

“Currency Inflows, Foreign Exchange Rates and the Regulatory Environment”

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Philippine Investment Summit for Global Fund Managers
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Outline

- I. Global economic situation**
- II. Issues on capital flows**
- III. Issues on foreign exchange**
- IV. The regulatory framework**
- V. Conclusion**



Global growth trends and forecasts

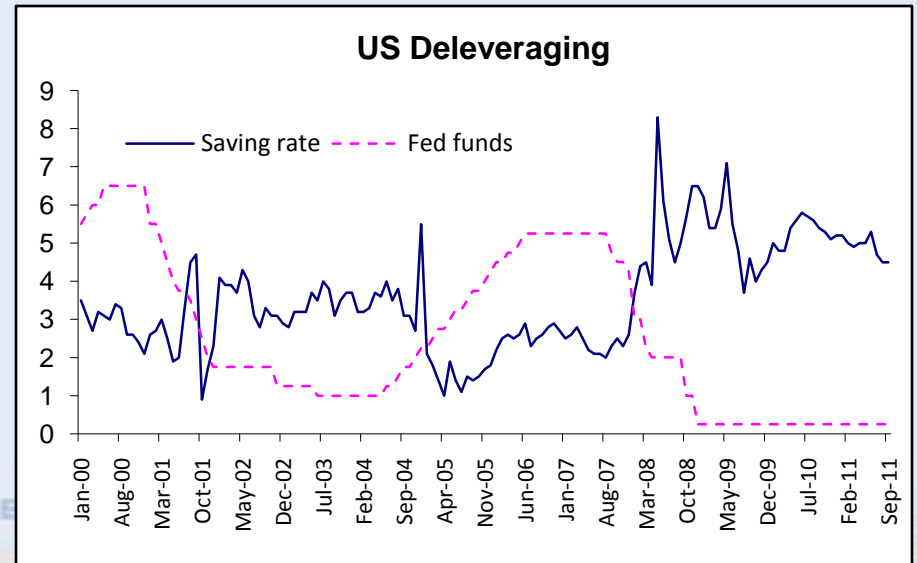
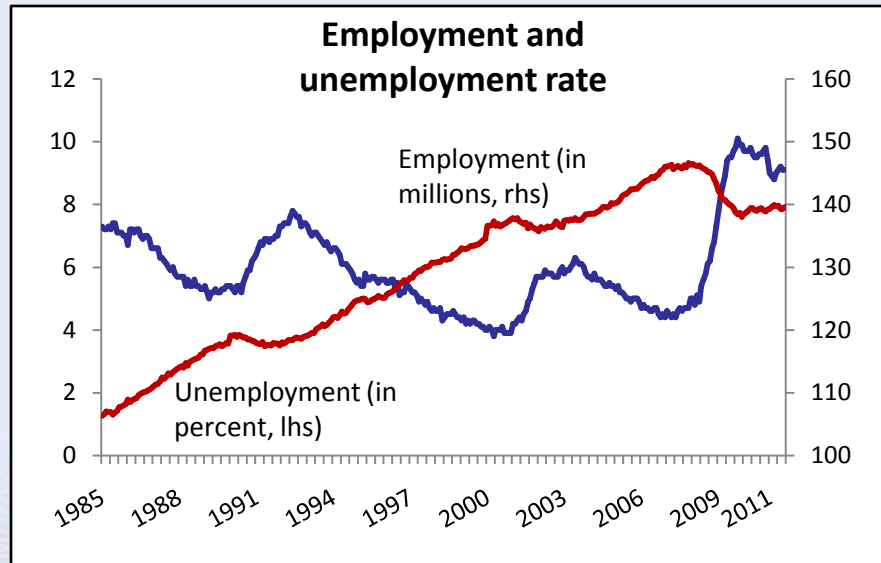
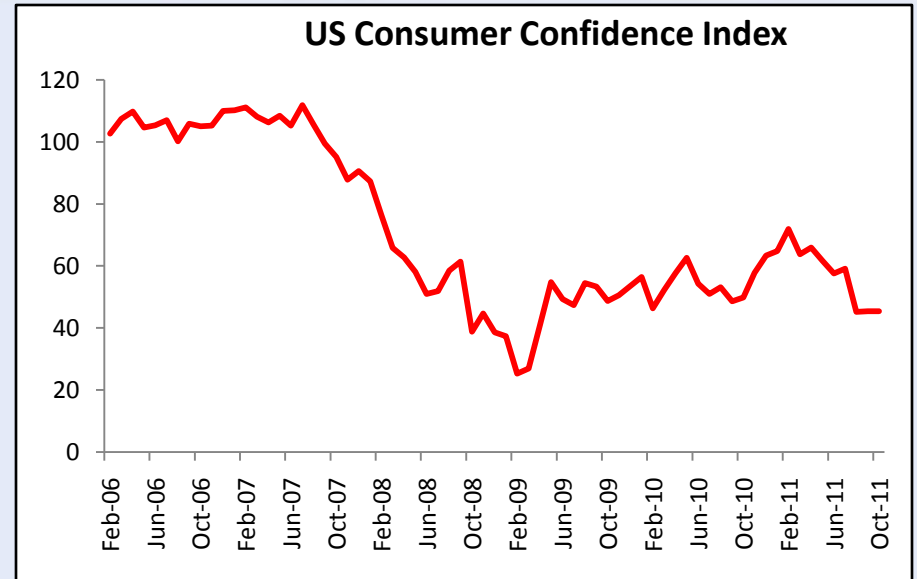
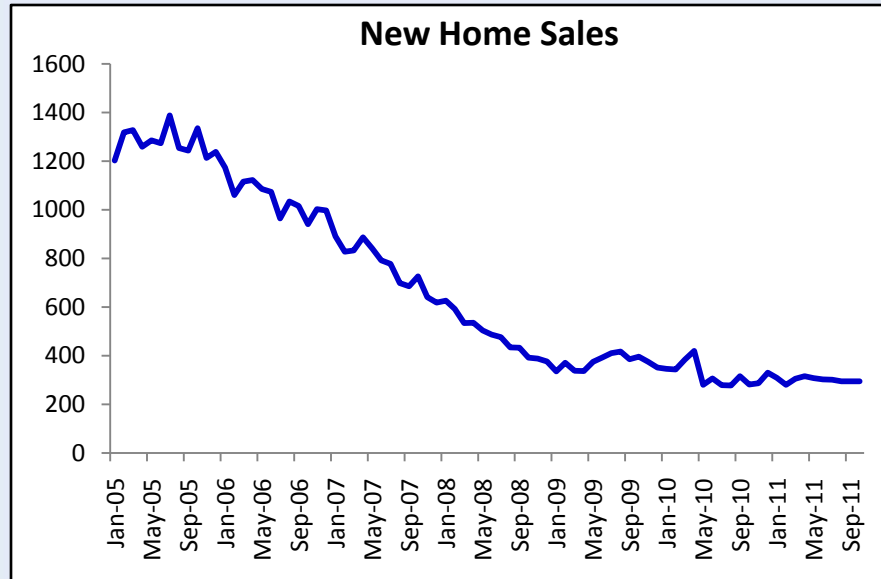
	Real GDP growth rates								
	Actual	IMF		World Bank		ADB		Bloomberg Consensus	
		2010	2011	2012	2011	2012	2011	2012	2011
Global GDP	5.1	4.0	4.0	3.2	3.6				
United States	3.0	1.5	1.8	2.6	2.9	1.6	2.2	1.6	2.2
Euro Area	1.8	1.6	1.1	1.7	1.8	1.7	1.3	1.7	1.0
Japan	4.0	-0.5	2.3	0.1	2.6	-0.5	2.8	-0.4	2.5
Emerging and developing economies	7.3	6.4	6.1	6.3	6.2				

Sources: IMF WEO, Sep 2011, WB Global Economic Prospects, Jun 2011, and ADB Asian Development Outlook 2011 Update, Sep 2011, and Bloomberg.



