

# BSP UNBOUND

Central Banking and the COVID-19  
Pandemic in the Philippines

BANGKO SENTRAL NG PILIPINAS





**BSP UNBOUND:**  
**Central Banking and the COVID-19 Pandemic in the Philippines**

## About the Cover

The line diagram is a stylized representation of the impact of the COVID-19 pandemic on workplace activity in the Philippines. It is based on the Google COVID-19 Community Mobility Report graph that tracked the percentage change in the number of workplace visitors in the Philippines from mid-February to early October relative to the median value between early January 3rd and February 6th 2020. The graph shows a sharp drop immediately after the imposition of a lockdown in Metro Manila and the rest of Luzon in mid-March, and a gradual if uneven recovery in the following months. The stark image brings to mind the International Monetary Fund (IMF)'s warning that many countries face a "long ascent" as they recover from the worst effects of the global public health emergency. *Illustration and cover design by Beatrice Anne Belen-Ferrer and Dennis Q. Catacutan.*





**BSP Unbound:  
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in the Philippines**

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## ABBREVIATIONS

4Ps - Pantawid Pamilyang Pilipino Program

Ab - Antibody

ACH - Automated Clearing House

ACPC - Agricultural Credit Policy Council

AE - Advanced Economy

AFC - Asian Financial Crisis

AFCS - Automated Fare Collection System

AGFP - Agricultural Guarantee Fund Pool

AIIB - Asian Infrastructure Investment Bank

AKAP Program - Abot-Kamay ang Pagtulong Program

ANOVA - Analysis of Variance

APoP - Authority and Proof of Purchase

APPEND - Alliance of Philippine Partners for Enterprise Development, Inc.

ARISE Act - Accelerated Recovery and Investments Stimulus for the Economy of the Philippines Act

ARISE, Inc. - Accelerating Recovery to Intensify Solidarity and Equity, Inc.

