

Coping with Macroeconomic Vulnerabilities and Spillovers: The Philippine Experience

IMF and University of Tokyo Joint Seminar on
Coping with Macroeconomic Vulnerabilities and
Spillovers
7-8 November 2016
Tokyo, Japan

**DIWA C.
GUINIGUNDO**
Deputy Governor
Monetary Stability Sector



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I. Vulnerabilities and Spillovers

- Fragile global growth and trade prospects
- Asynchronous monetary policies
- Brexit potential impact

II. Policy Responses

- Ample monetary, fiscal policy space
- Sound macroprudential policies
- Flexible exchange rate, comfortable FX reserves
- Structural reforms



Vulnerabilities and Spillovers

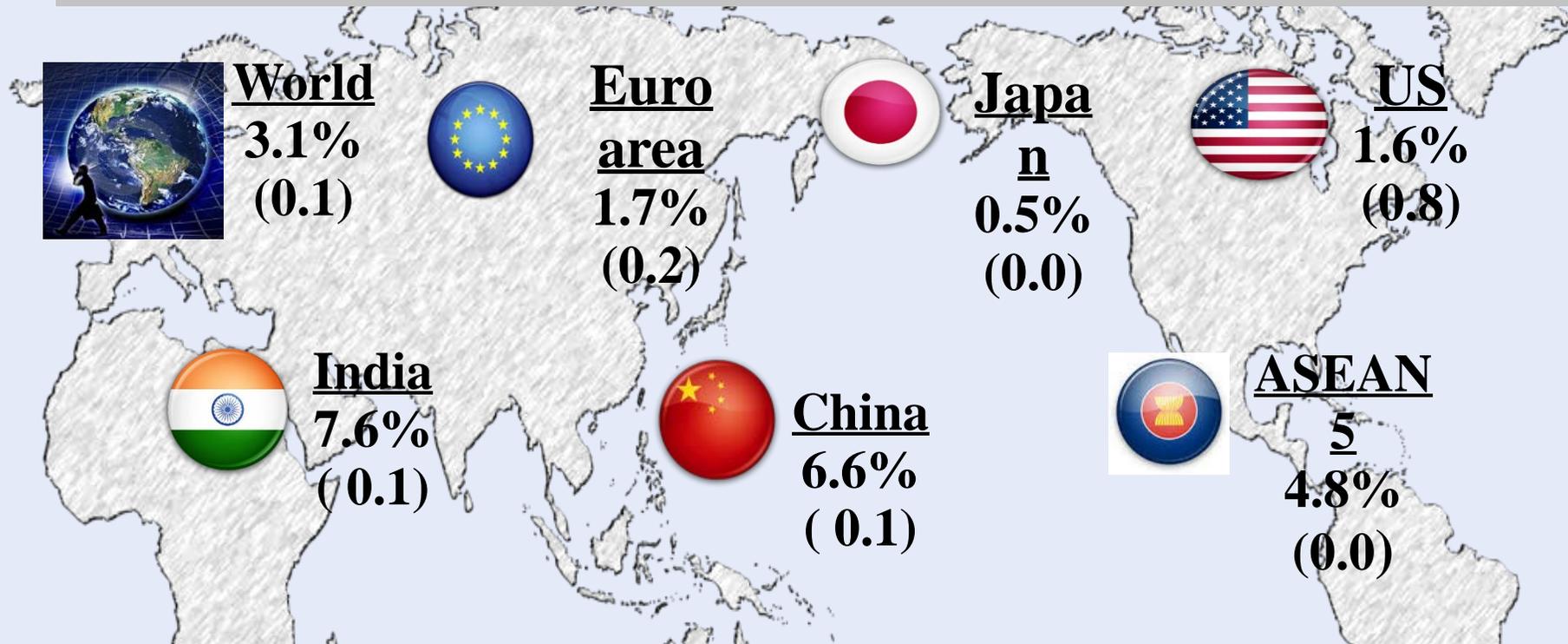


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Economic activity remains sluggish in many advanced economies...

IMF 2016 Growth Projections, as of October 2016*

(Difference from April 2016 WEO projections, in percentage points)



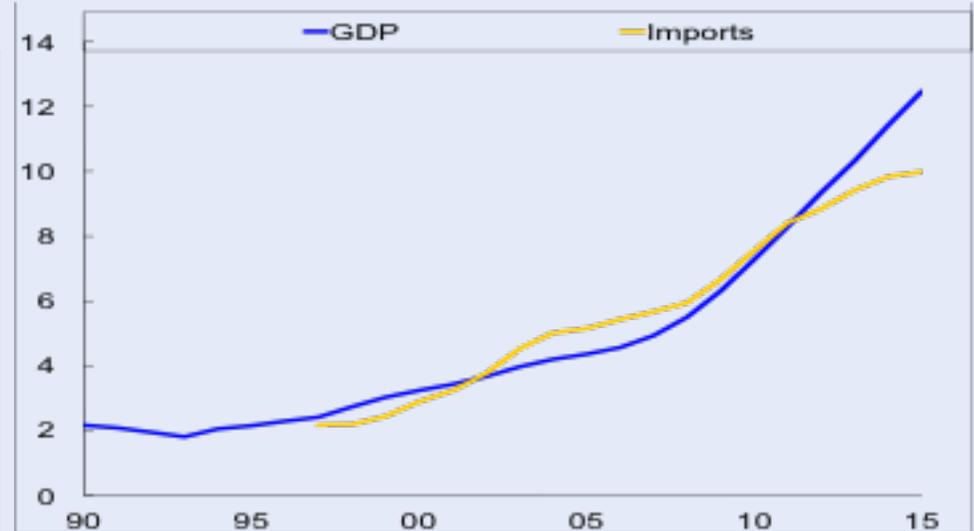
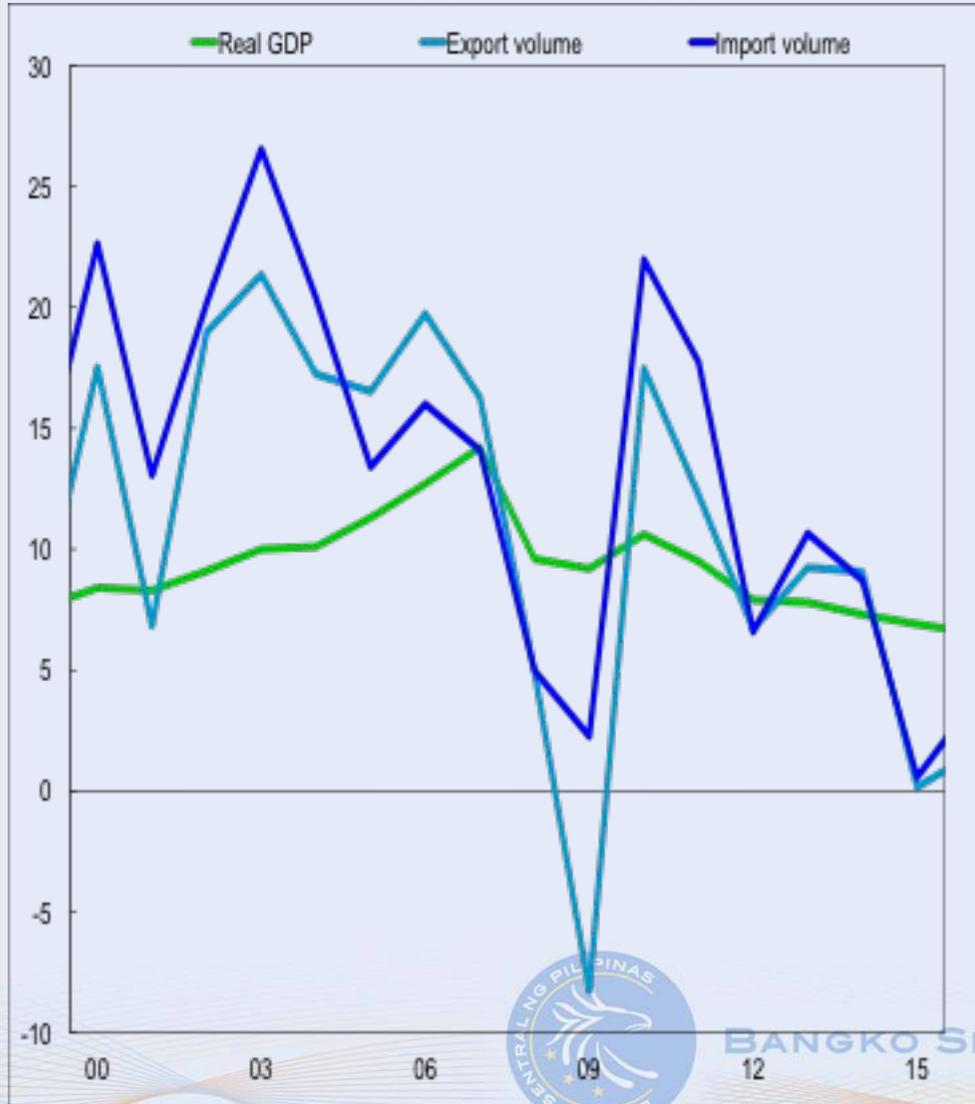
- **Growth prospects remain fragile and uneven**

- In advanced economies, a modest and uneven recovery is expected to continue
- Growth in emerging market and developing economies is even more varied than advanced economies, but is generally expected to strengthen in 2016

...compounded by the slowdown

China GDP and Trade Growth (% change, q-on-q)

China's Share of Global GDP and Imports (%)



China: Real Consumption and Investment (% of GDP)