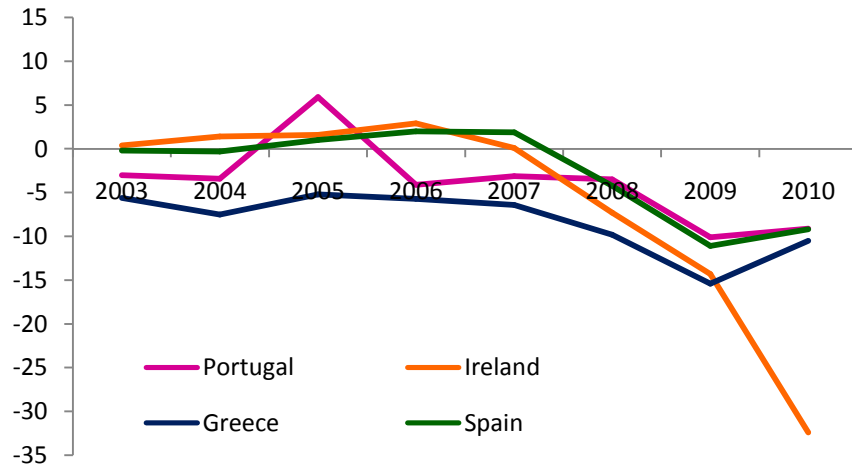
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Headwinds buffeting the US economy



Headwinds buffeting the Euro Area

Fiscal Balance (% of GDP)

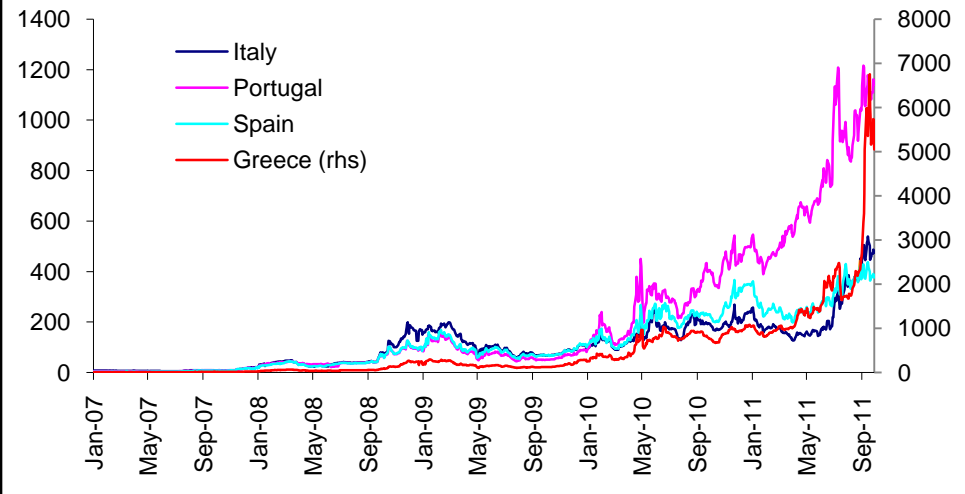


➤ GIPS continue to deal with fiscal challenges.

Source: Credit Suisse

➤ Euro area sovereign spreads continue to widen.

CDS of Selected Eurozone Countries



Source: Bloomberg

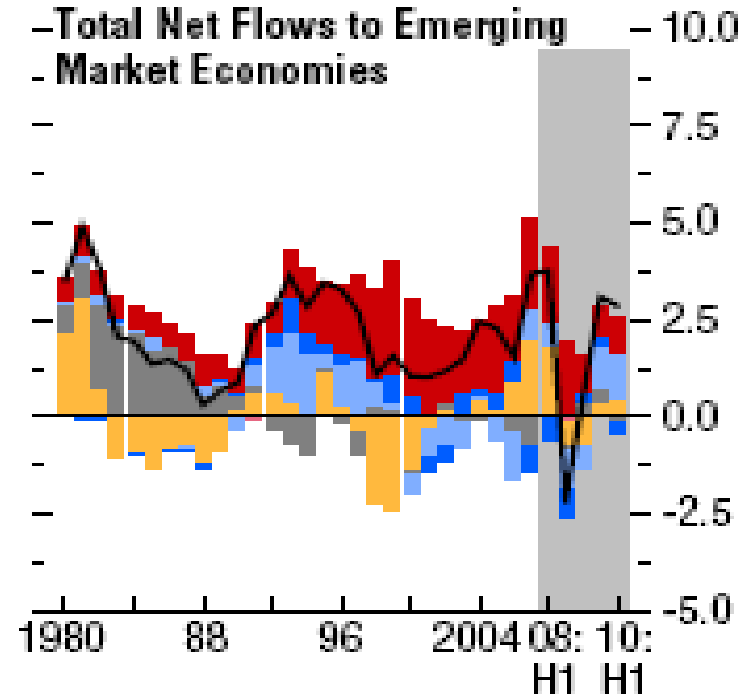
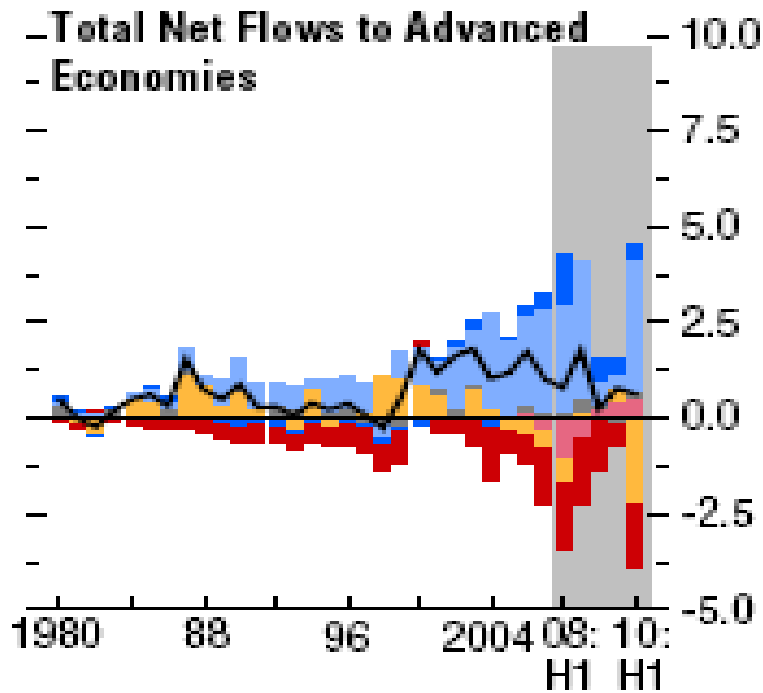


Policy responses of advanced economies: Monetary policy measures

	Policy Measures
US Federal Reserve	Increased Fed's balance sheet to USD2.1 trillion (in June 2010), from US\$800 billion Treasury notes before the recession, through quantitative easing.
	Implemented USD600 billion "Quantitative Easing (QE) II" bond-buying program (Nov 2010)
	Launched "Operation Twist" (21 Sep 2011)
Bank of England	Purchased GBP200 billion in assets. Announced extension of its QE by additional GBP75 billion (6 October 2011).
European Central Bank	Reintroduced year-long loans and resumed purchases of covered bonds.
	Purchased Spanish and Italian debt papers in the secondary market