ASEAN - Association of Southeast Asian Nations

ASF - African Swine Flu

ATM - Automated Teller Machine

AVCF - Agriculture Value Chain Financing

BAC - Bids and Awards Committee

BAP - Bankers Association of the Philippines

BCP - Business Continuity Plan

BDA - Basic Deposit Account

BIS - Bank for International Settlements

BLU - Branch-Lite Unit

BOP - Balance of Payments

bp - Basis Point

BPO - Business Process Outsourcing

BSFI - BSP-Supervised Financial Institutions

BSOS - Banking Sector Outlook Survey

BSP - Bangko Sentral ng Pilipinas

BTCA - Better Than Cash Alliance

BTr - Bureau of the Treasury

BYOD - Bring Your Own Device

CAM - Consumer Assistance Mechanism

CAMS - Consumer Assistance Management System

CAR - Capital Adequacy Ratio

CBP - Central Bank of the Philippines

CCAP - Credit Card Association of the Philippines

CCB - Capital Conservation Buffer

CCyB - Countercyclical Capital Buffer

CDS - Credit Default Swap

CEG - Consumer Empowerment Group

CFM - Capital Flows Measures

CFP - Contingency Funding Plan

CICO - Cash-In and Cash-Out

CIO - Chief Information Officer

CLIA - Center for Learning and Inclusion Advocacy

CO - Communication Office

COVID-19 - Coronavirus Disease 2019

CRD - Credit Risk Database

CSF - Credit Surety Fund

CSS - Corporate Services Sector

D-SIB - Domestic Systematically Important Banks

DA - Department of Agriculture

DBCC - Development Budget Coordination Committee

DBP - Development Bank of the Philippines

DDA - Demand Deposit Account

DepEd - Department of Education

DFS - Digital Financial Services

DGS - Department of General Services

DIC - Data and Information Classification

DOF - Department of Finance

DOH - Department of Health

DOLE - Department of Labor and Employment

DOT - Department of Tourism

DOTr - Department of Transportation

DSSI - Debt Service Suspension Initiative

DST - Documentary Stamp Tax

DSWD - Department of Social Welfare and Development

DTI - Department of Trade and Industry

EBIT - Earnings Before Interest and Taxes

ECL - Expected Credit Loss

ECLAC - Economic Commission for Latin America and the Caribbean

ECQ - Enhanced Community Quarantine

EDYRF - Exporters Dollar and Yen Rediscount Facility

EFLC - Economic and Financial Learning Center

EM-DAT - The Emergency Events Database

EMBI - Emerging Market Bond Index

EME - Emerging Market Economies

EMEAP - Executives' Meeting of Asia-Pacific Central Banks

EMI - Electronic Money Issuer

EPFS - Electronic Payment and Financial Services

EPU - Economy, Policy and Uncertainty

EWI - Early Warning Indicators

FCL - Flexible Credit Line

FCP - Financial Consumer Protection

Fed - Federal Reserve

FI - Financial Institution

FIA - Foreign Investment Act

FIST - Financial Institutions Strategic Transfer

FISTC - Financial Institutions Strategic Transfer Corporations

FMED - Facilities Management and Engineering Department

## ABBREVIATIONS

FMI - Financial Market Infrastructure	IDA - International Development Association	MS - Management Systems
FMOSS - Financial Market Operations Sub-Sector	IFI - International Financial Institution	MSME - Micro, Small and Medium Enterprises
FSCC - Financial Stability Coordination Council	IMF - International Monetary Fund	NBFI - Non-Bank Financial Institution
FSPC - Financial Stability Policy Committee	IMT - Incident Management Team	NBQB - Non-Bank with Quasi Banking Functions
FSS - Financial Supervision Sector	IQA - Independent Quality Assessment	NDF - Non-Deliverable Forward
FX - Foreign Exchange	IRC - Interest Rate Corridor	NDRRMC - National Disaster Risk Reduction and Management Council
FXI - Foreign Exchange Intervention	IRO - Investor Relations Office	NEA - New Economy Arrangement
GCQ - General Community Quarantine	IRR - Implementing Rules and Regulations	NEDA - National Economic and Development Authority
GDP - Gross Domestic Product	ISSP - Information Systems Strategic Plan	NG - National Government
GEPU - Global Economic Policy Uncertainty	IT - Information Technology	NIRP - Negative Interest Rate Policy
GFC - Global Financial Crisis	ITO - Information Technology Office	NLEX - North Luzon Expressway
GFI - Government Financial Institutions	ITSG - IT Security Group	NNA - New Normal Arrangements
GFSN - Global Financial Safety Net	JICA - Japan International Cooperation Agency	NPA - Non-Performing Assets
GHS Index - Global Health Security Index	KYC - Know Your Customer	NRoSS - National Registry of Scrippless Securities
GNI - Gross National Income	LBP - Land Bank of the Philippines	NRPS - National Retail Payment System
GOCC - Government-Owned and Controlled Corporation	LCR - Liquidity Coverage Ratio	NSFR - Net Stable Funding Ratio
GPM - Global Protection Model	LDC - Least Developed Countries	OECD - Organisation for Economic Co-operation and Development
GPPB - Government Procurement Policy Board	LGU - Local Government Unit	OF - Overseas Filipino
GS - Government Securities	LTNCD - Long-Term Negotiable Certificate of Deposit	OFW - Overseas Filipino Worker
GSIS - Government Service Insurance System	MB - Monetary Board	OMO - Open Market Operations
GUIDE Bill - GFIs Unified Initiatives to Distressed Enterprises for Economic Recovery Bill	MCPI - Microfinance Council of the Philippines, Inc.	OPS - Operators of Payment Systems
HoPE - Head of Procuring Entity	MDB - Multilateral Development Bank	OSRM - Office of Systemic Risk Management
HQLA - High-Quality Liquid Assets	MECQ - Modified Enhanced Community Quarantine	OTC - Over-The-Counter
HR - Human Resource	MEM - Multi-Equation Model	P2M - Person-to-Merchant
HWD - Health and Wellness Department	MERS - Middle East Respiratory Syndrome	P2P - Person-to-Person
I-O - Input-Output	MFA - Multi-Factor Authentication	Pag-IBIG Fund - Home Development Mutual Fund
IATF-EID - Inter-Agency Task Force for the Management of Emerging Infectious Diseases	MFI - Microfinance Institution	PAMPh - Policy Analysis Model for the Philippines
IATF-TWG-AFP - Inter-Agency Task Force Technical Working Group for Anticipatory and Forward Planning	MGCQ - Modified General Community Quarantine	PDEx - Philippine Dealing & Exchange Corp.
IBCL - Interbank Call Loan	MLR - Minimum Liquidity Ratio	PESONet - Philippine Electronic Fund Transfer System and Operations Network
ICT - Information and Communication Technology	MM - Money Multiplier	PFRS - Philippine Financial Reporting Standards
	MOS - Monetary Operations Systems	
	MPM - Macprudential Measure	

## ABBREVIATIONS

PH-PROGRESO - Philippine Program for Recovery with Equity and Solidarity

PhilGuarantee - Philippine Guarantee Corporation

*PhilPaSS* - Philippine Payment and Settlement System

PhilSys - Philippine Identification System

PIPS - Prominently Important Payment System

PMI - Purchasing Manager's Index

PPE - Personal Protective Equipment

PPMI - Philippine Payments Management, Inc.

