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The Only Game in Town: Assessing Monetary Policy Tools in Response to COVID-19

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"I know it's crooked, but it's the only game in town."

- Neil Gaiman, *American Gods* (2001)

The COVID-19 crisis has prompted central banks around the world to take unprecedented monetary actions to cushion the economic impact of the pandemic. Most central banks have taken proactive steps to introduce policy measures meant to ensure sufficient liquidity and access to credit. This approach is best described as "whatever it takes"—famously [coined by Former European Central Bank \(ECB\) President Mario Draghi in 2012](#).

The "whatever it takes" approach is seen in the plethora of tools introduced by various central banks in response to the crisis. Apart from conventional tools such as the policy interest rate and reserve requirement ratio, central banks—particularly those in developed markets—have taken to unorthodox methods to fulfill their mandate. The US Federal Reserve cut rates to near zero-percent, committed to buying corporate bond exchange traded funds, and expanded its municipal liquidity facility. The ECB announced a pandemic emergency purchase program amounting to EUR 750-billion. The Bank of Australia ventured into targeting the three-year Australian government bond yield at 0.25-percent and introduced a term funding facility to lower funding costs for the broad banking system.

For its part, the Bangko Sentral ng Pilipinas (BSP) purchased PhP 300-billion in government securities from the Treasury, on top of cutting the policy rate by 125 basis points to 2.75-percent and reducing the reserve requirement ratio by 200 basis points to 12.0-percent. BSP Governor Benjamin Diokno said that ["we will do everything necessary to avoid a recession in the Philippines"](#) and that the Philippine central bank has more tools in its arsenal to combat the economic fallout from COVID-19 ("Philippines vows to 'do everything necessary' to avoid recession," *Financial Times*, 01 April 2020).

It is known that monetary policy actions come with a "lag"—the Bank for International Settlements estimates [such lag to last for about five to six quarters](#) for Australian farm and non-farm output. Hence in the current context, the effects of the actions by central banks will likely be felt in the next one to two years, when global economies are supposedly in the recovery stage.

Worth exploring also, however, is the "reach" of these policy tools to the real economy, which are primarily realized in the form of credit and eventually in domestic demand. Despite the extraordinary measures taken by central banks, financial institutions are in a precarious situation and will likely be cautious with lending activities—largely driven by concerns on loss provisioning and non-performing loans. As a result, the supposed impact of monetary stimulus is thinned by its transmission mechanism.

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Consider the case of the Philippines following the 1997 Asian financial crisis and 2008 global financial crisis. From 1997 to 1999, the BSP slashed the reverse-repurchase policy rate (RRP) by almost half, from 15.0-percent to 8.75-percent. During this time period, the BSP also trimmed the reserve requirement ratio (RRR) from 14.0-percent to 9.0-percent. Similarly, from 2007 to 2009, the BSP cut the RRP from 7.5-percent to 4.0-percent and the RRR from 10.0-percent to 8.0-percent (Figures 1 and 2, page 2).

Figure 1. BSP Reverse Repurchase Facility Interest Rate (1993-2019)

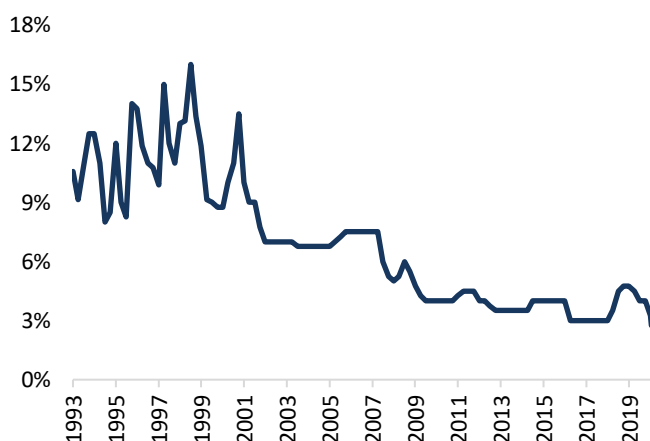
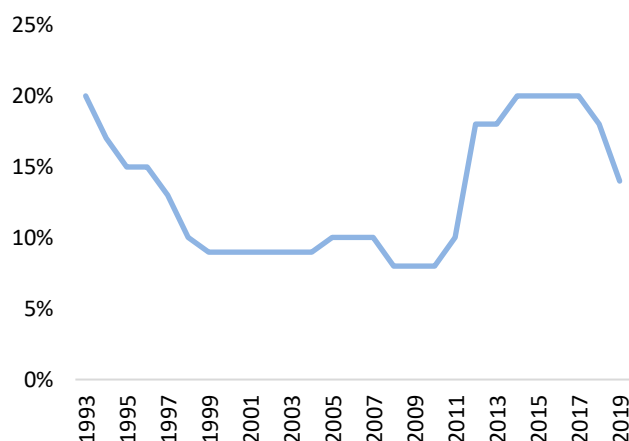