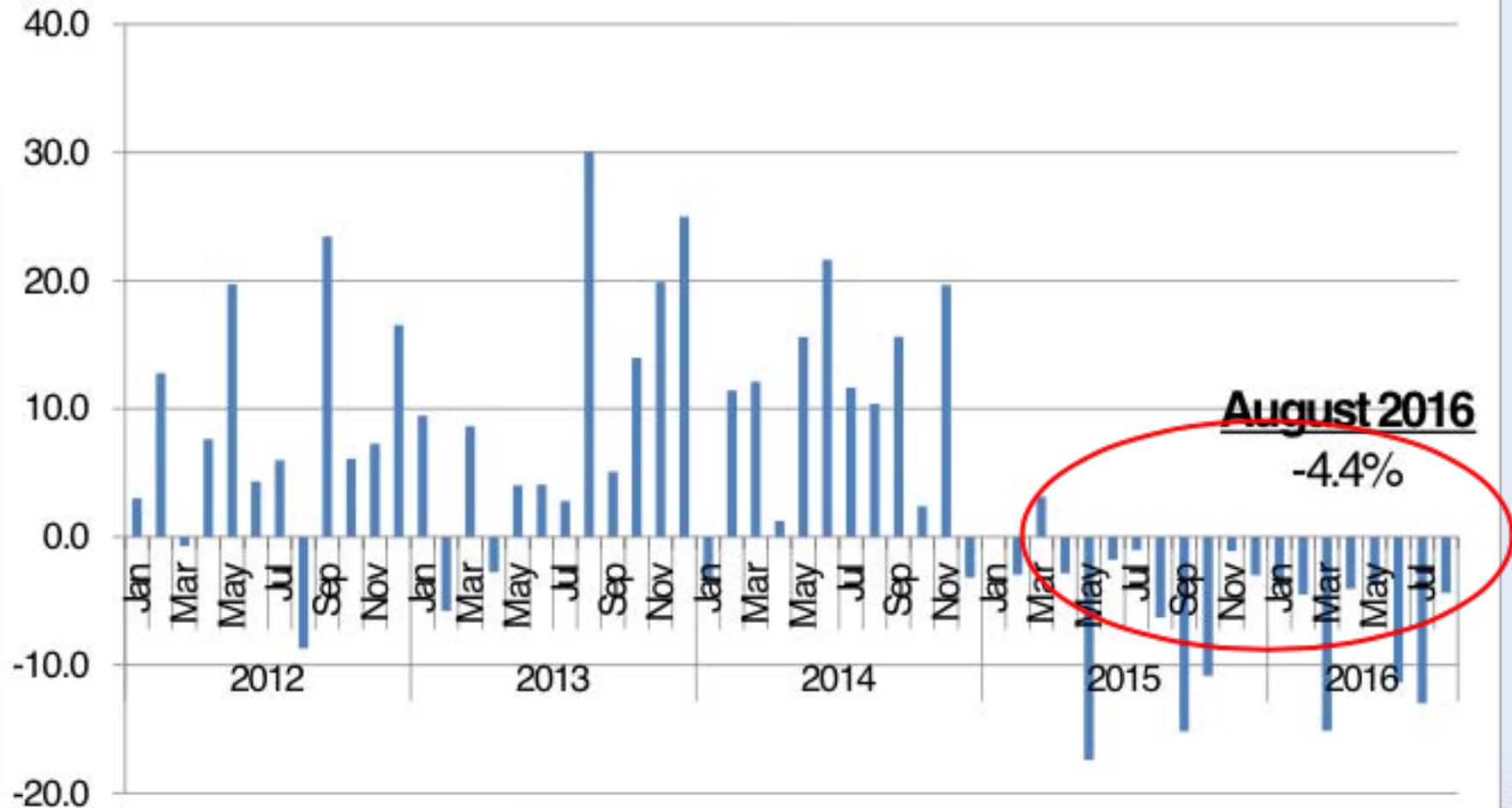


Source: IMF WEO; IMF Staff Calculations

Weak external environment moderates Philippine growth...

Philippine Merchandise Exports

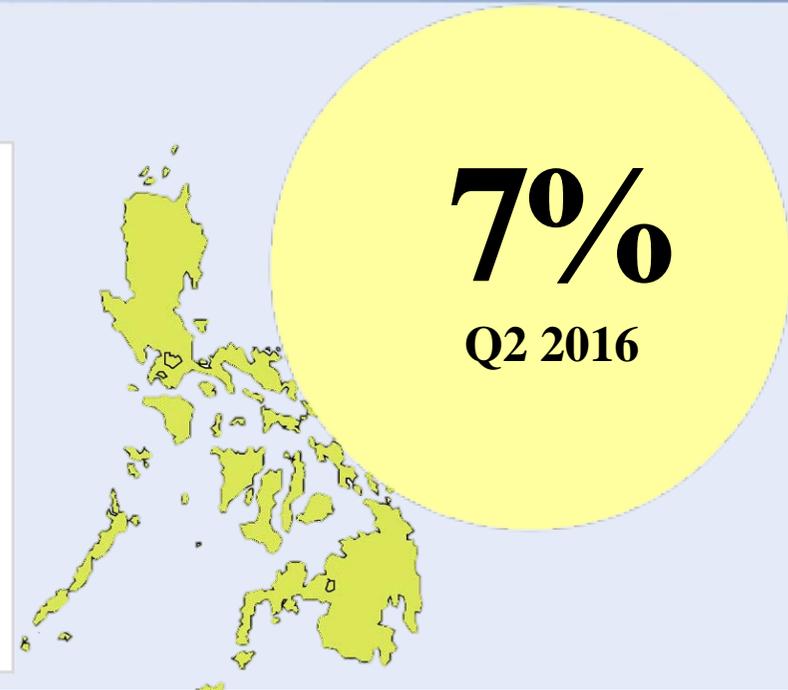
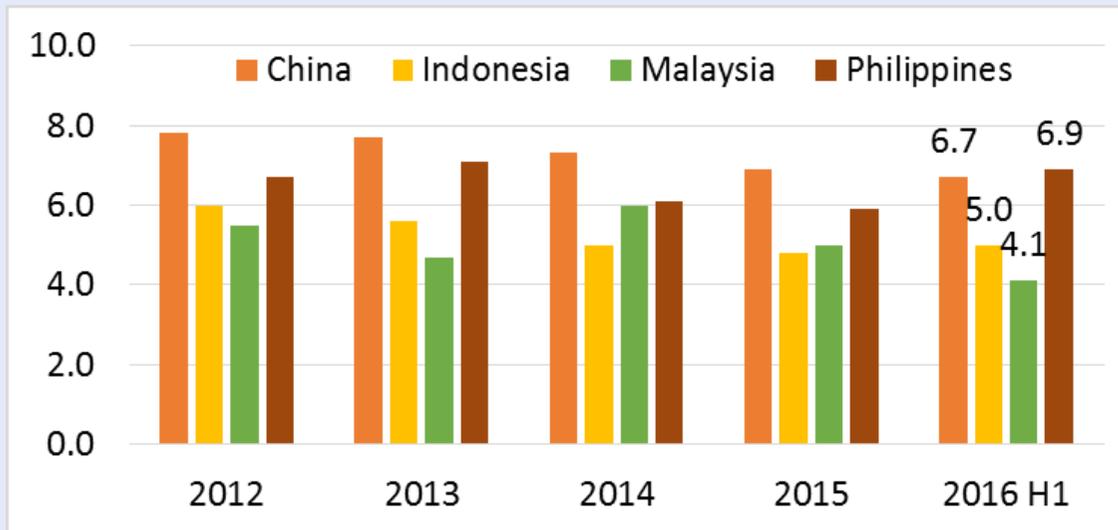
Year-on-year growth rate, in percent, Jan 2012 - August 2016



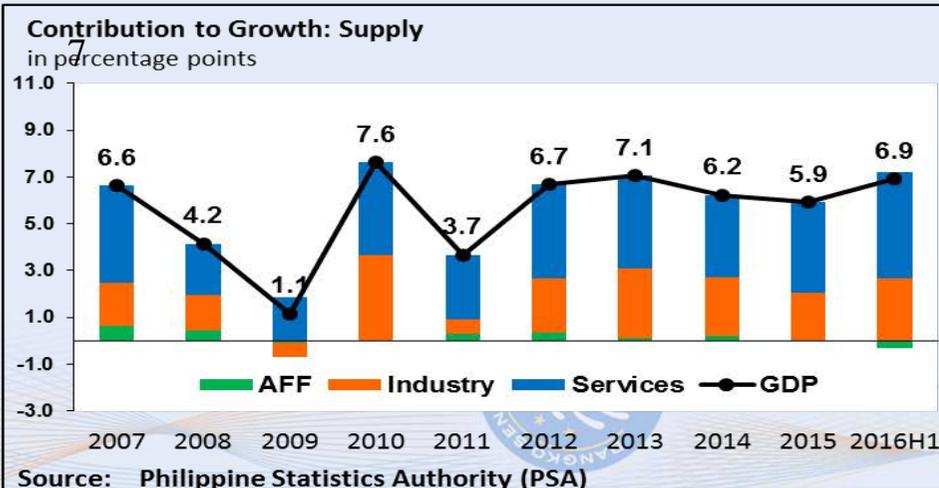
Source: PSA
(NSO)

...but strong domestic demand supports economy's near-term outlook

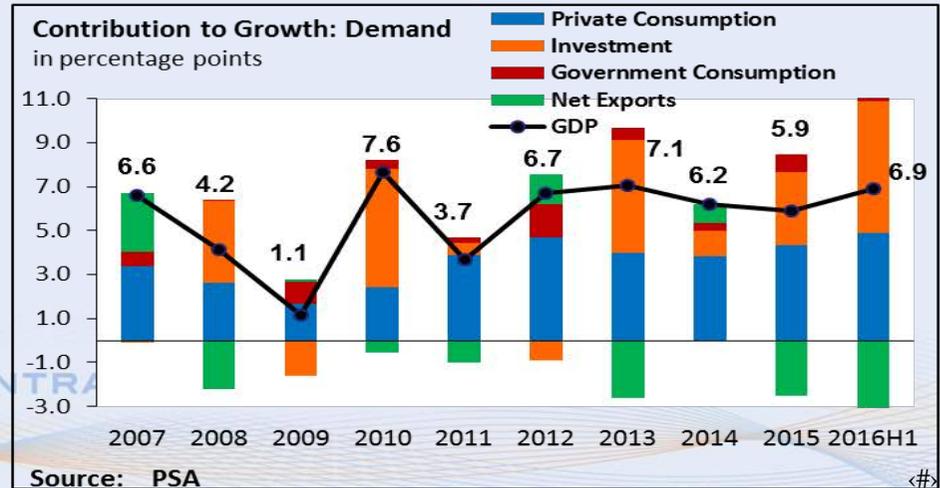
Real GDP Growth (in %)