PPSA - Personal Property Security Act

ppt - Percentage Point

PR - Purchase Requisition

PRC - Philippine Red Cross

PrO - Procurement Office

PSA - Philippine Statistics Authority

PSEi - Philippine Stock Exchange Index

PSO - Payments and Settlements Office

PSOF - Payment System Oversight Framework

PSP - Payment Service Provider

QE - Quantitative-Easing

QMS - Quality Management System

QR Code - Quick Response Code

RA - Republic Act

RC - Remittance Channel

RCB - Rural and Cooperative Bank

RCO - Risk and Compliance Office

RDP - Remote Desktop Protocol

repo - Repurchase

REST - Real Estate Stress Test

RFA - Regional Financing Arrangement

RR - Reserve Requirement

RRP - Reverse Repurchase

RRR - Reserve Requirement Ratio

RT-PCR - Reverse Transcription Polymerase Chain Reaction

RTGS - Real-Time Gross Settlement

SAFr - Supervisory Assessment Framework

SAP - Social Amelioration Program

SARS - Severe Acute Respiratory Syndrome

SBCorp - Small Business Corporation

SBL - Single Borrowers Limit

SBWS - Small Business Wage Subsidy

SCBA - Self-Contained Breathing Apparatus

SCF - Supply Chain Financing

SEC - Securities and Exchange Commission

SIPS - Systematically Important Payment System

SMO - Systems and Methods Office

SOC - Security Operations Center

SPC - Security Plant Complex

SPV - Special Purpose Vehicle

SRCM - Systemic Risk Crisis Management

SSD - Security Services Department

SSS - Social Security System

STG - Sub-Tasks Groups

T-bill - Treasury bill

TB - Thrift Bank

TDF - Term Deposit Facility

TPPSP - Third-Party Payment Service Provider

TRISD - Technology Risk and Innovation Supervision Department

TSA - Treasury Single Account

TSP - Third-Party Service Provider

UAE - United Arab Emirates

UBP - Union Bank of the Philippines

UITF - Unit Investment Trust Fund

UK - United Kingdom

UKB - Universal and Commercial Bank

UMP - Unconventional Monetary Policy

UNISDR - United Nations International Strategy for Disaster Reduction

US - United States

VAR - Vector Autoregression

VCE - Virtual Currency Exchange

VIX - Chicago Board Options Exchange Volatility Index

VPN - Virtual Private Network

WB - World Bank

WEO - World Economic Outlook

WFH - Work-From-Home

WHO - World Health Organization

WinPro 10 - Microsoft Windows 10 Professional

WMOR - Weighted Monetary Operations Rate

WUI - World Uncertainty Index

WUI-APAC - World Uncertainty Index for Asia and the Pacific

YoY - Year-on-Year

ZLB - Zero-Lower Bound

## FOREWORD

## Central Banking and the BSP in the Time of COVID-19

Governor Benjamin E. Diokno, Ph.D.

The Bangko Sentral ng Pilipinas (BSP) is no stranger to crisis.

The two major crises in recent memory—the Global Financial Crisis and the Eurozone’s banking-and-sovereign-debt crisis—have changed the complexion of central banking. It was during these times that we witnessed experiments of advanced economies with extraordinary monetary policy measures, whose vestiges remain at the onset of the COVID-19 pandemic.

Clearly, disruptions present important lessons in crisis planning and underline the need for prudence and disciplined policy making—reforms included. The pace of financial market reforms was hastened in the aftermath of the crises. Foreign exchange reserves were also built up as protection against external downdrafts.

This is the reality that I was stepping into as BSP Governor. And as a reformist at my core, I was in comfortable territory. I was prepared to bring about reform anywhere I am. However, I would discover that today’s circumstances demand we implement reforms in record time and under the most trying environment.

Almost a year into my tenure as BSP Governor, I was invited by the President to join him at the North Luzon Expressway (NLEX) Harbor Link C3-R10 section inspection. Nobody knew it then, but this would mark one of the earliest milestones of the COVID-19 pandemic in the Philippines.

On 7 March 2020, the first local transmission of the virus was confirmed. This was two days after the event where all attendees were advised to self-quarantine because of exposure to an individual with COVID-19 during the inspection.

But even during quarantine, there was no time to waste.

The BSP immediately went to work as the world was entering a new era with the COVID-19 pandemic disrupting old ways of doing things. The colossal epidemic exposed deficiencies in public health systems and crippled real activity around the world, at a time when global politics is in a state of flux.



As economies came to grips with the severity of its impact, central banks suited up and aggressively unrolled their policy toolkit as defense against systemic collapse. Central banks were among the first responders—departing from the usual gradualist approach.

Central banks implemented deep policy rate cuts, larger-than-normal liquidity injections, expansion of lending facilities and massive asset purchases that extend to non-financial corporate sectors in some jurisdictions. These were complemented by regulatory relief measures. These extraordinary measures bought time for the government to rescale and redesign its war plan against the pandemic.

There are now significant undercurrents in the central banking paradigm. Many advanced economies entered the pandemic with policy rates at the effective lower bound. Thus, what used to be temporary unconventional measures have become the primary mechanisms for achieving the central banks’ objectives in many advanced economies.

Emerging market economies (EMEs) have implemented smaller-scale unconventional measures, most of which are targeted and time-bound. At the same time, policymakers need to keep a tight balance between steering expectations towards their preferred policy direction and creating unnecessary expectations that are difficult to disengage from in the future.

Like other EMEs, the Philippines was not a mere bystander. We waded through the murky pandemic waters more exposed to disruptive amplification of financial market volatilities. The BSP, in performing its mandates of maintaining price stability and protecting financial stability and payments systems, moved swiftly to prevent the initial onslaught of the pandemic from damaging the financial system. The duration and breadth of the pandemic required policy stamina and adroitness in coordinating multiple policies in a cohesive manner.

The COVID-19 crisis cut the deepest since the Asian financial crisis in 1997-1998. Economic activities came to a screeching halt as community quarantines were

enforced. Our robust macroeconomic fundamentals and regulatory buffers, products of a long history of structural reforms, served us well.

We started our policy rate cut as early as February. When the community quarantine was imposed on March 17, 2020, nervous market participants aggressively sold their government securities (GS), leading to a sharp rise in GS yield and a plunge in daily trading volumes. As tax revenues plummeted, the GS sell-off reduced the availability of immediate funds for the government's massive health and social safety net programs.

With the authority allowed by the new BSP Charter, we extended emergency financing to the national government through a repurchase agreement and opened a daily one-hour window for purchasing GS in the secondary market.

Financial institutions were granted a wide range of regulatory and operational relief measures. To encourage lending to micro, small and medium enterprises (MSMEs), we reduced reserve requirements and allowed MSME loans to qualify as compliance with the required reserve ratio. In August, we eased the real estate loan limit of universal and commercial banks but maintained the soft limits on real estate risk exposures that banks can demonstrably manage.

As of early September, the BSP has deployed approximately ₱1.3 trillion worth of policy support measures. Our monetary policy tools and regulatory space are far from exhausted. But they are not limitless. When we deploy our policy ammunition, our action has always and will remain evidence-based with due consideration to trade-offs and unintended consequences. We must not deplete our policy levers even as we endeavor to remain responsive and prompt in our policy actions.