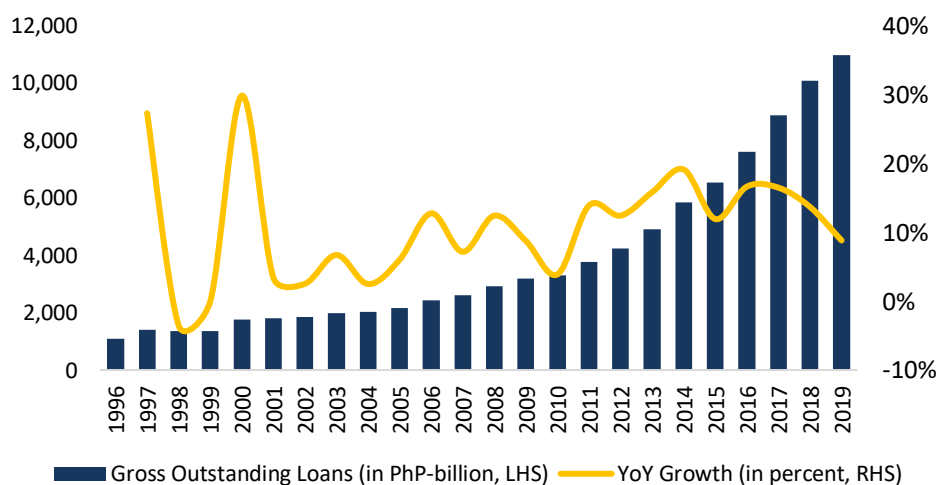
Figure 2. BSP Reserve Requirement Ratio (1993-2019)



Sources: Bangko Sentral ng Pilipinas, Bank for International Settlements

Despite these actions to improve domestic credit conditions in 1997 to 1999 and 2007 to 2009 however, BSP data shows that loan growth in ensuing years was relatively weak (Figure 3). Loan growth stood at -3.6-percent in 1998 and 0.0-percent in 1999. Meanwhile, system loan growth decelerated to 8.7-percent in 2009 and 3.9-percent in 2010, from 12.7-percent in 2008. Notably, the Philippines did not see a meaningful acceleration in credit growth until 2000 and 2011—approximately three years after the peaks of those respective crises (Figure 3).

Figure 3. Philippines Gross Outstanding Loans (1996-2019)



Source: Bangko Sentral ng Pilipinas

On a sectoral basis, mining and quarrying, community, social, and personal activities, trade, and manufacturing experienced the highest reduction in outstanding loans in 2009, with their loan books contracting by 38.9-percent, 21.6-percent, 20.2-percent, and 18.2-percent respectively. Notable also is how the outstanding loans of the fishing, education, and community sectors contracted for two consecutive years in 2009 and 2010.

Table 1. Philippine Financial System Gross Outstanding Loans by Sector (2007-2009)