Supply-side drivers: Industry and Services

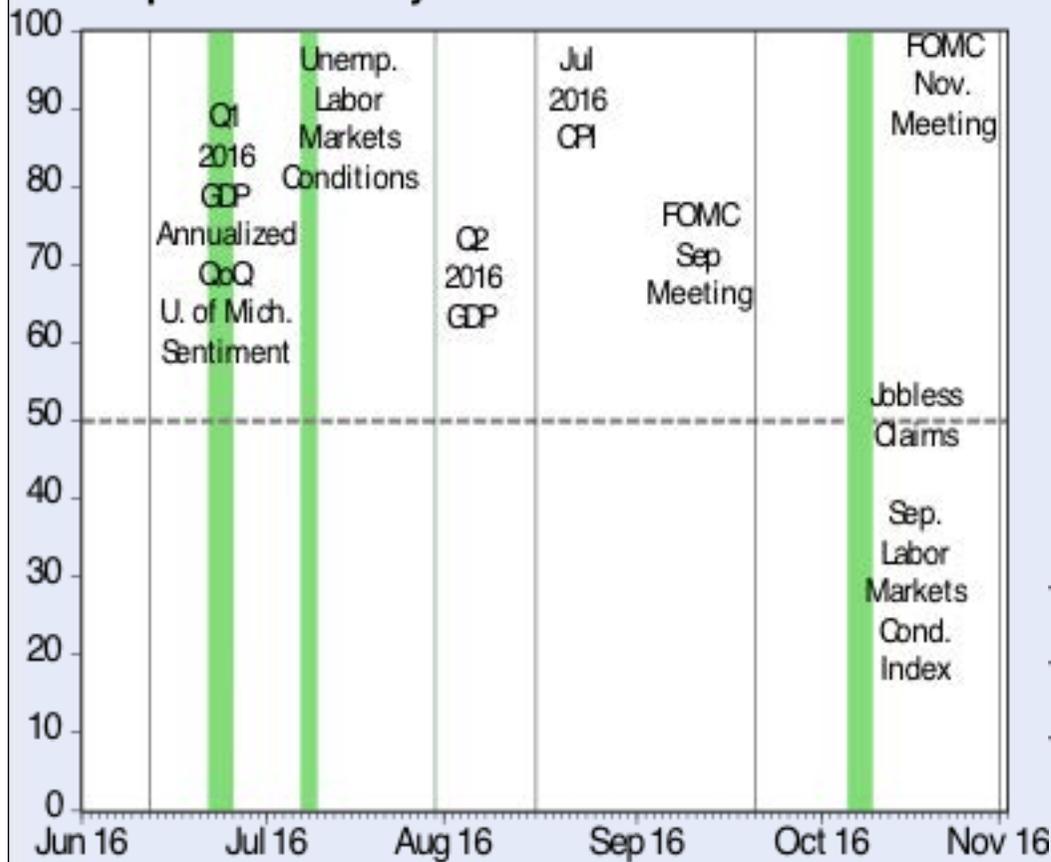


Demand-side driver: Private consumption

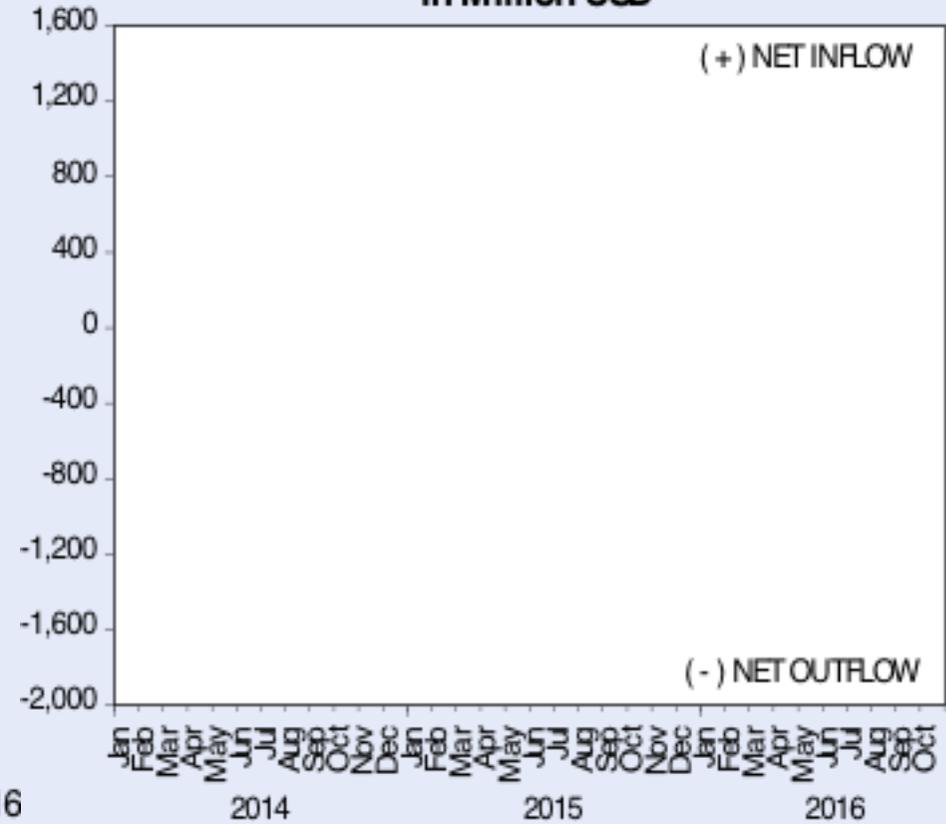


US Fed move induces capital flow reversal; uncertainty over timing fuels market volatility

Implied Probability of a December 2016 Rate Hike



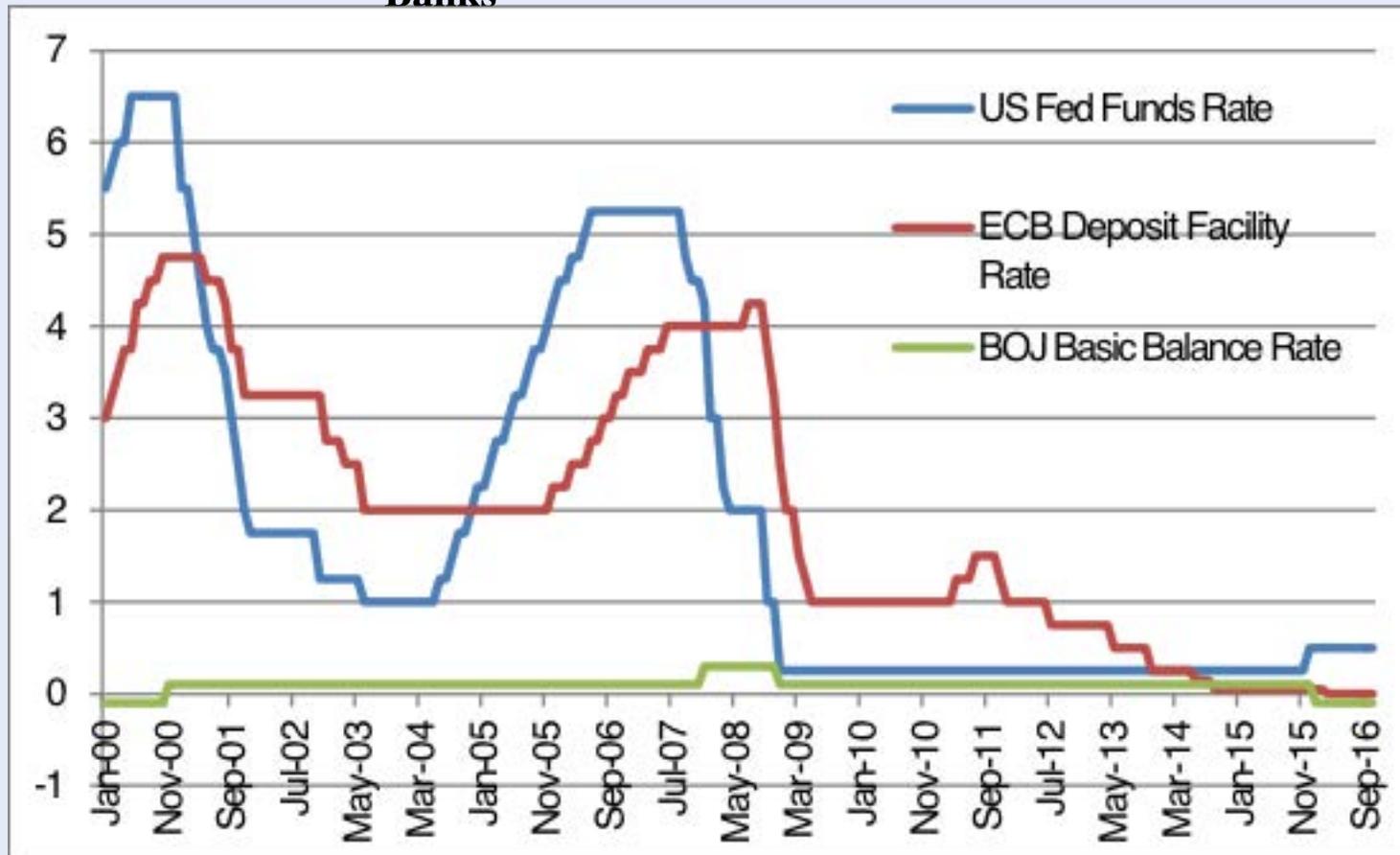
BSP-Registered Portfolio Investments in Million USD