Capital flows surge to emerging market economies



■ Foreign direct investment
■ Portfolio debt flows
■ Other government flows
— Total

■ Portfolio equity flows
■ Bank and other private flows
■ Derivative flows

Source: IMF World Economic Outlook, April 2011



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Capital flows: Pull factors

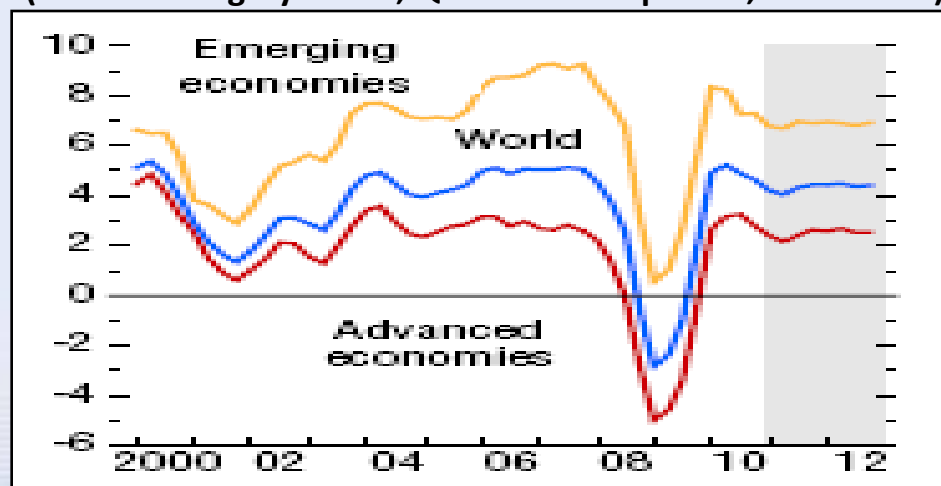
Brighter growth prospects in emerging markets

	Actual	IMF		World Bank		ADB		Bloomberg Consensus	
	2010	2011	2012	2011	2012	2011	2012	2011	2012
Indonesia	6.1	6.4	6.3	6.3	6.5	6.6	6.8	6.5	6.6
Thailand	7.8	3.5	4.8	3.7	4.2	4.0	4.5	4.1	4.7
Malaysia	7.2	5.2	5.1	4.8	5.7	4.8	5.1	5.0	5.4
Philippines	7.6	4.7	4.9	4.5	5.0	4.7	5.1	5.0	5.7

Sources: IMF WEO, Sep 2011, WB Global Economic Prospects, Jun 2011, and ADB Asian Development Outlook 2011 Update, Sep 2011, and Bloomberg.

GDP Growth: World Economy

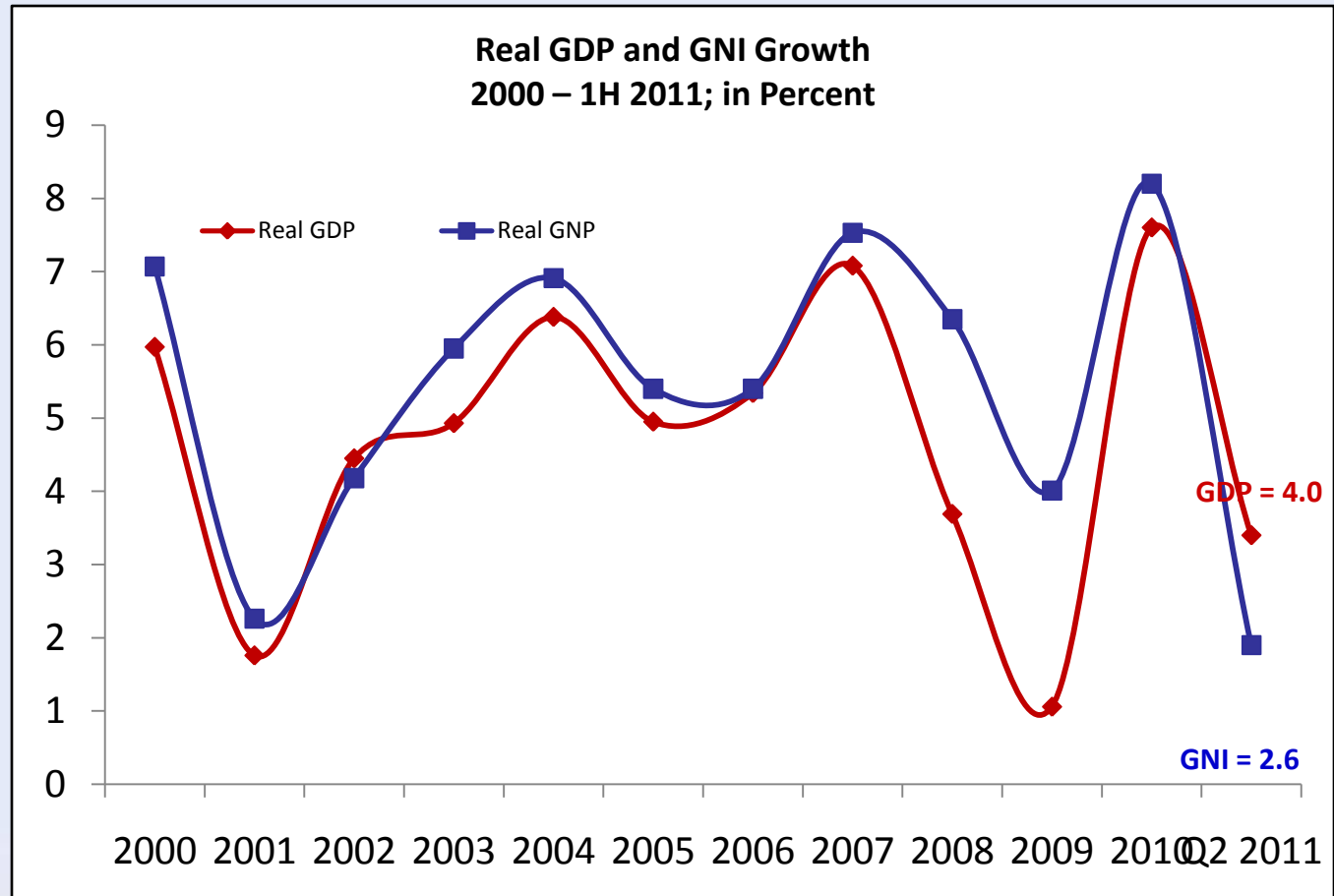
(Forecasts in gray shade; Quarter-over-quarter, annualized)



