

THE BSP: PAYING THE PRICE FOR STABILITY

The primary objective of the Bangko Sentral ng Pilipinas is to promote price and financial stability conducive to balanced and sustainable economic growth. It also seeks to maintain monetary stability and the convertibility of the peso.

In this connection, the BSP performs a wide range of functions involving money, banking and credit in the performance of this mandate for stabilization.

Today, the BSP is faced with the challenge of dealing with the consequences of strong foreign exchange inflows that have resulted in strengthening the Philippine peso against other currencies. This phenomenon is not unique to the Philippines; the same challenge faces other central banks in economies that receive heavy foreign exchange inflows.

In response to the heavy capital inflows, the BSP has been implementing various stabilization measures to moderate sharp currency movements. However, stability comes at a price. The BSP has been incurring heavy financial losses in its efforts to temper currency fluctuations which could be destabilizing.

The losses are generated primarily because of two reasons:

FIRST, AS THE PESO STRENGTHENS, THE BSP INCURS FOREIGN EXCHANGE REVALUATION LOSSES SINCE THE VALUE OF ITS FOREIGN EXCHANGE HOLDINGS FALLS BELOW THEIR ACQUISITION COST.

When there is a surge of foreign exchange into the country, the peso strengthens against the dollar.

A strong peso is good for importers and those with foreign debts. For instance, a person would need about P50 in 2001 to pay a \$1 debt; today, that person would need only about P41 to pay a \$1 debt.

On the other hand, a strong peso means that exporters and other forex earners such as overseas Filipino workers get less pesos for every dollar they convert. At some time in 2001, every \$1 remitted by an overseas Filipino could be exchanged at an average of about P50. Today, a dollar of remittance is worth about P41.00.

To moderate the strong gains in the value of the peso, the BSP buys foreign exchange by participating in the currency trade.

However, the BSP incurs foreign exchange losses when it buys foreign exchange at a time when the peso is appreciating. This is similar to stocking up on goods that are declining in value while

paying for it with a currency that is gaining in value. The decline in the value of the BSP's foreign exchange holdings compared to its acquisition cost is recorded as a foreign exchange loss. In 2012, losses from forex fluctuations reached P50.4 billion.

Could these losses be avoided? The mandate of the BSP is to provide price and financial stability using various measures available to it; sometimes, losses are incurred in the process.

Essentially, the BSP performs a balancing act to maintain stability. It participates in currency trade to prevent the peso from moving up too fast or from dropping too fast, as both could trigger adverse effects on the economy. In moderating the movements of the peso, the BSP does not favor one sector over another. The BSP's goal is clear: to promote price stability consistent with balanced, sustainable and inclusive growth.

SECOND, WHEN THE BSP BUYS FOREIGN EXCHANGE, IT PAYS IN PESOS. THIS INCREASES THE AMOUNT OF PESOS CIRCULATING IN THE PHILIPPINE ECONOMY. TO MOP UP EXCESS LIQUIDITY, THE BSP INCURS INTEREST EXPENSES.

Having more money in circulation could lead to higher inflation, which adversely affects all Filipinos, whether an exporter, overseas worker or domestic producer. To ensure continued low and stable inflation, the BSP implements measures to siphon off these pesos. The BSP pays interest on these funds that are mopped up. Funds placed with the reverse repurchase (RRP) window are paid 3.5 percent while those placed with the special deposit account (SDA) facility make 2.0 percent. On the other hand, the BSP earns lower interest income from the investment of its international reserves, as global interest rates have declined to their historic lows.

Instead of allowing inflation to adversely affect the whole economy, the BSP absorbs the cost of managing inflation through its balance sheet. This is similar to preventing floods from spilling across an entire city by containing floodwaters within a reservoir.

WHAT WE HAVE ACHIEVED

The BSP's stabilization measures have been successful: it has provided a stable environment for our economy to expand and for our people to preserve their purchasing power.

However, this has come at a price. The BSP's losses have been eroding its capital. The BSP needs to increase its capitalization to strengthen its balance sheet to promote price and financial stability in the context of the growing Philippine economy.

The following points should be considered in assessing the BSP's financial position:

- Need for more capital. The BSP's present authorized capital of P50 billion was set way back in 1993 or 20 years ago. This is no longer appropriate given the growth in size and scale of the Philippine economy and the financial system.
- BSP pays taxes on transactions arising from its core functions.

- Lack of burden sharing arrangement for losses. The BSP's charter provides for mandatory remittance of 75% of its net income to the Bureau of the Treasury. However, there is no burden sharing arrangement with respect to losses incurred. Thus, when the BSP makes a profit, the BSP by law has to share its gains with the National Government (NG) by remitting 75 percent of its net income to the Bureau of the Treasury as dividends. However, when the BSP incurs a loss that reduces its capital, there is no arrangement between the BSP and the NG on the replenishment of its eroded capital.

So far, the National Government has remitted P40 billion in paid-up capital to BSP out of its authorized capital stock of P50 billion.

In turn, the BSP has paid P154 billion in dividends and taxes to the National Government since its creation in 1993 and nurtured the BSP into a P4-trillion institution in terms of assets.

WHAT WE CAN DO

To address these constraints, the BSP is proposing amendments to its charter, the highlights of which include:

- Increasing the BSP's authorized capital from P50 billion to a higher level commensurate with the expansion in the size of the economy and the financial system;
- Setting up of a formal arrangement on the sharing of gains and losses between the NG and the BSP;
- Restoring the BSP's ability to issue its own debt securities to enable it to siphon excess money supply from circulation;
- Allowing the BSP to set up reserves to absorb losses from foreign exchange fluctuations; and
- Granting tax exemption to the BSP.

The passage of legislation amending the BSP charter as proposed will provide the BSP greater ability and flexibility to carry out its mandate to maintain macroeconomic stability that will sustain growth that is more balanced, more sustainable, and more inclusive. The BSP looks forward therefore to engaging our lawmakers in addressing these concerns.