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Sustained accommodation by ECB and BoJ could offset potential capital flow reversals

Policy Rates of Major Central Banks



Source:
Bloomberg



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Philippines' good macro fundamentals and outlook strong pull factors

6.9 %

(H1 2016, 2000=100)

GDP Growth

1.6 %

(Jan-Sep, 2006=100)

Headline Inflation

-1.7 %

(Jan-Jun, % of GDP)

Fiscal Balance

15.8

(Consolidated, Mar 16)

Capital Adequacy Ratio

-7.8 %

(Jan-Aug, % Growth)

Merch. Exports

14.1%

(Jan-Aug, % Growth)

Merch. Imports

**US\$15.3
billion**

(Jan-Jul)

OF Cash Remittances

US\$1.5 billion

(Jan-Aug)

Balance of Payments

**US\$85.9
billion**

(end-Sept)

Gross Reserves

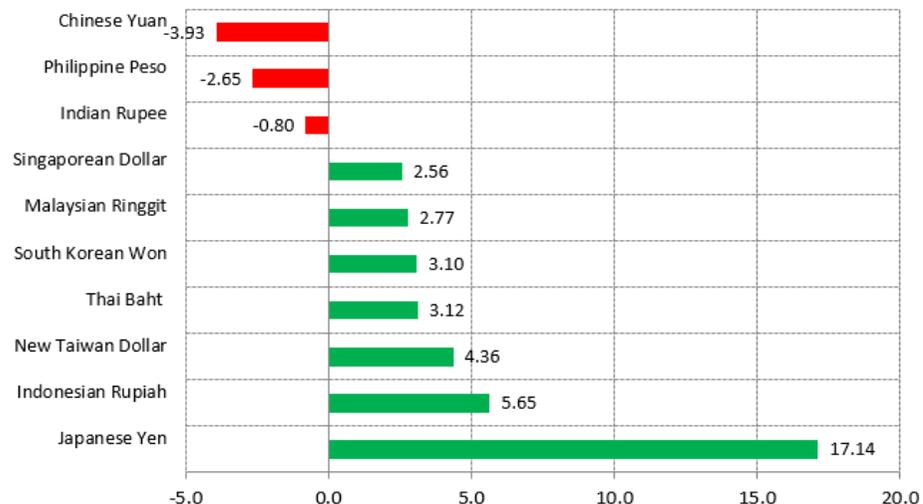


Sources: BSP, PSA

** Data on merchandise trade is based on BSP BOP Statistics

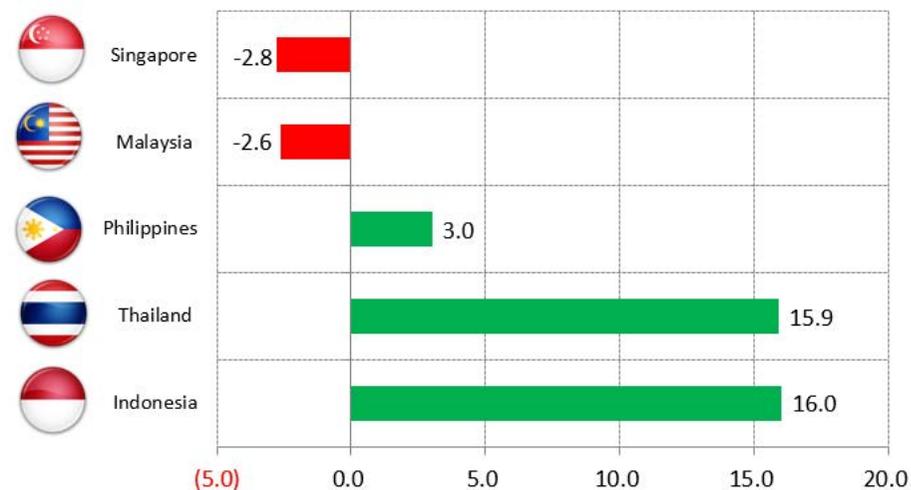
Capital flows may affect monetary and financial stability

Year-to-date Appreciation/Depreciation of Asian Currencies against US dollar
(in percent, as of 03 November 2016)

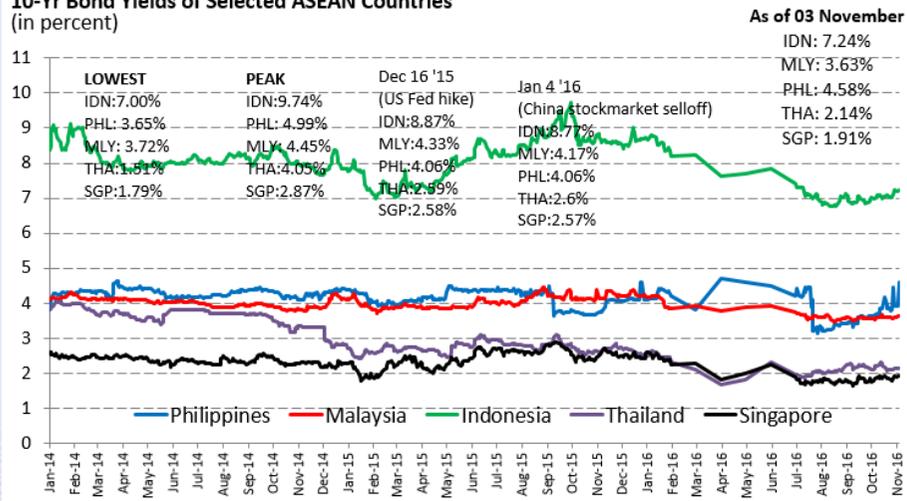


Note: Based on last done deal transaction (closing price) as of 4:00pm, Manila Time

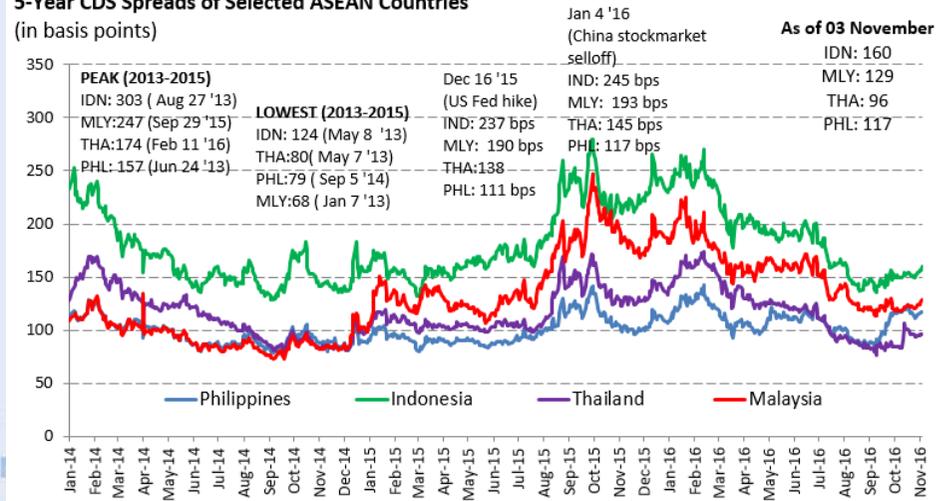
Year-to-date Growth in ASEAN Stock Exchange Indices
(in percent, as of 03 November 2016)



10-Yr Bond Yields of Selected ASEAN Countries
(in percent)



5-Year CDS Spreads of Selected ASEAN Countries
(in basis points)



Direct impact of Brexit on Philippines limited...

PH-UK Bilateral Relations

	2012	2013	2014	2015	2016
EXPORTS					(Jan-Jul)
% of Total Exports	1.3	1.0	0.7	0.8	0.9
FOB Value (in US\$ billion)	0.66	0.58	0.46	0.50	0.28
IMPORTS					(Jan-Jul)
% of Total Imports	0.4	0.5	0.6	0.6	0.6
FOB Value (in US\$ billion)	0.27	0.30	0.39	0.40	0.29
GROSS PLACEMENT OF FDI					(Jan-Jul)
% of Total Gross Placement of FDI	1.7	3.8	6.7	14.4	0.5
Gross FDI (in US\$ billion)	0.04	0.09	0.15	0.39	0.01
GROSS PLACEMENT OF FPI					(Jan-Sep)
% of Total Gross Placement of FPI	27.0	27.0	25.5	26.5	30.4
Value (in US\$ billion)	4.95	7.52	5.53	5.25	4.18
REMITTANCES					(Jan-Aug)

*...but questions remain on broader impact
on EU and rest of the world*

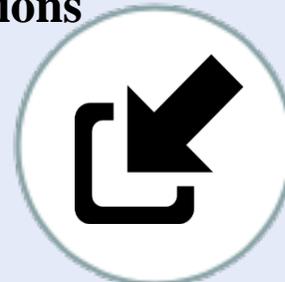
**Philippines – Europe Bilateral Economic
Relations**