Source: IMF World Economic Outlook, April 2011

Capital flows: Pull factors

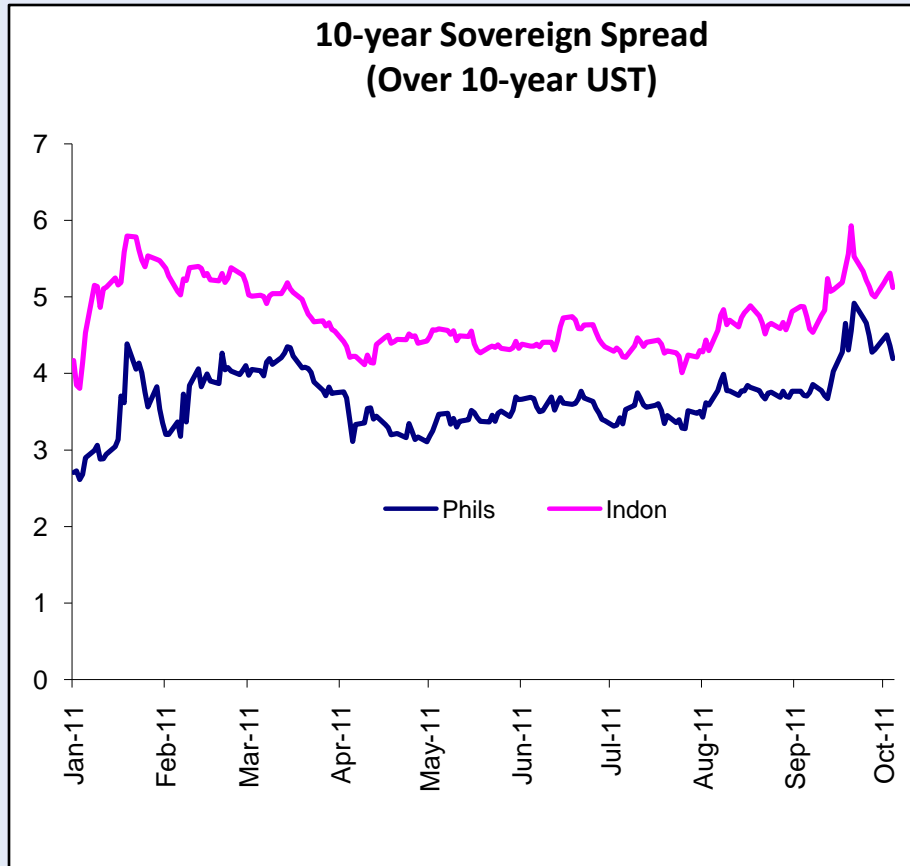
- The Philippine economy: Resilient and broad-based growth amid the global financial crisis.



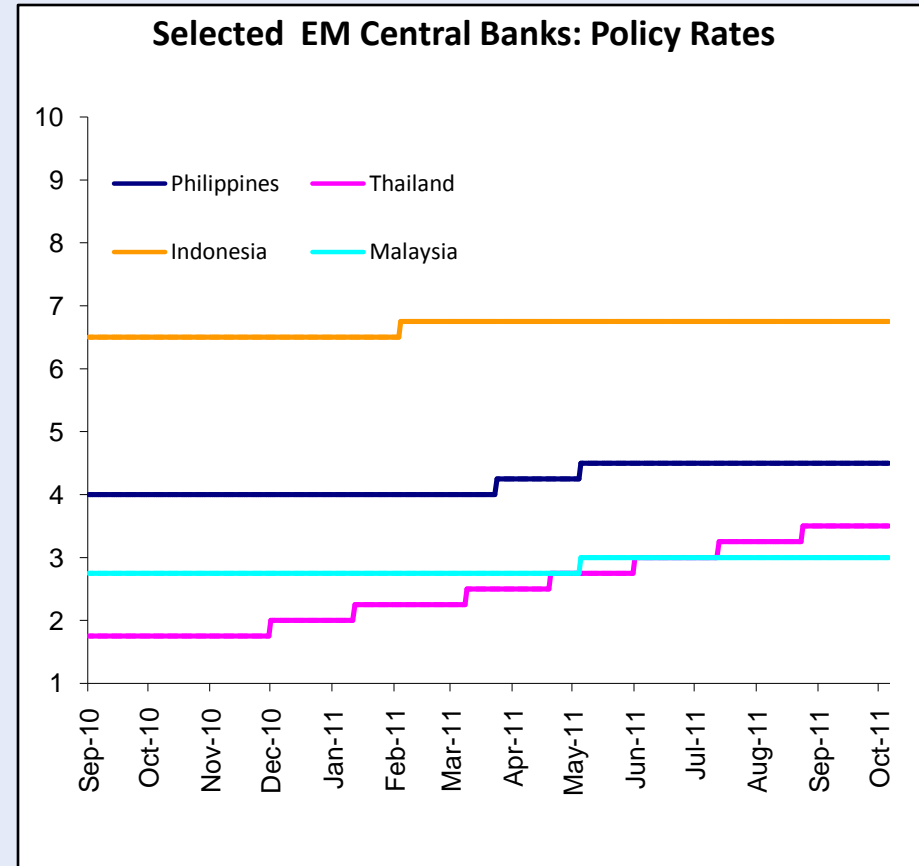
Source: National Statistical and Coordination Board.

Capital flows: Pull factors

- Higher yield differential of emerging market economies (EMEs)



Source: Bloomberg



Source: Bloomberg



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Capital flows: Benefits and potential risks

Benefits of capital inflows are well known...

- Ease financing constraints
- Shore up BOP position
- Lower domestic interest rates
- Enhance longer-term economic prospects

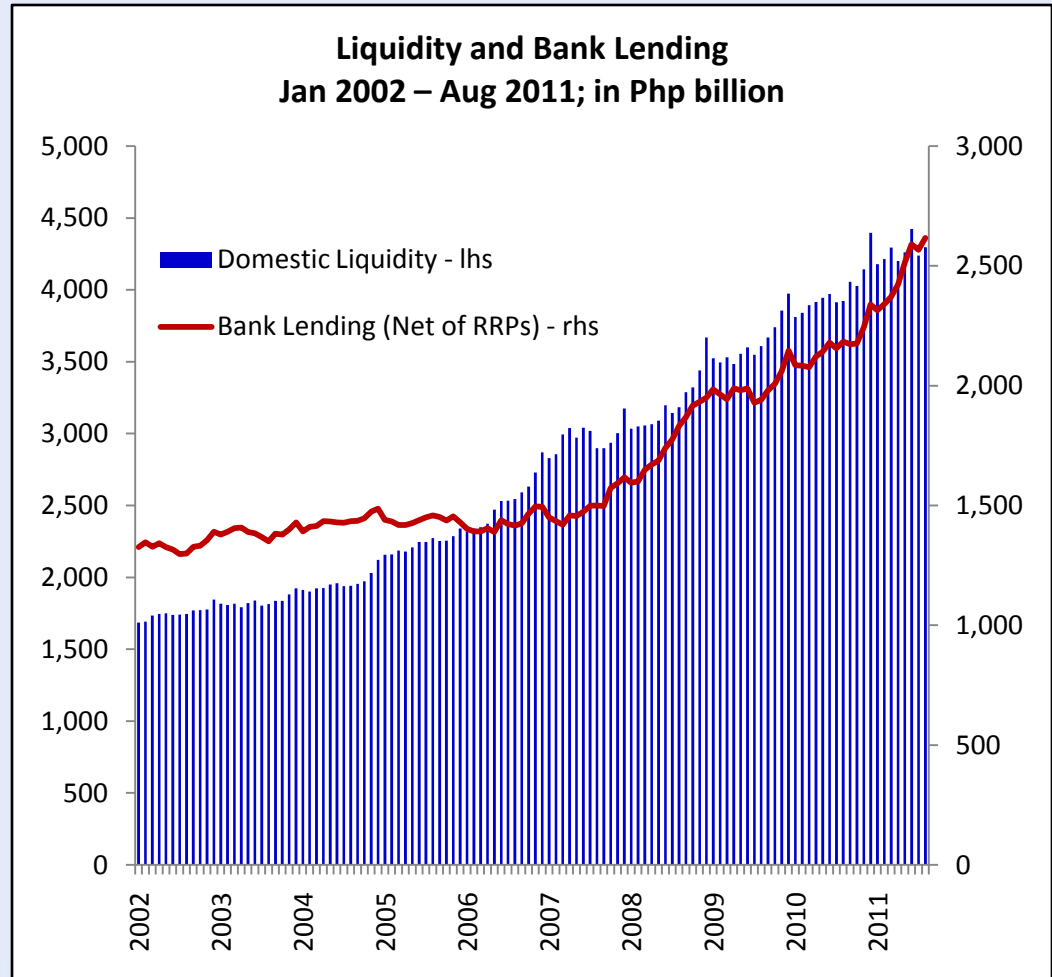
But so are the risks.