While COVID-19 may have disrupted the progress of current programs, it also quickened the pace of reform implementation. What were previously medium- to long-term reforms are now front and center in the crisis recovery plan. These include the modernization of the country's public health system; massive upgrading of the information and communications technology (ICT) infrastructure; modernization of Philippine agriculture and the government's supply chain management system; and strengthening our educational and skills development system to future-proof our workforce.

My goal to shift at least 50 percent of payment transactions into digital form has also been fast-tracked because of the pandemic. With various quarantine measures being observed and physical distancing as a norm during this time, electronic means of payment has been essential. This is evident in the substantial increase in transactions in PESONet and InstaPay, the two automated clearing houses (ACHs) formed under the National Retail Payment System (NRPS).

In performing our sworn duty to the nation, tighter policy coordination while safeguarding our independence is necessary. As we battle the crisis at all fronts,

we also face the challenge of communicating our policy actions. There is less scope for ambiguous narratives. Instead, communication must be prompt, clear, decisive and truthful to avert confidence problems. We have deployed more nuanced communication techniques that are tailored to specific information requirements of different stakeholders.

At the organizational level, agility in adapting to the abrupt changes is key to survival. Suddenly, the future of work has arrived at our doorstep. Our service delivery routes have been transformed; our traditional systems and processes have been upended to give way to better and smarter ones.

As we overhaul the infrastructure facility that supports the rapidly evolving systems and processes, human resources remain the cornerstone of our identity. Our people shape the direction of organizational reforms that the BSP is currently pursuing. The same principle applies to our efforts in enhancing the digitalization of financial services for the common Filipinos.

Optimism, caution and disciplined action define our character as an institution. We will endeavor to ensure that our monetary policy framework and policy agenda remain relevant and agile as we steer through the pandemic. We remain steadfast in pursuing continuity, preserving our credibility and undertaking well-considered reforms as we carry out our mandates of price stability, financial stability and efficient payments and settlements system.

This encapsulates the theme that resonates in the articles written by BSP staff. This book chronicles our early journey in pandemic response, the lessons we continuously learn and unlearn, and the challenges we face after the threat of the pandemic has receded.

But we cannot squander the wave of reform momentum that has been painstakingly built over several decades. We must ride it to usher in the new economy and put the COVID-19 crisis—much like the crises that came before it—behind us.

In any case, the BSP remains a vanguard of firmness and maturity of policies in support of sustainable and inclusive economic growth, not just for the present but the future.



# Central Banks and Crises: Keeping a Step Ahead of Uncertainty

Nickson J. Cabote, Vic K. Delloro and Laura L. Ignacio\*

CHAPTER  
**ONE**



*we don't know when or from where the next crisis will come,  
but it will surely come.*

— a popular aphorism on the Great Financial Crisis  
(McKenzie and Tasky, 2020)

## 1. Introduction

Crises are inevitable—the only certainty, in fact—but pronouncements on their nature, breadth or timeline require some form of divination. How then does one prepare for what one does not know? Wisdom and experience suggest that the best response to uncertainty is readiness and resilience—the two pillars on which central banks' crisis frameworks are built.

The financial system is the lifeblood of the economy—providing the means to make payments for the exchange of goods and services; managing savings and providing households and firms with funds for investments; and assessing and managing financial risks. A stable financial system is critical for economic growth—it allows for a functioning economy even when macroeconomic conditions are less than ideal. One of the fundamental tasks of central banks is to maintain and promote the stability of the financial system.

## 2. Safeguarding the financial system: Central banks' crisis management frameworks

The financial system, through the financial markets, financial institutions and processes, enables transactions necessary for the economy to function. An essential task of financial authorities, particularly the central bank, is to maintain the confidence of the public—households and businesses—in the financial system. This is critical in a crisis—a loss of trust may result in large withdrawals and asset sales that compel central banks to increase liquidity to keep the financial system working.

It, therefore, falls upon the central bank to assure the public by sustaining the stability and building the resilience of the financial system. Resilience does not

only mean adequate capital and sufficient liquidity. It also entails operational flexibility or the ability of financial institutions, financial market infrastructure<sup>1</sup> and the financial system as a whole “to prevent, adapt and respond to, recover and learn from, operational disruption” (BoE, 2018).

Central banks must develop crisis management frameworks and business continuity management plans (McKenzie and Tasky, 2020). A crisis management framework includes the identification, mitigation, reporting and monitoring of both financial and non-financial risks. A business continuity management plan, on the other hand, lists measures to ensure the continuation of critical operations and the safeguard of employees during crises. While central banks carry out their own business continuity management plans in the midst of a crisis, they must also make sure that supervised financial institutions are properly implementing theirs.

Preparing for a crisis is not that simple, though. For one, a crisis is a low-probability event. Management may be reluctant to plan and spend resources for a far-fetched event (Crandall et al., 2010) but should realize that a crisis with a low probability can be highly damaging. Moreover, plans do not always lead to the expected outcomes, especially in the financial markets where market players may be irrational and “markets are... prone to excesses, manipulations and fickleness” (Yunus, 2015). Crisis management frameworks must have the flexibility to respond to a range of conditions.

Communication is an essential component of any crisis management framework by facilitating coordination and collaboration. In particular, it clarifies authorities' actions and policies to the public and market participants.

