the benefits of various tax reforms and revenue enhancement measures put in place to tame our fiscal deficit and achieve a balanced budget. Improved revenue collection from key tax measures enhanced business confidence, empowered government to raise spending on infrastructure and social services, and thereby contributed to the overall expansion of the domestic economy.

Remittances have historically been an important pillar of the Philippine economy. Do you expect this to continue for the foreseeable future?

Remittances from overseas Filipinos will continue to be a key driver of our economy. Remittance flows are expected to remain strong in the medium and long term, given the Philippines' large pool of skilled and professional labour and the continued preference for Filipino workers abroad. Likewise, the continuing initiatives of the banking sector to encourage overseas Filipinos to channel their remittances through formal channels are expected to result in the better capture of these transfers.

The World Bank reported that the Philippines is the fourth largest remittance-receiving country in the world, next to India, Mexico and China. Remittances of overseas Filipinos reached US$ 12.8 billion in 2006, an increase of 19.4 per cent from the 2005 level. During the first seven months of 2007, remittances amounted to US$8.1 billion, or a year-on-year growth rate of 16 per cent.

Remittances from overseas Filipinos have raised forex supply in the country, helping stabilise volatile movements in the exchange rate. In turn, this has contributed to a more stable price level in the economy. Moreover, remittances spur consumption and housing demand, which encourages domestic production and growth in economic activity. In leveraging remittances for economic development, the BSP undertakes financial literacy campaigns to promote a culture of savings and investments among overseas Filipinos and their families.

How do you see the outlook for the Philippine economy over the coming decade?

The medium-term outlook on the country's economic growth will depend primarily on how the downside risks in both external and domestic fronts affect the economy. On the external front, although the US market is showing signs of slowing down, the general upturn in Europe and Japan are all positive factors that could help underpin the Philippines' export performance. At the same time, we expect our growth momentum to be sustained by macroeconomic reforms and enhanced fiscal position. This should continue to boost market sentiment and investments in our economy. F