- Put pressure on liquidity management
- Vulnerable to reversal or sudden stop of inflows
- Lead to asset bubbles and financial imbalances



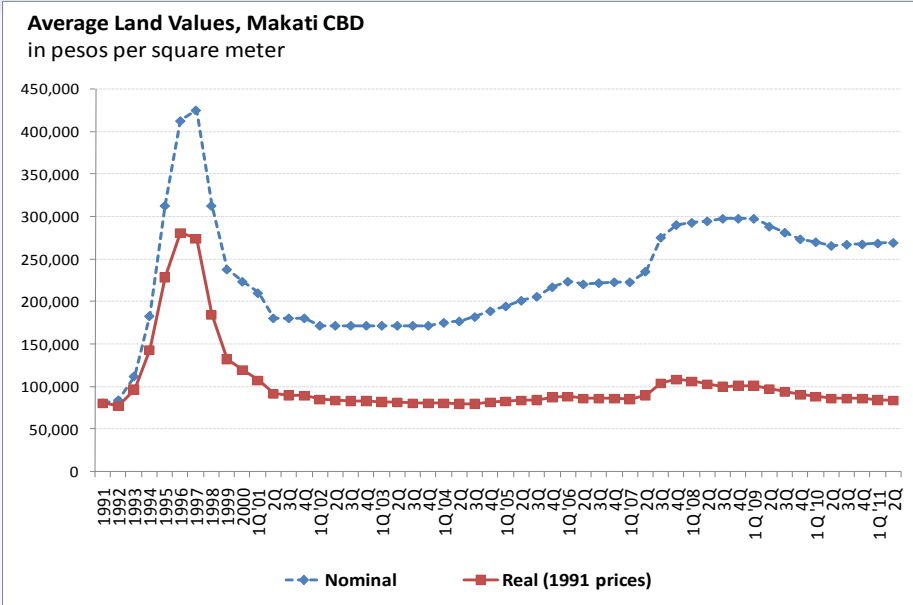
Capital flows risk: Complicate liquidity management

- Liquidity and credit conditions remain consistent with price and financial stability objectives



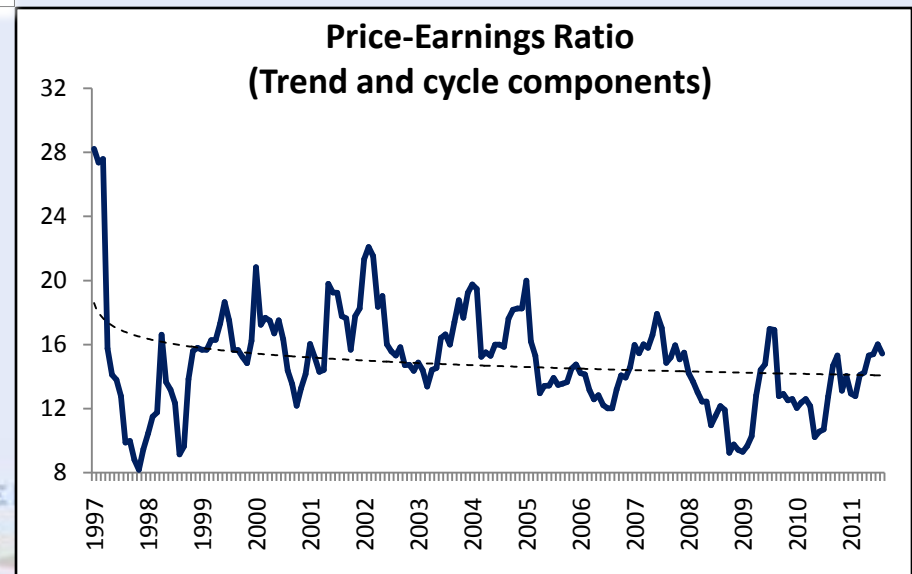
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Capital flows risk: Trigger asset bubbles