<sup>1</sup> A multilateral system, among participating institutions, including the operator of the system, used for the purposes of clearing, settling, or recording payments, securities, derivatives, or other financial transactions.

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Finally, crisis management frameworks recognize that responses vary depending on the type of crisis. Financial systems are occasionally hit by crises of financial origins such as the Asian Financial Crisis and the Global Financial Crisis. For financial crises, market surveillance plays a vital role. At other times, financial systems are struck by non-financial events such as natural disasters and pandemics. Crises have space and time dimensions (Crandall, et al., 2010). The impacts of a crisis may be limited within a locality or affect a wider region, an entire country, or even spread globally. Moreover, a crisis goes through stages or a life cycle—birth, an acute phase, which is the crisis, and an aftermath (Crandall et al., 2010).

### 3. Crises of financial origins

#### 3.1 Main factors driving financial crises

Financial crises can come from weaknesses in the private or public sectors' balance sheets, and their origins can be domestic or external. Notwithstanding its roots, a financial crisis is a combination of events. They include sizeable changes in credit volume and asset prices, stark interruptions in financial intermediation, especially a decrease in the supply of external financing, and massive balance-sheet problems. Often, they require significant government and international support (Claessens and Kose, 2013b).

While there are many factors influencing crises, they often occur after asset and credit booms. Indeed, busts, financial crises and weak growth go along with such expansions. Because of these types of associations, many researchers have written theoretical and empirical studies to explain the reasons for sharp changes in asset and credit markets (Brunnermeier, 2001 and Evanoff, Kaufman, and Malliaris, 2012 both cited in Claessens and Kose, 2013b). These studies distinguished among some proximate causes, such as financial liberalization, ineffective regulation and supervision, and inadequate interventions. However, many questions remain unanswered such as the factors that drive asset-price bubbles (Claessens and Kose, 2013b).

#### 3.2 Major types of financial crises

Although there are issues with dating, financial crises are quite common and likely cluster over time. They affect small and large countries as well as poor and rich ones. While there are many common causes, some authors have identified

specific theoretical factors and empirical determinants of each type of crisis (Goldstein and Razin, 2013). Claessens and Kose (2013a) classified crises into four groups, namely:

- **Currency crises.** A *currency crisis* consists of a speculative attack on the currency, which leads to a devaluation (or sharp depreciation). It can also compel authorities to defend the currency by drawing on its international reserves, or suddenly increase interest rates, or impose capital controls.
- **Sudden stops (in capital flows).** A capital account or balance of payments crisis usually occurs when there is a *sudden stop in capital inflows*—a massive (and unexpected) decline in international capital inflows or a sharp reversal in aggregate capital flows to a country.
- **Debt crises.** A country can experience a *foreign debt* crisis, either sovereign or private (or both), when it is unable to pay its external obligations. It can experience a *domestic public debt* crisis when it does not honor its domestic fiscal commitments in real terms. It can either default explicitly, or inflate or debase its currency, or resort to financial repression.
- **Banking crises.** In a *systemic banking crisis*, bank runs (actual or potential) and failures can cause banks to stop honoring their liabilities or require government intervention to prevent this by extending liquidity and capital assistance on a massive scale.

Transforming the predictions of theories into empirical applications remains a key challenge. Unlike currency crises and sudden stops, which can be identified using quantitative methods, the determination of debt and banking crises still relies on qualitative and judgmental decisions. Hence, the literature used a wide range of techniques in identifying and classifying crises (Claessens and Kose, 2013b).

Regardless of the classification employed, different types of crises often overlap. Many banking crises, for instance, are also linked to sudden stops and currency crises. The intersection of various types of crises creates additional challenges in identifying crises and assessing their underlying causes. Since banking and sovereign crises often overlap, it is hard to ascertain whether a banking crisis results in a sovereign crisis or vice versa (Claessens and Kose, 2013b).

### 3.3 Real and financial sector implications

Claessens and Kose (2013b) pointed out that crises have severe implications on the real and financial sectors and share commonalities across various types. Many crises exhibit recessions with significant output losses. Also, other macroeconomic variables usually record sizeable drops. Although there are variations concerning duration and severity, financial variables, such as asset prices and credit, often have the same quantitative patterns across crises. Aside from their negative short-run effects, financial crises usually have adverse medium- to long-run effects on activity.

Benigno et al. (2020) estimated a new model of the business cycle and focused on sudden stop crises. Utilizing Mexican data to analyze the duration of sudden stops, they reported substantial heterogeneity in crisis duration. They found that while the average conditional crisis duration is five consecutive quarters, some episodes lasted more than 20 quarters. They found evidence that for crises magnified by borrowing constraints, economic recovery may occur, albeit a sluggish one.

Chen et al. (2018) looked at a sample of 180 countries, which included advanced, emerging markets, and low-income developing nations, to quantify the reduction in economic activity ten years after the global financial crisis. The authors found that advanced economies and commodity-exporting low-income developing countries were hit harder compared to others. About 85 percent of the economies that experienced a banking crisis in 2007-2008 are still producing output below pre-crisis trends. They concluded that beyond the well-documented adverse effects on growth, the global financial crisis has long-term consequences, including a steeper decline in fertility rates in many economies and the decline in net migration rates among advanced economies.