**EXPOR
TS**

13.3 %

(Jan-Jul, % of total)
FOB Value: US\$4.2 billion



**IMPOR
TS**

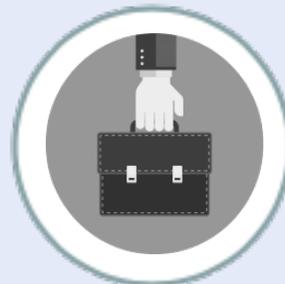
9.0 %

(Jan-Jul, % of total)
FOB Value: US\$4.1 billion



**GROSS
FDI
PLACEMENT**
10.0 %

(Jan-Jul, % of total)
US\$0.2 billion



**GROSS FPI
PLACEMENT**
49.2 %^{NT}

(Jan-Sep, % of total)
US\$6.8 billion



**REMITTAN
CES**
14.3 %

(Jan-Aug, % of total)
US\$2.5 billion



**TOURIST
ARRIVALS**
10.7 %

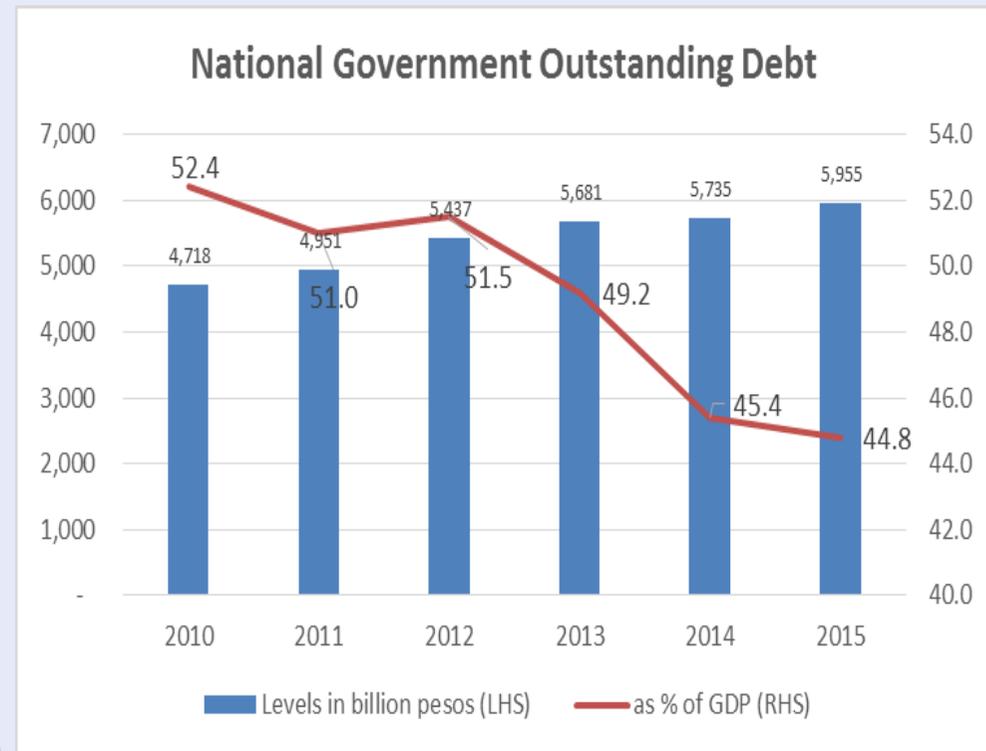
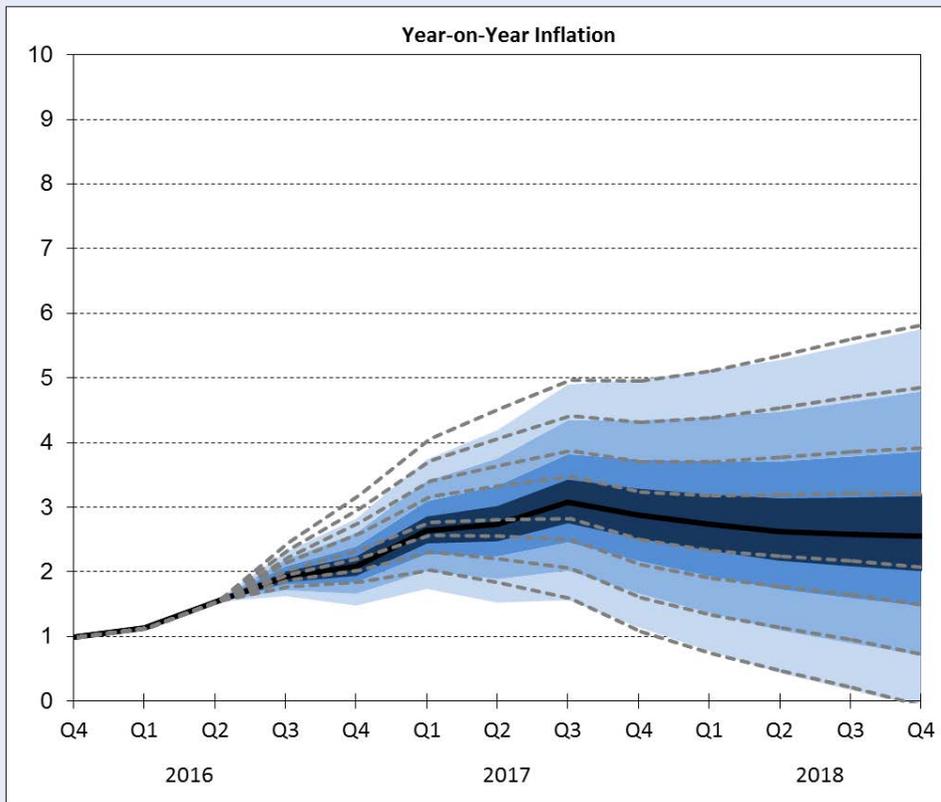
(Jan-Jul, % of total)
377,000 persons

Policy Responses



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Ample policy space: monetary, fiscal



As of 5 August 2016 (11 August 2016 MB Meeting)

As of 6 September 2016 (22 September 2016 MB Meeting)

Source: BSP, DBM
BESF

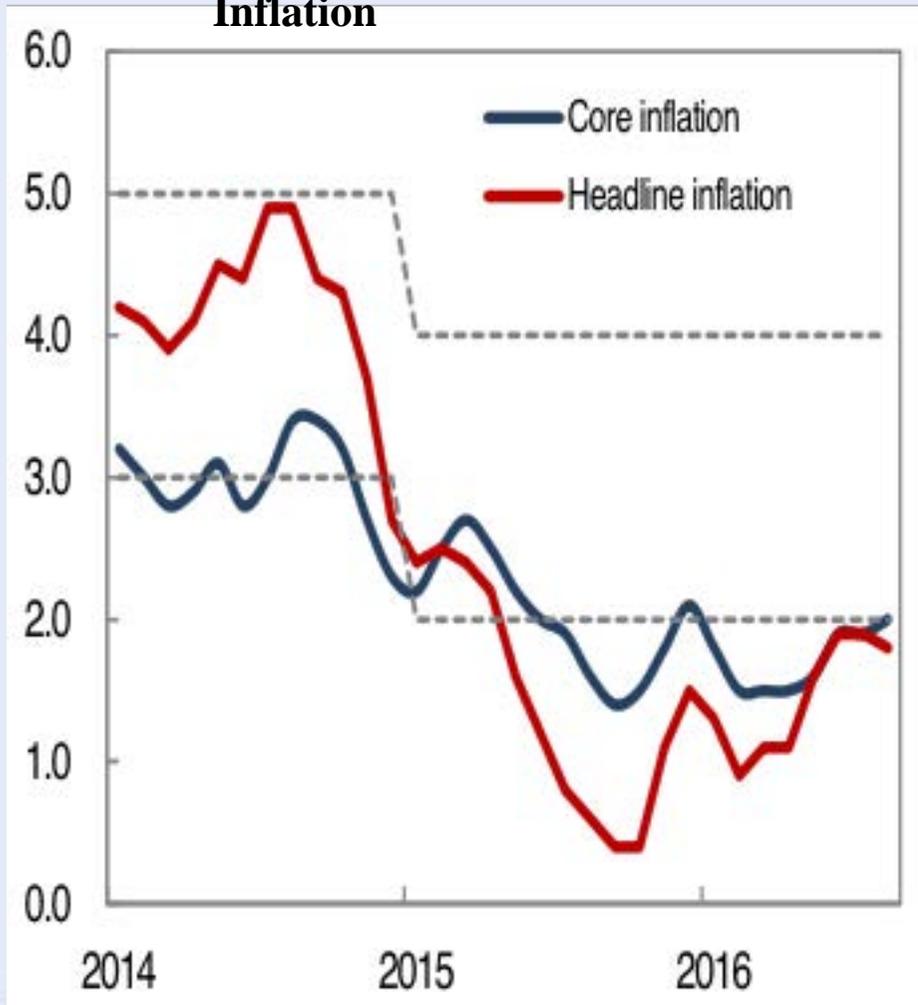
Source: BSP



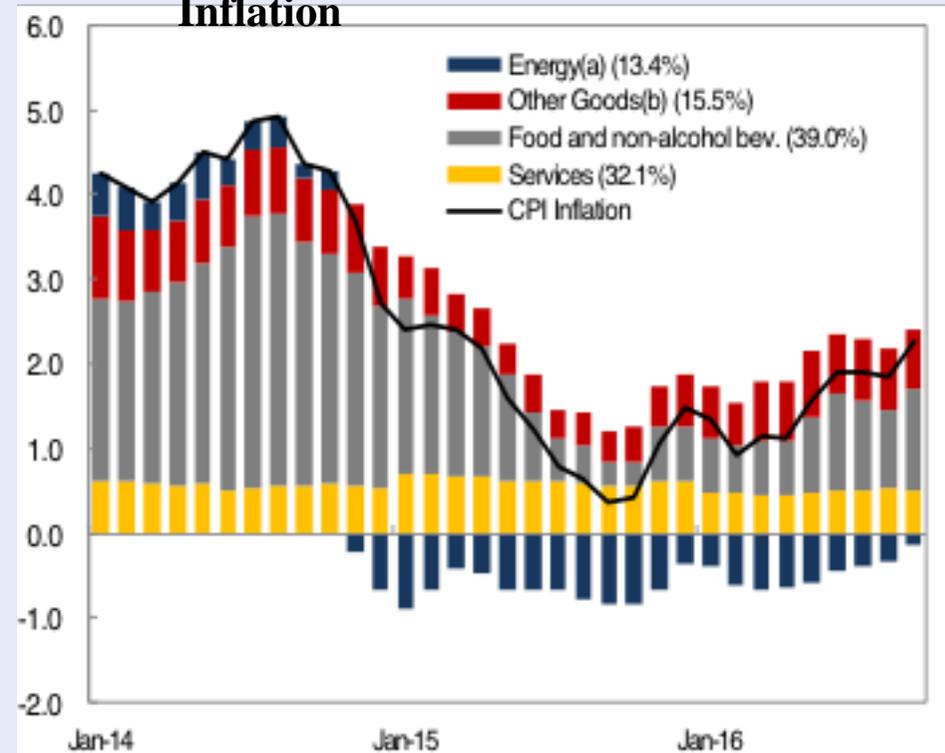
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Supply-driven inflation allows BSP to maintain monetary policy settings

Core and Headline Inflation



Factors Driving Headline Inflation



DER staff estimates

(a) Transport services namely, passenger transport for road, air, railway, and sea are included under energy items due to oil-price effect on fares.