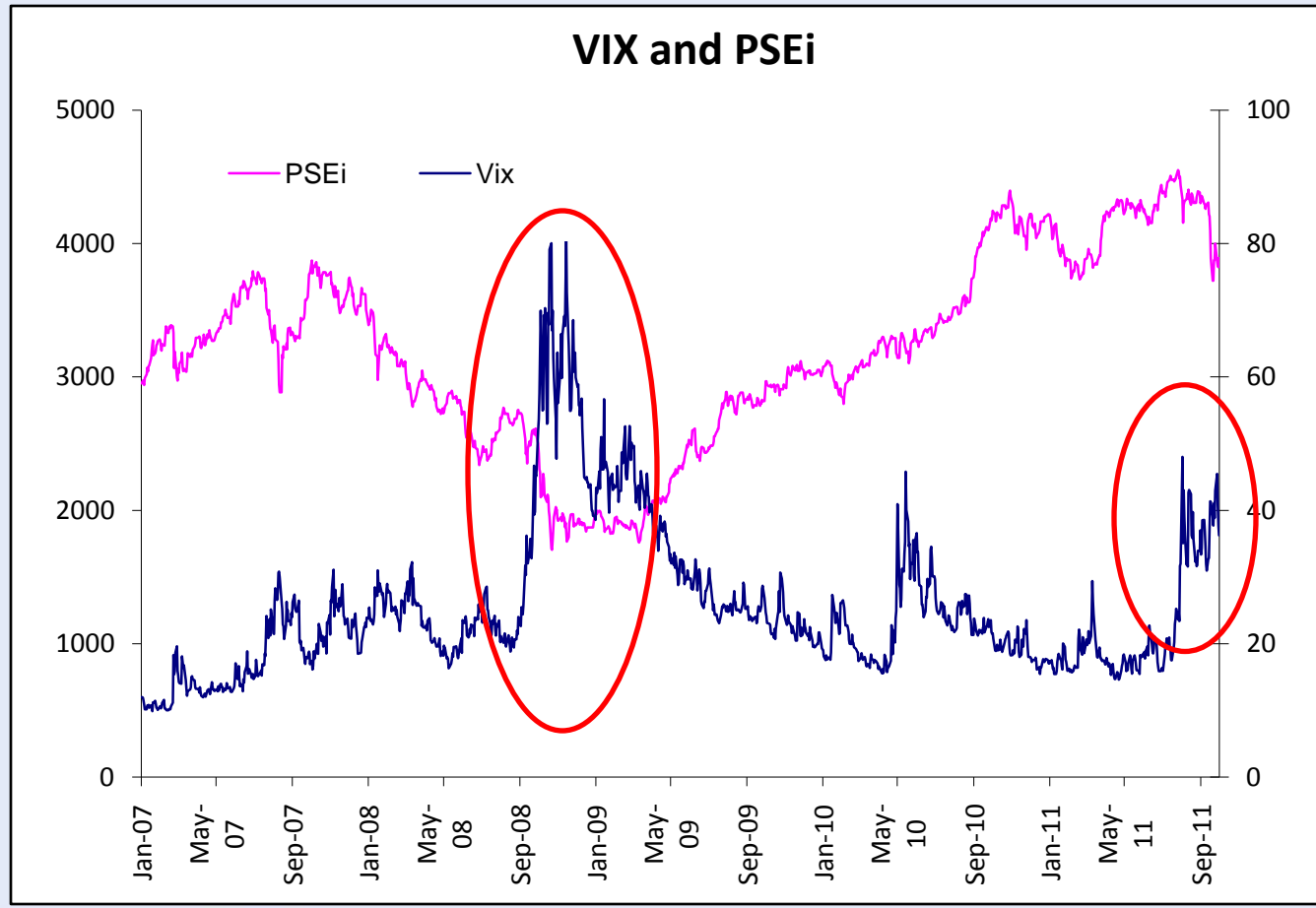


➤ Property markets are fairly stable

➤ Pick-up in P/E ratio is well below the 1997 Asian crisis levels



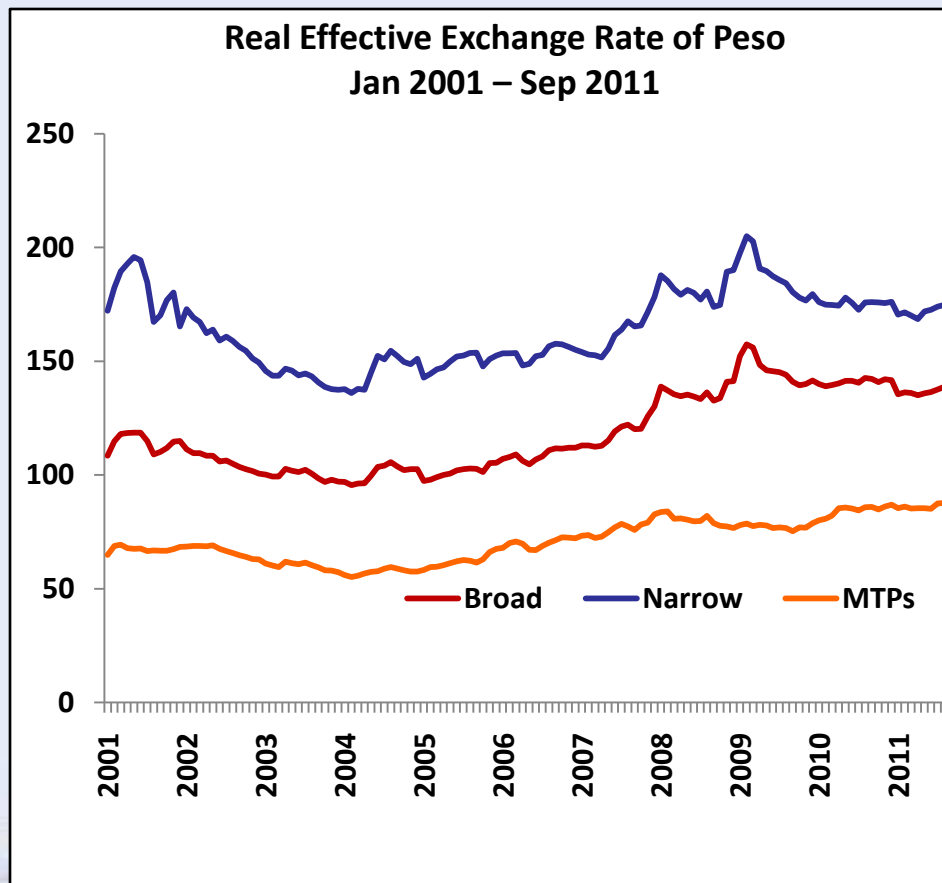
Capital flows risk: Reversal or sudden stoppage of inflows



Note: The Chicago Board of Exchange Volatility Index or Vix measures the cost of using options as insurance against declines in the Standard & Poor's (S&P) 500 Index.

Issues on the exchange rate

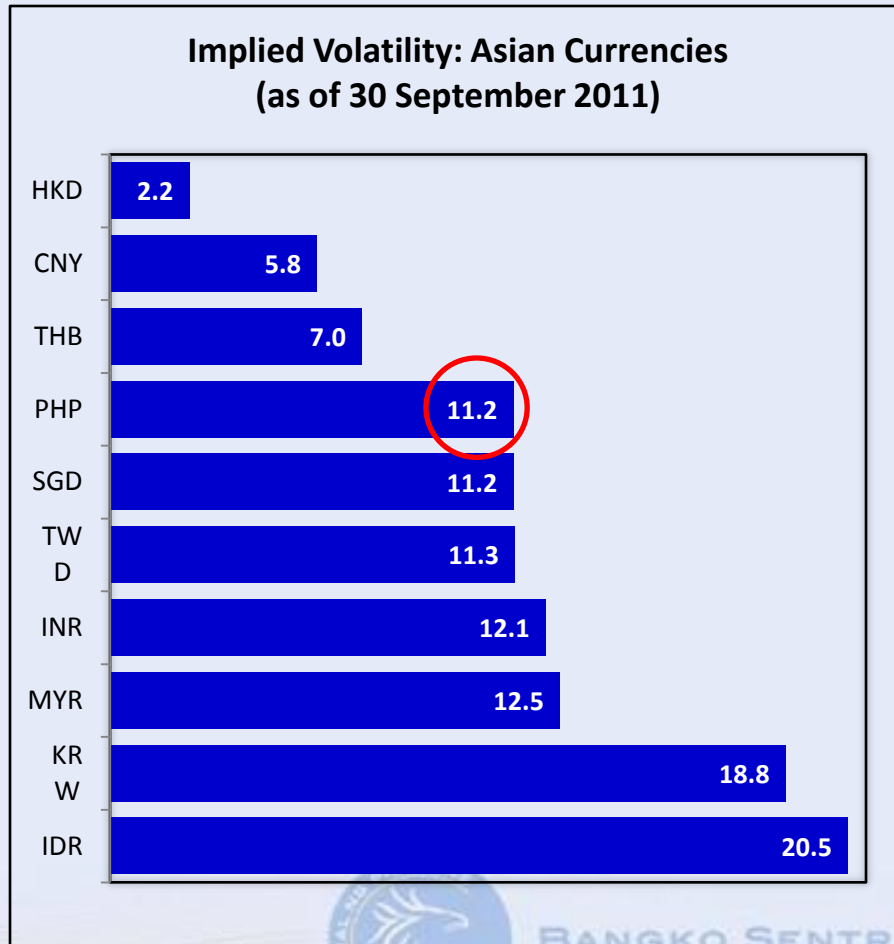
Surges in capital inflows could cause sharp adjustments in the domestic currency that could weigh down on the country's export competitiveness



➤ Exchange rate of the peso remains broadly competitive.

Issues on the exchange rate

Surges in capital inflows could also magnify FX volatility



➤ Implied volatility of the peso remains one of the lowest in the region.