### 3.4 Are financial crises demand or supply shocks?

Benguria and Taylor (2020) attempted to answer the fundamental macroeconomic question of whether financial crises are negative demand or supply shocks. They built a simple open economy model of deleveraging

shocks to households and firms (i.e., demand and supply shocks). They set up the model so that the behavior of the economy in response to shocks to firms or households would be different. On the one hand, firm deleveraging shocks reduce exports, keep imports largely the same and appreciate the real exchange rate. On the other hand, household deleveraging shocks tend to reduce imports, keep exports largely unchanged and depreciate the real exchange rate. Their study covered 195 crisis episodes, consisting of 77 in advanced countries and 118 in developing countries. Of the crises studied, 108 occurred after World War II and 87 happened before.

Benguria and Taylor (2020) found statistical evidence strongly in favor of the demand-side view. Their results are robust even after controlling for other types of crises, such as currency and inflation crises, stock market crises, external and domestic sovereign debt crises, and sudden stop episodes. In summary, their findings clearly point that financial crises are negative shocks to demand.

## 4. Financial markets hit by acts of nature

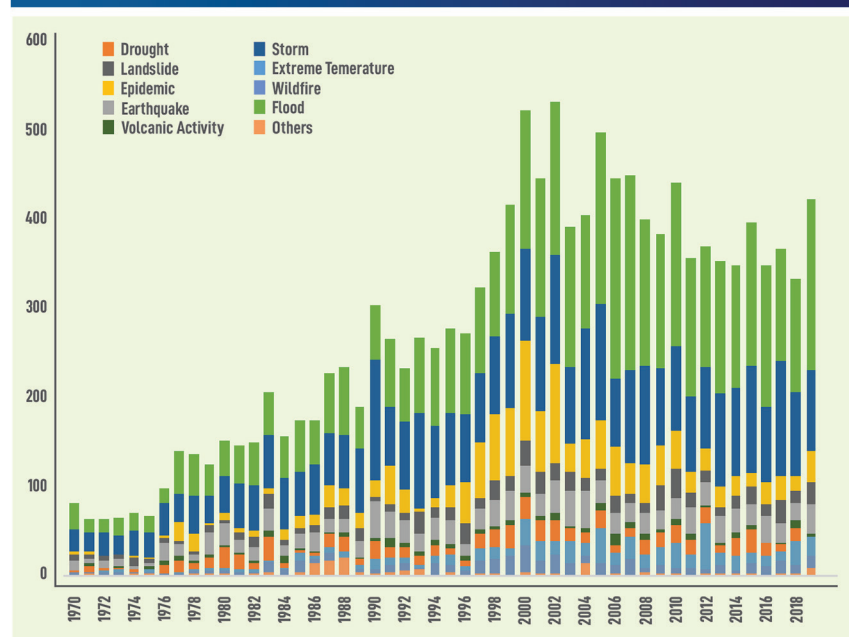
### 4.1 Natural disasters and their impact on the people and the economy

Natural disasters<sup>2</sup> have become more frequent, deadly and costly in recent years (UNISDR, 2011). Disaster frequency has doubled every ten years since 1900 (Djalante and Thomalla, 2012). The same can be seen from the International Disaster Database (EM-DAT)<sup>3</sup>—the number of reported natural disasters trended upwards between 1970 through 2019 (Figure 1.1). In terms of geographical location, Asia records the highest number of natural disasters for the period. The most frequent natural hazards are flooding and storms affecting most of the world's population and resulting in the costliest damages.

<sup>2</sup> A natural disaster occurs when a natural hazard interacts with a population, causing harm to people, property damage and social environmental disruption (Xu et al., 2016). Natural hazards generally occur following meteorological events (such as hurricanes and floods) or geological events (such as earthquakes and landslides). They may happen rapidly and without warning. Moreover, they may progress slowly, over the span of days, weeks, months or even years (Noy and duPont, 2016).

<sup>3</sup> EM-DAT defines a disaster as "a natural situation or event that overwhelms local capacity and/or necessitates a request for external assistance. For a disaster to be entered into the EM-DAT database, at least one of the following criteria must be met: (1) 10 or more people are reported killed; (2) 100 people are reported affected; (3) a state of emergency is declared; or (4) a call for international assistance is issued." (Cavallo, et al., 2010)

Figure 1.1. Frequency and Types of Disasters (1970–2019)



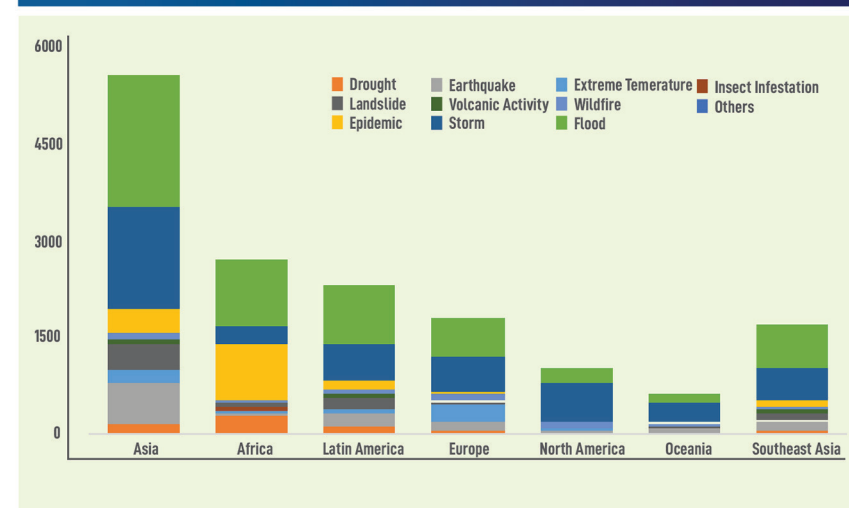
Source: International Disaster Database (EM-DAT)

Natural disasters affect people, communities and economies, both directly and indirectly. The direct costs of disasters are primarily the loss of life and the corresponding morbidities (illnesses and injuries) inflicted on the devastated population. Economies also suffer in terms of damages to fixed assets and capital, raw materials and extractable natural resources. (Pelling et al., 2002; ECLAC, 2003). The direct costs<sup>4</sup> of natural disasters have also increased sharply since the 1970s. For the period 1970–1979, annual damages due to natural disasters averaged only US\$5.4 billion. These ballooned to an average yearly loss of US\$168.9 billion for 2010–2019 (EM-DAT, 2020).