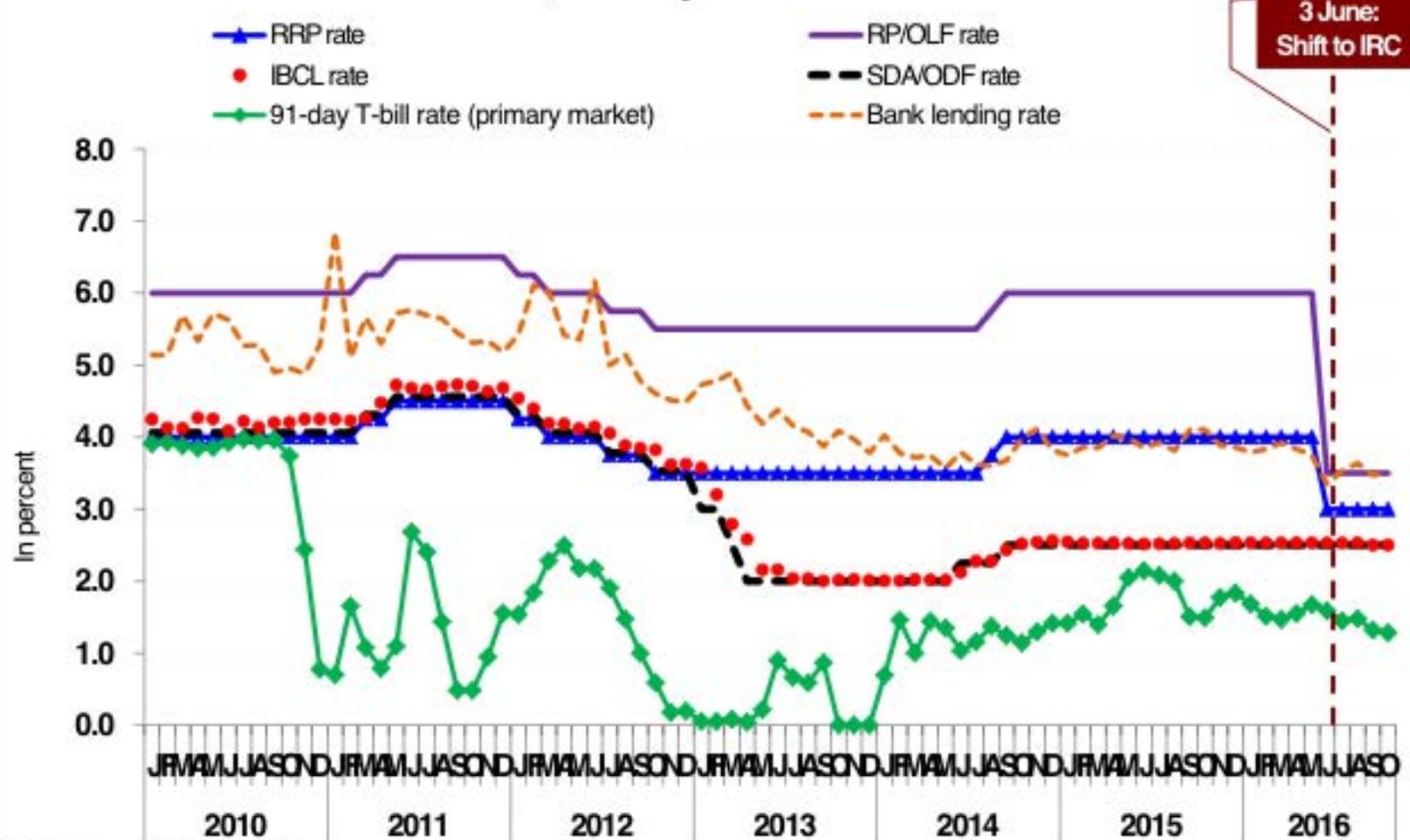
(b) Computed as the difference between headline inflation and sum of other contributions as identified in the chart.



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Recent reforms to strengthen monetary policy implementation

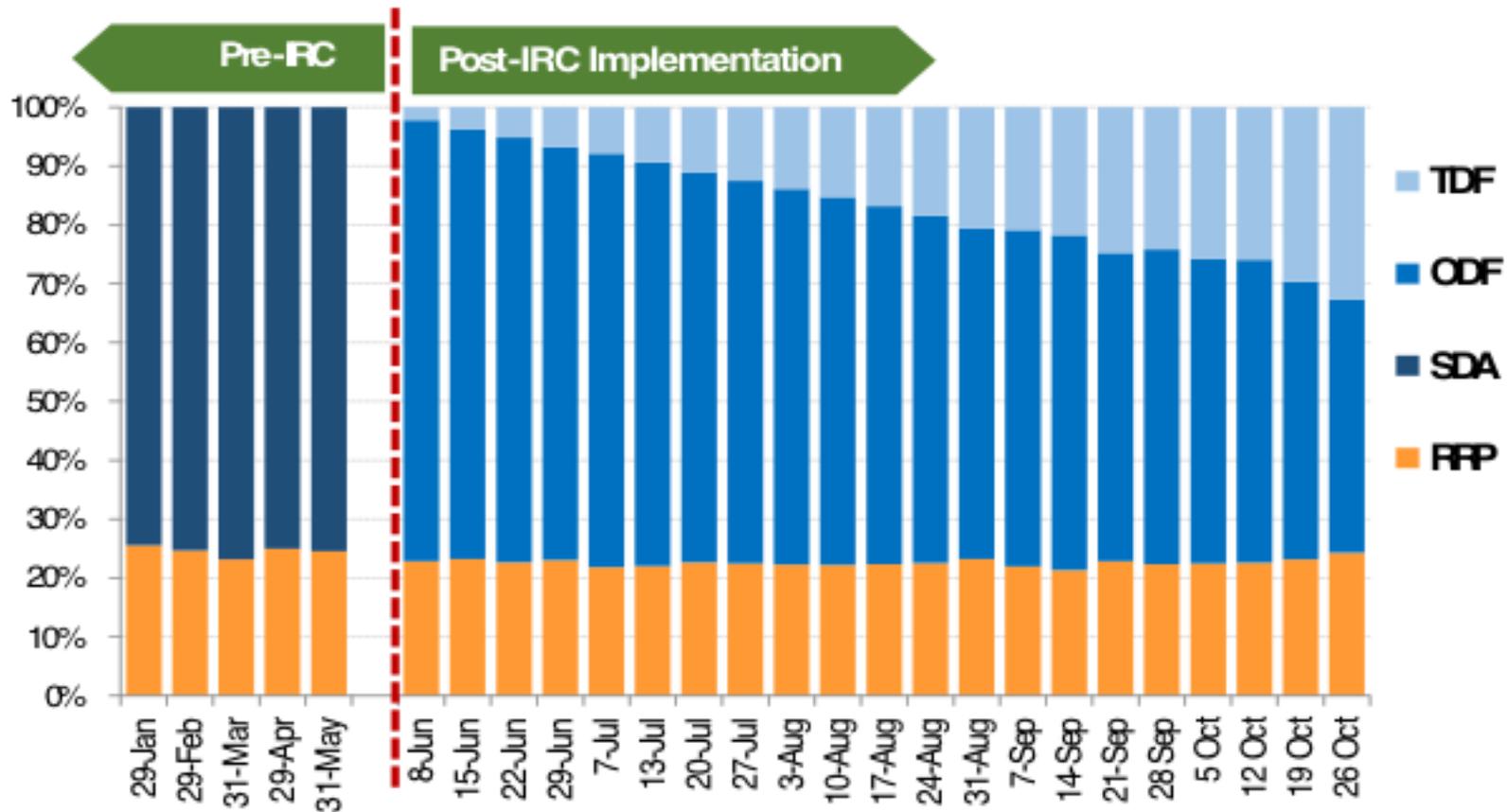
BSP and Market Interest Rates, January 2010 - October 2016



Note: Data as of 27 October 2016

IRC allows BSP to better manage domestic liquidity conditions

Distribution of Outstanding Volume of BSP Monetary Operations
January - October 2016



Notes:

TDF = Term Deposit Facility; ODF = Overnight Deposit Facility; RRP = Reverse Repurchase Facility;
SDA = Special Deposit Account

Some caveats on limits of traditional monetary policy instruments

- **Prudential regulation and supervision**, BSP's first line of defense against possible financial imbalances brought on by capital flows
- Expanded **macroprudential toolkit**:
 - Real Estate Stress Test (REST) Limit for Real Estate Exposures
 - Guidelines on Sound Credit Risk Management Practices
 - RREPI to better capture real estate dynamics
- Revisiting **other applicable macroprudential measures**, such as existing caps on loan-to-value (LTV) ratios, SBL...



