Maintaining a Conducive Macroeconomic Environment[1]

Mr. Guenter Taus, ECCP President, distinguished officers and members of the ECCP, special guests, ladies and gentlemen, good afternoon.

The European Union (EU) with its 28 member states and 512 million citizens forms the second largest economic market of the world. Closer to home, 15 percent of Philippine total exports go to the EU, making it a key trading partner. A major source of direct investments comprising roughly 12 percent of total gross placement of foreign direct investment comes from the EU. Moreover, nearly 12 percent of total cash remittances from Filipino Overseas workers originate from the EU. ... It cannot be doubted that the EU is a formidable economic partner of the Philippines.

With this important relationship in mind, and with a view of building stronger ties, cooperation and collaboration, it is my pleasure and privilege to be your guest speaker at today's membership luncheon.

I thank the European Chamber of Commerce of the Philippines (ECCP) for the invitation and welcome this opportunity to speak about our initiatives at the Bangko Sentral ng Pilipinas which are aimed at promoting a conducive business climate. I am also pleased to share in greater detail how the Philippines offers significant investment prospects as the economy is expected to grow strongly in the next few years.

As long-term investors in the country, you may have witnessed how the macroeconomic stability we now enjoy was brought about by significant structural reforms pursued through the years. The list of reforms is long and the scope wide ranging. It is because of these reforms that price and financial stability have been achieved and maintained.

Since adopting the inflation targeting framework in 2002, inflation has generally been kept low and stable. This is our source of credibility as a monetary authority. To sustain the positive growth and inflation dynamics in the country, the BSP enhanced the implementation of inflation targeting through the adoption of the interest rate corridor (IRC) system. The IRC enhances the link between the BSP's monetary policy stance and financial markets, and from there its impact on the real economy. The primary benefit of the adoption of an IRC system in the Philippines is the strengthening of monetary policy transmission by ensuring that money market interest rates are meaningfully influenced by the BSP's policy rate.

Importantly, the IRC system also supports the development of the Philippine capital market by promoting money market transactions and active liquidity management among Philippine banks. The ensuing higher level of activity in the money market in turn helps promote price discovery.

[1] Speech delivered by BSP Governor Nestor A. Espenilla, Jr. for the European Chamber of Commerce of the Philippines (ECCP) Membership Luncheon Event on 25 October 2017 held in Makati Shangri-La, Makati City.

For the first nine months of 2017, the inflation rate averaged 3.1 percent. We remain on track to stay within the target range of 3.0 percent ± 1.0 percentage point for 2017. This sustained low and stable inflation lends support to robust household spending, preserves the public's purchasing power and supports the demand for goods and services. Based on our latest forecasts, inflation is likely to settle near the midpoint of the Government's target range of 2 to 4 percent in 2017 to 2019.

Carefully-calibrated and well-communicated monetary policy has effectively anchored market expectations. It has enabled us to maintain price stability while providing support to economic expansion. We shall continue to improve the IRC system towards a more market-friendly implementation of monetary policy.

The financial sector also demonstrates stability and sustained growth. Domestic liquidity conditions remains ample to finance the requirements of a growing economy. Bank lending is upbeat and loans continue to flow into the country's productive sectors such as wholesale and retail trade, motor repair; manufacturing; electricity, gas and water utilities; financial services; and real estate.

The level of non-performing loans (NPLs) has been relatively flat since 2008 despite the continued uptrend of total loan portfolios (TLP). The Philippine banking system's non-performing loan ratio (NPL) stayed low at 2.0 percent of total loans as of end-August 2017. This is fully covered as NPL coverage ratios registered at 114.1 percent.

Philippine banks have developed a good ability to absorb losses. Data as of end-June 2017 shows that the capital adequacy ratio (CAR) of universal and commercial banks is stable at 15.3 percent on a solo basis and 16.0 percent on a consolidated basis. This is well above the minimum CAR requirements.

This robust ability of the banking system to provide credit support to the economy is the result of a long and systematic reform process, boldly implemented since the Asian Financial Crisis. These reforms include asset cleanup, industry consolidation, continuing enhancements of corporate governance and risk management standards, and strengthening of compliance and enforcement frameworks. We likewise pursued liberalization of foreign bank entry and rationalization of branching guidelines in order to promote healthy competition, resulting in greater market penetration and more efficient delivery of financial services.

We have further improved financial access through the promotion of various digital banking solutions and service delivery channels. The subsequent increase in the utilization of both traditional and non-traditional banking platforms has boosted deposit generation, resulting in its 14.1 percent expansion, to P11.0 trillion by the first half of 2017. In so doing, the banking system has a stable funding base, as deposits are primarily peso-denominated and sourced mostly from resident depositors.

Today, we continue to pursue prudential reforms that promote financial stability. In a series of circulars dated 22 August 2017, the Monetary Board approved enhanced guidelines raising the bar on corporate governance, setting minimum prudential requirements on risk governance, and strengthening the compliance framework. The corporate governance guidelines are anchored on the fundamental principle that the tone of good governance should come from the top and set out enhanced requirements on the membership composition of the board. Further, the risk governance policy framework integrates the principles set out in other risk-related issuances of the BSP under one umbrella. Finally, the compliance framework provides the role of the board of directors in establishing a compliance system, and emphasizes the shared responsibility of all personnel, officers, and the board in managing business risk.