The indirect costs of natural disasters pertain to the loss of economic activity and the foregone production of goods and services. The shortfall in production stems from the damages to physical infrastructure. These indirect damages also include the added costs of employing alternative and possibly inferior means of production and distribution to keep the economy afloat and continuously supply the demand for goods and services (Cavallo and Noy, 2009). Also, post-disaster recovery efforts could crowd-out other productive expenditures such

<sup>4</sup> The direct costs of a disaster cover only direct damages such as the destruction of infrastructure, crops and housing.

Figure 1.2. Frequency of Disasters (1970–2019)



Source: International Disaster Database (EM-DAT)

as education, health and infrastructure, which may have severe implications for long-term economic development.

At the household level, reduced economic activity translates to unemployment and, subsequently, loss of income. In the Philippines, Dacuycuy (2016) observed Filipino families shifting to cheaper food and non-food items in times of severe weather disturbances, conditional on the needs of vulnerable household members (e.g., the children and the elderly).

The indirect impact of disasters is far from negligible as it often constitutes a substantial portion of a disaster's total damages (Pelling et al., 2002; Tierney, 1997). The aggregate loss to households and firms is reflected by the overall contraction of economic activity measured by the GDP. Severe disasters could significantly drag down annual GDP growth; this was the case for Developing Asia (Dagli and Ferrarini, 2019).

Natural hazards could also endanger the government's fiscal position because of higher reconstruction spending and lower tax revenue in light of economic

disruptions. This could lead to higher government debt both for national and subnational levels of government (Koetsier, 2017 and Chen, 2019). Consequently, severe disasters may also set back both bilateral and multilateral trade among affected territories and their trading partners as adverse shocks also spread through the production networks or supply chains (Sheffi and Rice, 2005; Gassebner et al., 2010; Oh and Reuveny, 2010; Felbermayr and Groschl, 2013).

Resilience from natural disasters is noted to be closely determined by the country's level of development. Wealthier nations suffer fewer natural hazards-related deaths. In particular, democracies and countries with strong institutions recorded lower disaster-related mortality (Kahn, 2005). On the other hand, poorer countries and island nations are found to suffer more deaths (UNISDR, 2011). Moreover, less developed countries are also found to be less resilient from disasters over the long term (Noy and duPont, 2016). Thus, the following country characteristics are associated with disaster resilience: high income, strong institutions, high literacy, a high degree of openness to trade, more developed financial systems, high level of government spending and sound disaster risk reduction and management policy (Toya and Skidmore, 2007; Noy, 2009).

From the standpoint of central banking, there is growing recognition among monetary authorities, financial regulators and bank supervisors that the severe and shifting weather patterns have increasingly become a source of downside risks to the financial system's health (Bolton et al., 2020). In the Philippines, Bayangos et al. (2020) highlighted the deterioration of deposits, loan growth and quality, along with lower profitability of banks, albeit short-lived, following extreme weather episodes.

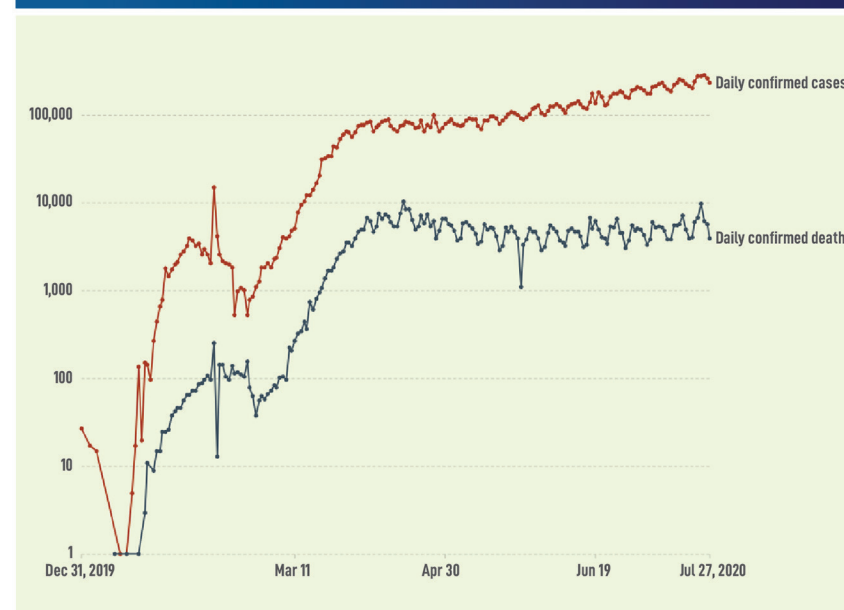
#### 4.2 Pandemics and the economy

Humankind has long been plagued by various transmissible diseases in the form of epidemics. The continent of Africa recorded the highest number of epidemics from 1970 to 2019. There is also a considerable number of disease outbreaks documented in Asia and Latin America (EM-DAT, 2020). Modern health care systems were able to eradicate some of these life-threatening infections (e.g., smallpox). However, world governments and international health organizations, to this day, continue the work to combat epidemic-causing diseases such as malaria, influenza, tuberculosis, HIV-AIDS, Ebola virus disease, and now COVID-19.<sup>5</sup>

<sup>5</sup> COVID-19 is an infectious disease due to the recently discovered coronavirus. This new virus and infection were unknown before the outbreak began in Wuhan, China last December 2019. The World Health Organization declared COVID-19 as pandemic, affecting many countries globally, on March 12, 2020.