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*There may also be some short-term gains
from capital controls...*



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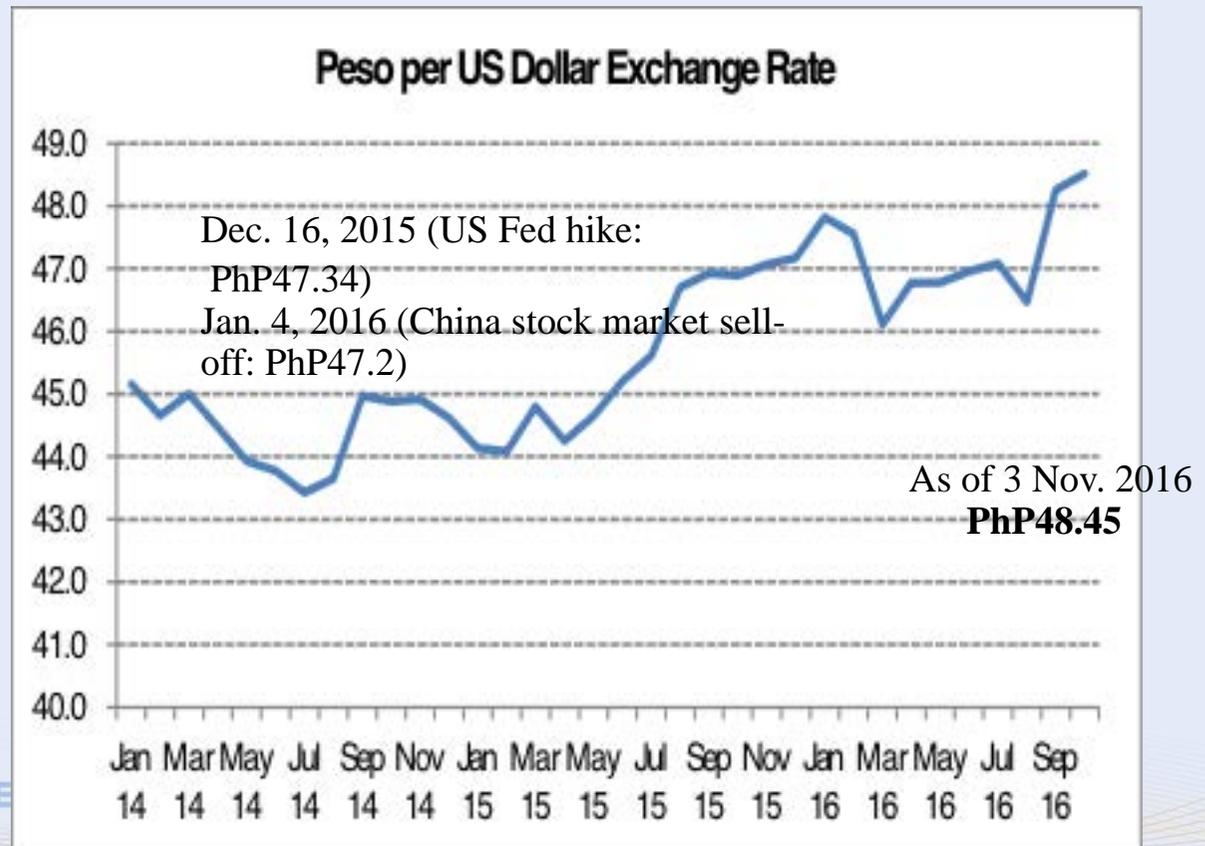
*...but there are also practical questions
on imposing capital controls*



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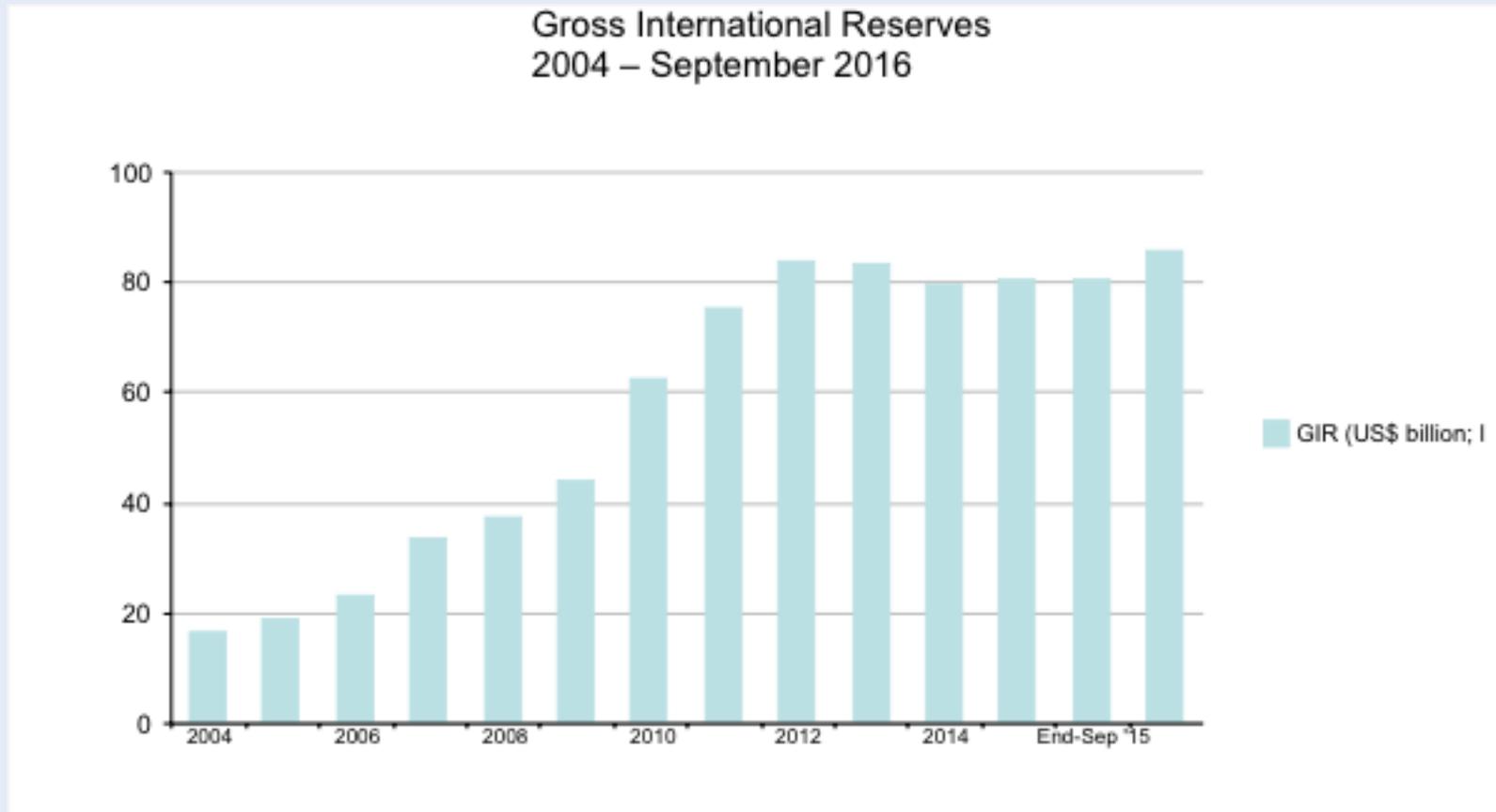
Adhering to market-friendly measures to deal with capital flows...

- **Exchange-rate flexibility**, buffer against external shocks and allows for some degree of monetary autonomy
 - FX market participation to limit volatility to the extent that movements affect the outlook for inflation and growth



Gross FX reserves can help calm markets

- The country's GIR can cover 10 months' worth of imports of goods and payments of services.



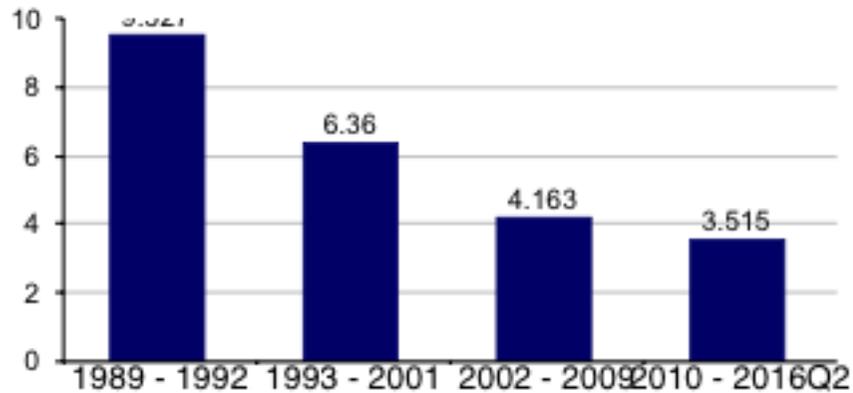
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Sustaining resiliency: Establishing reform-oriented institutions

Year	Selected Structural/Policy Reforms in the Philippine Economy (1993-2016)
1993	Creation of the Bangko Sentral ng Pilipinas
1994 - 2001	Liberalization of foreign bank entry and the telecommunications industry; Privatization of water services (MWSS); Deregulation of the oil industry; Passage of the Philippine E-Commerce Act; Liberalization of the power sector
2002	Adoption by BSP of Inflation Targeting Framework
2003-2009	Passage of the Securitization Act; Adoption of Basel II; Passage of expanded value-added tax; Establishment of the Wholesale Electricity Spot Market (WESM); Full implementation of risk-based bank supervision; Privatization of the National Transmission Corporation and National Power Corporation
2011-2015	Adoption of phased-in migration to Basel III; Liberalization of Entry of Foreign Banks in the Philippines; Implementation of macroprudential measures on real estate exposure; Passage of the Philippine Competition Act
2016	Credit Card Industry Regulation Law; Amendment to Foreign Investment Restrictions; Economic and Financial Literacy Act; Freedom of Information; Further Liberalization of FX regulations; Implementation of Interest Rate Corridor; Financial Inclusion Steering Committee; Implementing Rules and Regulations of the Philippine Competition Act