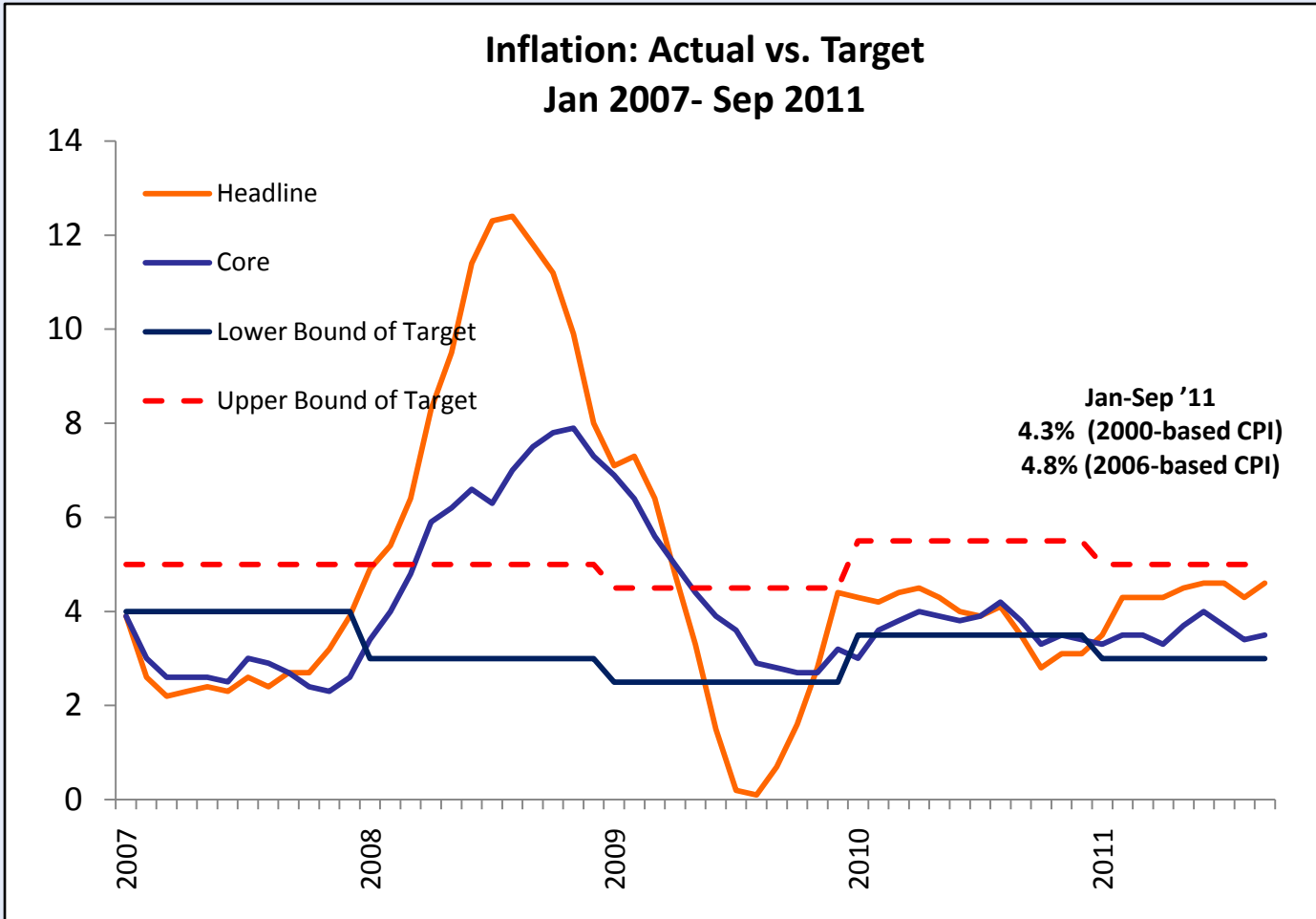


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BSP policy toolkit in managing capital flows

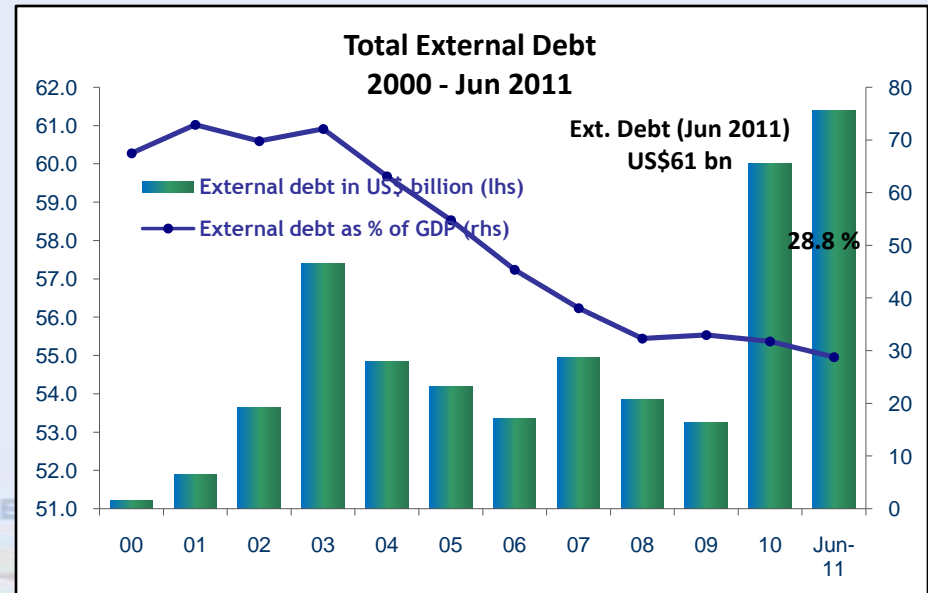
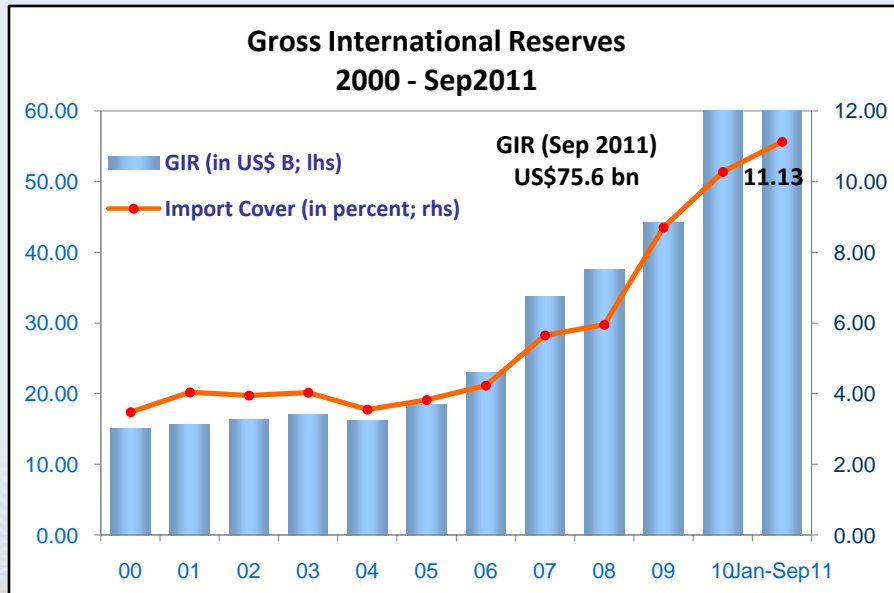
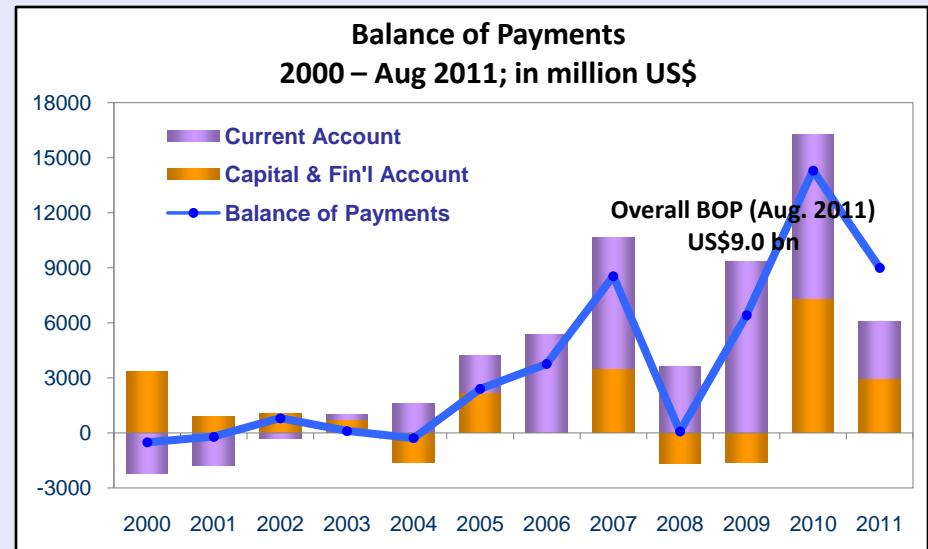
	Done	Work Underway
Improved monitoring/understanding of nature of FX inflows	✓	
Exchange rate flexibility	✓	
Reserve accumulation and associated liquidity management	✓	
Financial sector reforms to deepen financial markets	✓	
Macroprudential measures	✓	
Reform of the FX regulatory framework	✓	
Prepayment of external debt	✓	
Careful communication to markets about central bank's views and policy responses	✓	
Calibrations in monetary policy, if necessary	✓	
Restoration of ability to issue own instruments		✓
Full capitalization of BSP		✓
Capital Control		?