| | Gross Outstanding Loans (in PhP-billion) | | | | Year-on-Year Growth Rate (in percent) | | |
|---|---|--------------|--------------|--------------|--|------------|------------|
| | 2007 | 2008 | 2009 | 2010 | 2008 | 2009 | 2010 |
| Agriculture | 136 | 337 | 358 | 405 | 148.4 | 6.3 | 13.2 |
| Fishing | 10 | 7 | 6 | 5 | -28.6 | -14.5 | -13.6 |
| Mining and Quarrying | 11 | 10 | 6 | 16 | -11.9 | -39.0 | 176.9 |
| Manufacturing | 392 | 418 | 342 | 403 | 6.7 | -18.2 | 17.7 |
| Electricity, Gas & Water | 124 | 140 | 148 | 170 | 13.1 | 5.3 | 15.0 |
| Construction | 36 | 41 | 33 | 36 | 14.3 | -20.3 | 11.1 |
| Wholesale, Retail, Trade & Repair | 279 | 279 | 289 | 303 | 0.1 | 3.7 | 4.9 |
| Hotel and Restaurant | n.d. | 25 | 32 | 39 | n.d. | 30.4 | 19.1 |
| Transportation, Storage & Communicatiuon | 98 | 121 | 159 | 155 | 23.5 | 31.7 | -2.6 |
| Financial Intermediation | 797 | 616 | 823 | 717 | -22.7 | 33.5 | -12.8 |
| Real Estate, Renting & Business Activities | 290 | 400 | 448 | 497 | 37.9 | 11.9 | 11.0 |
| Public Administration & Defense: Compulsory Social Security | 39 | 55 | 67 | 68 | 40.2 | 22.3 | 1.0 |
| Education | 15 | 17 | 17 | 16 | 11.2 | -1.4 | -3.2 |
| Health & Social Work | 11 | 13 | 15 | 15 | 13.8 | 14.4 | -0.1 |
| Other Community, Social & Personal Activities | 173 | 122 | 96 | 88 | -29.4 | -21.6 | -7.5 |
| Private Households with Employed Persons | 174 | 43 | 37 | 42 | -75.4 | -13.0 | 12.7 |
| Others | 18 | 281 | 304 | 326 | 1441.7 | 8.4 | 7.2 |
| Total | 2,603 | 2,924 | 3,180 | 3,303 | 12.4 | 8.7 | 3.9 |

Source: Bangko Sentral ng Pilipinas; n.d. stands for "no data"

Note: Values for gross outstanding loans include memo items (e.g. interbank loans, loans and receivables arising from repurchase agreements).

From these observations on credit growth post-Asian financial crisis and post-global financial crisis, four conclusions arise on how to further stimulate lending activity and effectively induce domestic demand amid COVID-19.

First, the Bangko Sentral should not hesitate to introduce unorthodox policy actions (e.g. additional asset purchases), if these will boost confidence in debt markets and stimulate credit activity. While it is expected that central banks from emerging markets such as the Philippines will stick to a conservative playbook, unconventional methods such as additional asset purchases may be warranted in light of the unprecedented collapse ensuing from the pandemic.

Second, the national government should maximize its credit guarantee facility to promote lending activity in the private sector amid heightened concerns of default and inability to pay financing costs; these government-backed guarantees will provide lenders with stamps of confidence and assurance. There is currently [PhP120-billion worth of guarantees via the Philippine Guarantee Corporation \(PhilGuarantee\)](#); the Bayanihan to Heal as One Act enables the government to expand the size of this credit facility. Credit guarantees may prove to be an effective lifeline for the Philippine government to extend to MSMEs and large corporates in hard-hit industries.

Third, successful passage of the Financial Institutions Strategic Transfer (FIST) Act in Congress will likely aid the Bangko Sentral in fulfilling its mandate via its transmission mechanism. The FIST Act will provide relief on the balance sheets of financial institutions as it allows for the transfer of distressed assets to a special purpose vehicle, alongside time-bound fiscal incentives. Such provision is likely to relieve pressure on non-performing loans and loss provisions, thus providing leeway for incremental lending activity. According to BSP Governor Diokno, the FIST Act is [“a necessary measure to assist the domestic financial system in the aftermath of this health crisis”](#) (“BSP: Proposed FIST law to buttress PH banks even if bad loans double,” *The Philippine Daily Inquirer*, 22 May 2020).

Lastly, while monetary policy plays an important role in the recovery path of the economy, it is [“not the only game in town,” as qualified by Governor Diokno](#). The “main game in town” is arguably in the arsenal of fiscal policy; it is a consensus among central bankers that the more relevant stimulus to rise from this pandemic is fiscal in nature. Looser monetary conditions will help facilitate growth, but it is fiscal stimulus that is central to reviving domestic demand. According to Federal Reserve Chair Jerome Powell, [“additional fiscal support could be costly, but worth it if it helps avoid long-term economic damage and leaves us with a stronger recovery”](#) (“Fed Chair Warns the Economy May Need More as Congress Hesitates,” *The New York Times*, 13 May 2020).

A [previous policy brief](#) stated that the Philippine government should adopt a “whatever it takes” approach for COVID-19 public spending. It is paramount that the government apply the same approach taken by central banks in delivering a much-needed strong fiscal response.

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