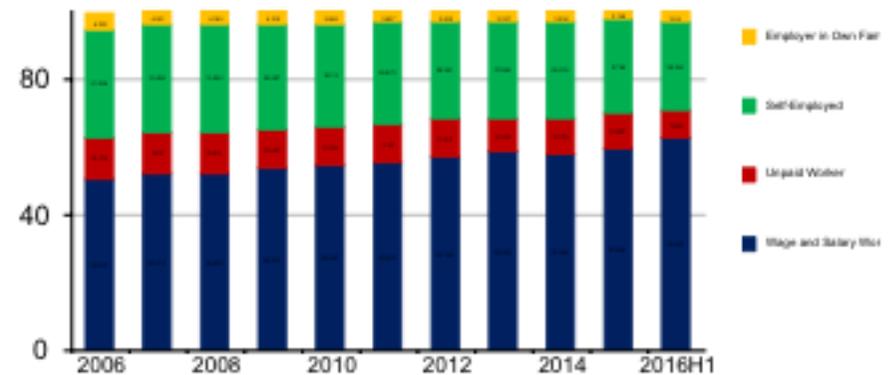
Sustaining resiliency: Elevating potential capacity

Incremental-Capital Output Ratio



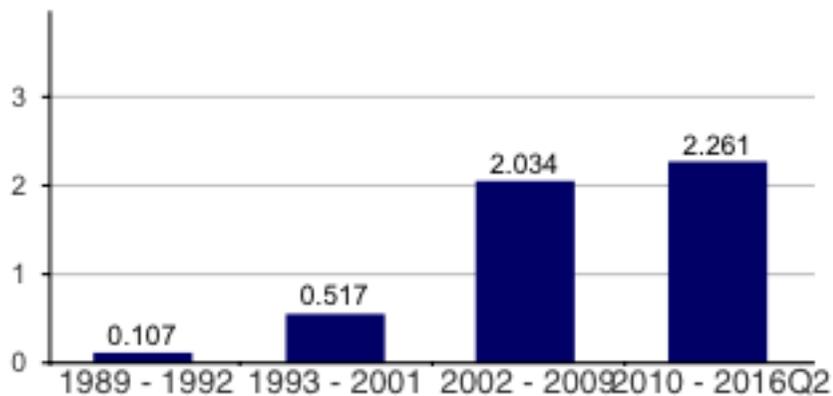
Source: Latest BSP staff estimates

Employment Share by Class of Workers



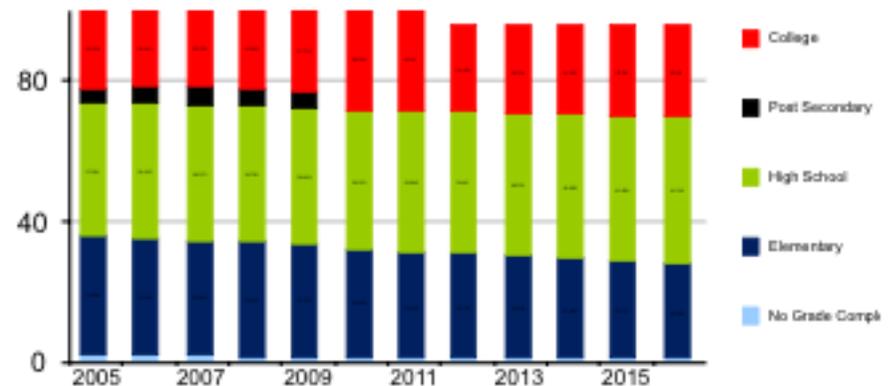
Source: Philippine Statistics Authority (PSA)

Total Factor Productivity



Source: Latest BSP staff estimates

Employment Share by Educational Attainment



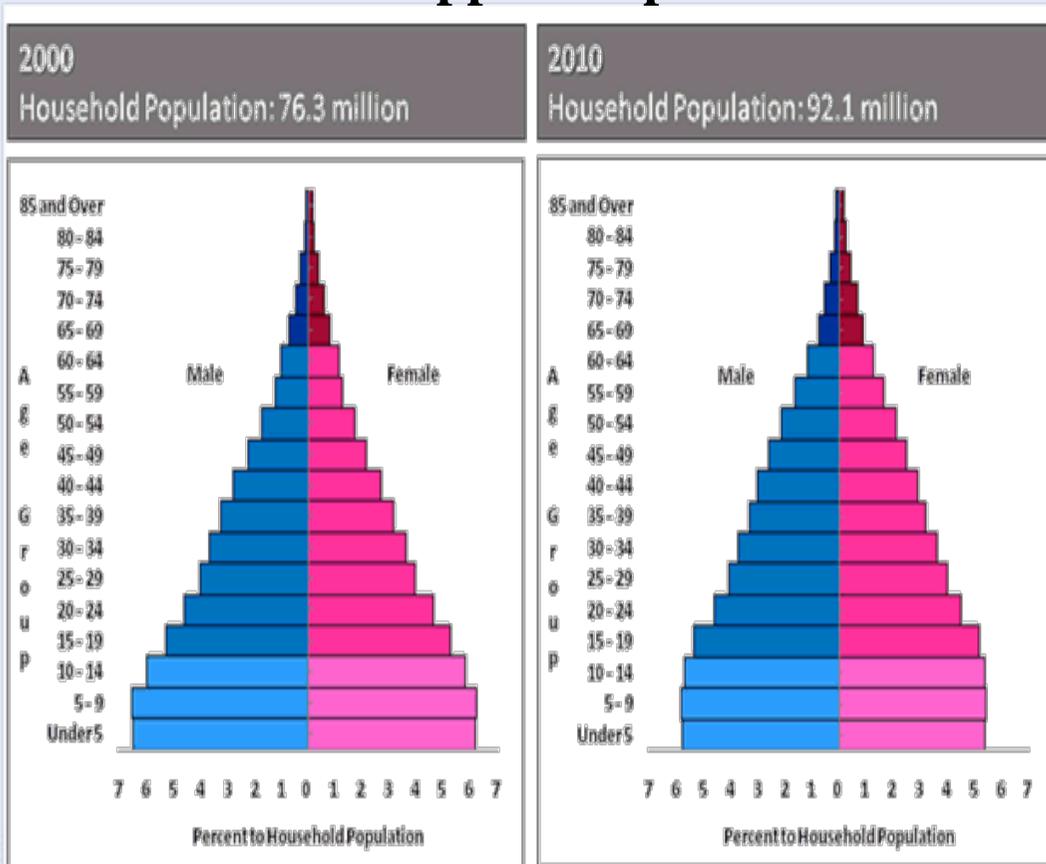
Source: PSA



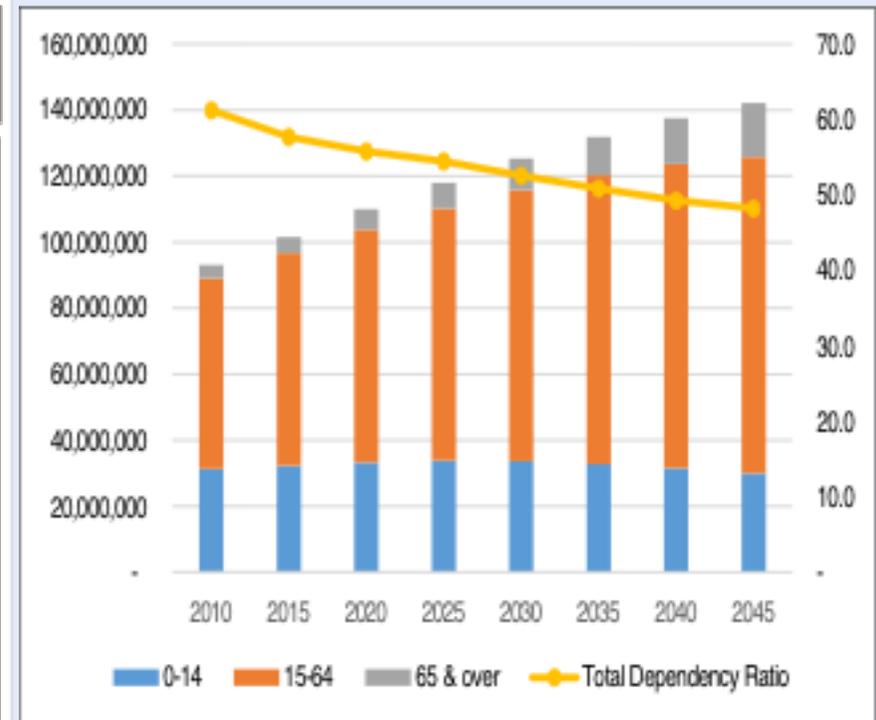
Sustaining resiliency: Optimizing demographic sweet spot

- The Philippines is in a **rare demographic window** of opportunity that could spur rapid economic growth over a long period.

Age-Sex Structure of the Philippine Population



Total Dependency Ratio (%)



Total dependency ratio to decline from 61.2% in 2010 to 48.2% by 2045

Median Age of the Population: **23.4 years old**

Sustaining resiliency: governance and doing business

*Results of institutional and governance reforms are positively recognized
by independent third-party assessors*



Source: Various third-party annual ranking reports, DOF, DTI



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Long term perspective: Amendments to the BSP charter

- Increase in capitalization
- Restoration of authority to issue debt securities
- Granting of authority to obtain pertinent data from all entities, public or private
- Authority to put up reserves against FX fluctuations and cost of monetary operation
- Formal recognition of financial stability in the BSP mandate



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Summary

- Philippine economy derives resilience from structural and policy reforms.
- BSP operates with monetary, fiscal space to address macroeconomic vulnerabilities with new initiatives including IRC , macroprudential measures
- Institution building of the monetary authority is critical if it were to continue helping stabilize macroeconomy and banking system



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