We continue to align our risk management guidelines with international standards. This month, the Monetary Board approved the enhancements to BSP's liquidity risk management guidelines. This is part of a broader set of BSP reforms on liquidity standards. Earlier last year, we have already issued the liquidity coverage ratio (or "LCR") framework. This will be followed by issuances on the implementation of the net stable funding ratio (or "NSFR"), which is also part of the Basel III Liquidity Standards; and intraday liquidity reporting requirements.

Ladies and gentlemen, I have just outlined some of the key initiatives focused on our core mandates, i.e. price and financial stability. In your invitation, I was asked to talk about my priorities and plans. I now wish to share with you game-changing financial sector reforms we are implementing over the medium-term.

These strategic reforms aim to deepen our local debt market, liberalize further the domestic foreign exchange market, digitalize our payment system, and ultimately enhance access to financial services and products. All these complement our financial inclusion agenda.

The Philippines has a lot of potential as a promising investment destination. Our capital market is being positioned to serve as an important source of long-term funding, in support of the National Government's "Build, Build, Build" agenda. Developing the domestic capital market is critical given its role in complementing bank lending to support economic growth. Last August 2017, the BSP, together with the Department of Finance (DOF), Securities and Exchange Commission (SEC) and Bureau of the Treasury (BTr), unveiled the roadmap to hasten the development of the domestic debt market. Deliberately, we sequenced and calibrated the roadmap to prioritize urgent and foundational issues. The initial phase will focus on improving market benchmarks, covers initiatives to increase volume of treasury issuances, promotes market-making and price discovery, enhances the yield curve, establishes an organized repo market, and strengthens regulatory oversight. We look forward to the launch of the first trade in the organized repo market by next month.

On the part of the BSP, we have started improving the regulatory framework for project financing starting last year with the issuance of Circular No. 914. Just this month, we issued Circular No. 976, which enhances prudential reporting requirements over project finance exposures. This will sharpen BSP's ability to assess bank exposures to project finance, and timely deploy macro-prudential measures, if necessary. Finally, we issued amendments to provide banks and quasi-banks (QBs) more flexibility in issuing bonds and commercial papers. These proactive measures are important as demand for infrastructure picks up and gains traction.

Complementing capital market development initiatives, we are also further liberalizing and rationalizing foreign exchange (FX) rules in order to reduce the cost of doing business and facilitate job-generating investments. This forms part of a broader FX market reform agenda to enhance transparency, improve price discovery, and increase availability of FX products, especially hedging instruments. Ultimately, a deeper FX market will increase resilience of our domestic economy against external shocks even as we allow greater exchange rate flexibility.

Finally, we come to a topic that is closest to my heart, our advocacy for financial inclusion. We are passionate about empowering Filipinos and we remain focused in our efforts to include those from the lower income groups into the formal financial system.

To further help expand the market and provide greater access to more Filipinos, we have been leveraging on technology and institutional networks. Financial technology is being harnessed especially for remittance and payment transactions. The BSP continues to provide an enabling regulatory environment, while raising the bar against cybercrime and related risks.

As part of our commitment to the national strategy for financial inclusion, the BSP is actively leading industry-wide initiatives to operationalize the National Retail Payment System (NRPS).

The NRPS is positioned to digitize retail payments and facilitate our transition to a cash-lite economy, bringing material benefits for government, businesses and consumers. This will enable customers to make payments and transfer funds between and among accounts using any digital device.

We are seeing progress in this area. The Philippine Payments Management, Inc. (PPMI) was recently registered with the Securities and Exchange Commission (SEC). It would act as the self-governing body in overseeing the development and operations of the retail payment system. We are also working with the industry on the formation of two priority Automated Clearing Houses (ACHs), the batch electronic fund transfer credit payment scheme (called PESO Net), and the real-time low-value push payment scheme (called InstaPay). The PESO Net can be the electronic alternative to the paper-based check system but will be more inclusive in terms of participants and users. InstaPay, on the other hand, is designed to facilitate small value payments and enable merchants to accept digital payments from both e-money and bank accounts without the use of a point of sale terminal. PESO Net is set to launch on November 8, 2017.

Our initiatives in the BSP are varied and we remain committed to ensuring that the macroeconomic environment for business is stable. We are vigilant so that the economic landscape will be conducive for business growth and increased investments for engaged stakeholders such as yourselves here at ECCP.

At the BSP, we are cognizant that trade, financial and other economic linkages with other economies such as the EU require us to regularly take note of global economic and financial developments.

The recently-concluded discussions during the Annual Meetings of the IMF-WB in Washington, D.C. highlighted that despite clear signs of global economic recovery, policy uncertainty remains at a high level and could well rise further. US economic policies, post-Brexit arrangements, geopolitical risks and other events could negatively impact confidence, deter private investment, and weaken global growth.

At the BSP, we have to take all of these into consideration in our analysis and in crafting our policy response.

Nevertheless, here in the Philippines, we remain positive.

Southeast Asia is one of the most economically-dynamic and fastest-growing regions in the world. In the Philippines, economic growth is expected to be sustained and is predicted to outpace regional growth, which is already faster than the rate of global growth.

Given shifting market conditions as well as the increasing sophistication of the global financial services industry, ladies and gentlemen, we assure you that the BSP remains strongly committed to the pursuit of ambitious financial sector reforms.

That I have had this opportunity to share all of these exciting initiatives with you and share the prospects of growth... on behalf of the BSP and the Monetary Board, I thank the ECCP, its distinguished officers and members. Thank you all for your kind attention.