Bangko Sentral ng Pilipinas

MANILA

OFFICE OF THE GOVERNOR

22 March 2006

Mr. APOLINAR G. SUAREZ, JR.
President
Philexport Cebu
Cebu City

Dear Mr. Suarez, Jr.:

Thank you for providing us with a copy of the position paper of the Confederation of Philippine Exporters Foundation (Cebu) Inc., entitled "On the Negative Effects of the Strengthening Philippine Peso" dated 8 March 2006. The BSP fully recognizes the impact of the strong peso on the export sector. At the same time, we may also need to look at the other side of the issue.

The appreciation of the peso brings several benefits to the Philippine economy. First, a stronger peso can help dampen inflationary pressures arising from increases in international prices of imported commodities, notably oil. For example, domestic prices of diesel and gasoline were rolled back 7 times and 6 times, respectively, in the last quarter of 2005, due to both the appreciation of the peso and the decline in international oil prices. Second, the National Government can realize savings from foreign debt servicing when the currency strengthens. For 2005, it is estimated that the strengthening of the peso has led to about ₱1.6 billion in interest payment savings by the National Government. These savings can be used to augment funds for various economic programs and reduce future public borrowing requirements.

Moreover, it is important to realize that the recent appreciation of the peso simply reflects the favorable outlook on the economy's prospects as this has been driven in part by the inflows of both foreign direct equity and portfolio investments. This is validated by the decision of CalPERS' (California Public Employees Retirement System) to retain the Philippines on its list of permissible investment markets and the sovereign credit rating outlook upgrades by S&P and Fitch from negative to stable on 9 and 13 February 2006, respectively.[1]

At the same time, an appreciating peso also presents challenges. As you correctly indicated in your position paper, exporters could find themselves less competitive in the global marketplace as exports become more expensive in dollar terms. However, our exporters have to be advised that other currencies in the region have also been strengthening against the US dollar. This process tends to dampen or even offset the loss in price competitiveness arising from the peso appreciation. We do realize that apart from the exporters, other sectors of the economy which may be hurt by a strong peso include the beneficiaries of OFW remittances, domestic producers of import substitutes and the tourism sector.

Given this reality, the BSP has focused on its own mandate which is keeping prices stable to help enhance the price competitiveness of our exports. Any price advantage that may be gained from a weakening of the peso may be eroded if domestic price increases accelerate. Thus, the exchange rate policy is likewise anchored on our main mandate of price stability. The BSP supports a market–determined exchange rate, with some scope for occasional BSP action to dampen sharp fluctuations in the exchange rate. On such occasions, the BSP takes the opportunity to provide indicative guidance to the foreign exchange market. This is intended to maintain order and stability in the foreign exchange market to mitigate possible adverse effects of significant exchange rate fluctuations on inflation and inflation expectations. When warranted, the BSP stands ready to provide some liquidity and ensure that legitimate demands for foreign currency are met.

The BSP also supports our domestic manufacturers by broadening access of businesses to credit through the peso rediscount facility which has a rediscount rate that is based on Treasury bill rates. The BSP likewise established the Exporters Dollar and Yen Rediscount Facility (EDYRF). The BSP sets aside a budget of $500 million for this facility. The peso rediscount facility as well as the EDYRF allow banks to rediscount their existing loans to exporters, thus freeing-up funds which the banks can use for further lending operations. Furthermore, the BSP is currently studying the possibility of increasing its contribution to the export promotion program of the Export Development Council. Other government agencies may also be tapped to provide additional funds for the program.

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[1] CalPERS, the largest US pension fund, also lifted the country's investment ranking from 18 to 14 among 26 emerging countries, ahead of countries like Malaysia, China, Russia, and India.

It may also be important to recognize that the long-term performance of the export sector is not determined by price competitiveness alone. It is quite clear that reforms to increase productivity are important in raising our overall competitiveness. In this regard, the efforts to develop the export sector could focus on improving key areas such as power and transportation infrastructure and labor skills. Moreover, market intelligence and promotion activities could be further enhanced for our products to capture greater market share in key markets. The exporters may also start exploring financial derivatives to hedge any potential loss from any currency adjustment in the course of the year.

In sum, the BSP is aware of the challenges faced by the export sector and continues to build a close working relationship with the sector. The BSP's main contribution is in the achievement of price stability and the promotion of an efficient financial system. The economic policymakers recognize the valuable contribution of the exporters to our economy in terms of generating both foreign exchange and employment. The BSP is always prepared to assist the export sector in anyway it can within its legal mandate.

Very truly yours,

AMANDO M. TETANGCO, JR.
Governor