Monetary policy: Maintain price stability



External sector policy: Maintain favorable external position

- Ensure that external vulnerabilities are reduced by promoting healthy external payments and sustainable external debt



Financial sector policy: Promote sound and stable banking system

- Continuing reforms in the banking system have sustained its soundness and stability, enabling it to perform a catalytic role for a more dynamic and participatory economic development.
- Macroprudential tools are being sharpened to strengthen further the financial system's resilience. These include:
 - ✓ Countercyclical policies
 - ✓ Limiting buildup of system-wide financial risks
 - ✓ Transparency of risk assessments



Countercyclical policies that influence the credit cycle

- ✓ Prudential measures through the imposition of limits/ceilings on credit exposures (e.g., limits on real estate loans; caps on loan-to-value ratios; large exposure limits)
- ✓ Macroprudential measures to limit build-up of system-wide financial risk (e.g., strong capitalization; liquidity cover; limits on proper foreign exchange positions)
- ✓ Promoting transparency of risk assessments (e.g., financial stability reviews; risk measurement tools)



FX policy framework: Further liberalization of FX environment

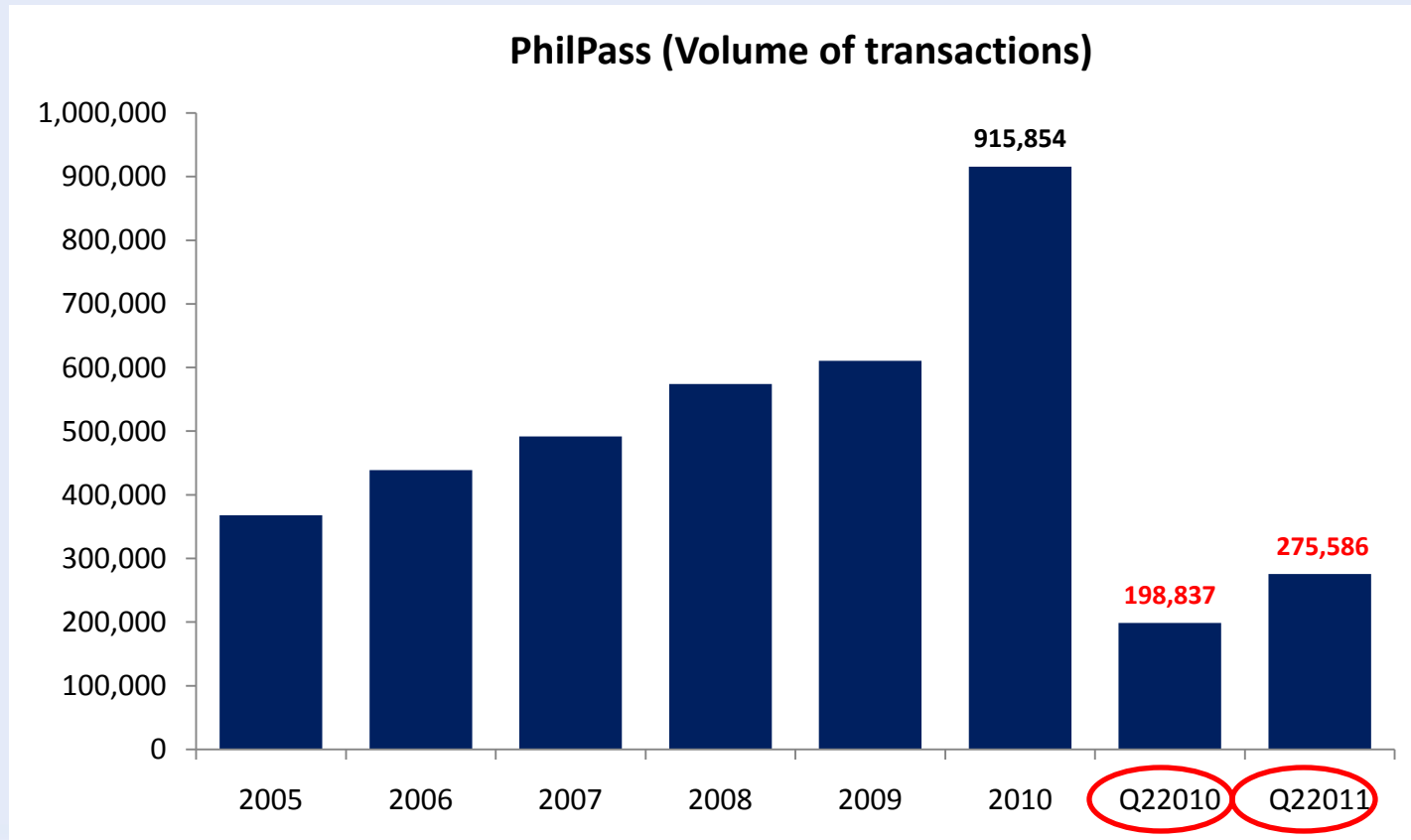
Recent FX Liberalization include:

- Raising cap on FX transactions:
 - Trade and non-trade transactions
 - Tourists' FX conversions
- Facilitation of easier pre-payment of foreign-dominated obligations
- Easing of FX conversion of outward remittances
- Raising limits on outward investments and purchases of Philippine offshore debt



Smooth functioning of the payments and settlements system

- Effective payments and settlements



Policy considerations going forward:

- Expand policy framework to prioritize financial stability alongside price stability
- Take explicit account of financial stability in monetary decision making



Concluding Note

*“Alone we can do so little;
together we can do so
much.”*

~ Hellen Keller



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