Pandemics are widespread outbreaks of infectious diseases, which could lead to intensified morbidity and mortality over large areas. They have been noted to cause significant economic, social and political disruption (Madhav et al., 2017). Pandemics have become pervasive in recent decades owing to heightened global travel and integration, rapid urbanization, shifting land use and increased misuse of the natural environment (Jones et al., 2008; Morse, 1995). There are several pandemics recorded in history, with the COVID-19 pandemic as the most recent. It began in China and quickly spread around the world in just a matter of months (Figure 1.3).<sup>6</sup>

Figure 1.3. Daily Confirmed COVID-19 Cases and Deaths (log), World



Source: European Centre for Disease Prevention and Control (ECDC) (Roser et al., 2020)

<sup>6</sup> Epidemics do not automatically evolve into pandemics, and the transition is not necessarily fast or straightforward. In the case of HIV-AIDS, the disease was considered an epidemic in West Africa for several decades before it was categorized as a pandemic in the late 20th century. With advancements in modern medicine, HIV-AIDS is now considered endemic, characterized by a controlled rate of infection and predictable infections among specific populations (Grennan, 2019).

As of 27 July 2020, the COVID-19 pandemic has already recorded 16 million infections across 216 countries and territories globally. In addition, about 645 thousand people are reported to have died from the disease. This brings the COVID-19's mortality rate to 4 percent, slightly higher than the Spanish flu.<sup>7</sup>

Epidemics, especially pandemics, can have sizable economic impacts in both the short and long term, mainly on account of population health being an important determinant of a nation's wealth and income (Bloom and Canning, 2013). They are noted to affect a country's economy through various channels. These include disruptions in the health, transportation, agricultural and tourism sectors (European Parliament, 2020). A substantial disease outbreak can overwhelm a country's health system, constraining its ability to deal with routine health issues, thus compounding the challenges to public health. Beyond shocks to the health sector, epidemics can reduce employment as well as productivity. Physical distancing measures may be required to rein in infection, which entails the shutdown of schools, enterprises, commercial establishments, transportation and public services. These then results to the disruption of economic and other socially important activities (Bloom et al., 2018).

Subsequently, trade with other countries could also be jeopardized as the highly interconnected global economy could hasten disease transmission via international supply chains. Along with rapid urbanization, increasing international travel and climate change make epidemics a global concern (European Parliament, 2020).

Before the COVID-19 outbreak, analysts have already projected the costs of pandemics to be sizable. Fan et al. (2018) estimated the yearly cost of an influenza pandemic to reach around US\$500 billion in lost income and cost of mortality. Further, Bloom et al. (2018) noted that these economic consequences could potentially worsen despite the limited deterioration of health indicators.

<sup>7</sup> Prior to COVID-19, the deadliest pandemic recorded was the Spanish flu of 1918. The virus affected around one-third of the world's population at that time and was responsible for about 20-50 million deaths—the mortality rate was estimated to be 1-3 percent. The H1N1 swine flu pandemic of 2009-2010 infected 700 million-1.4 billion people. Thus, the H1N1 infection rate considerably exceeds that of the Spanish flu in absolute terms; however, it recorded a lower mortality rate at 0.01-0.08 percent (Dawood et al., 2012).

This was seen in Liberia, which registered a contraction of 8 percentage points in GDP for 2013-2014 following the Ebola outbreak in West Africa despite falling mortality rates during the period.

Nonetheless, the current COVID-19 pandemic underscores the adverse impacts of pandemics on national and the global economy more than ever. Similar to natural disasters, pandemics affect the real sector and productivity losses are instantaneous. However, while natural disasters are typically considered one-off shocks to economic activity, the impacts of pandemics are more protracted.

The current health crisis is an exogenous shock that took governments by surprise. They found themselves confronted by tradeoffs between the implementation of containment measures needed to slow down the COVID-19 infection vis-à-vis the economic losses brought by the massive lockdowns and firm closures. The COVID-19 pandemic simultaneously disrupts supply, demand and productivity. Moreover, it happened almost simultaneously across countries. As of date, the health, social and economic consequences are devastating, and repercussions are feared to persist for a long time, potentially dwarfing the losses of other cataclysmic events in the past four decades (Ludvigson et al., 2020). To date, countries around the world continue to face uncertainties on when economic recovery could start and the trajectory this will take.

## 5. Summary and conclusion

Crises will inevitably occur, which would affect the functioning of the financial system, and subsequently, the economy. Central banks are tasked with putting in place crisis management frameworks and business continuity management plans to sustain the stability and build the resilience of the financial system.

Communication is essential to a crisis management framework to facilitate coordination and collaboration. Also, crisis management frameworks must have the flexibility to respond to a range of conditions as well as to have appropriate responses to different types of crises.

In general, financial crises occur due to the buildup of excesses and vulnerabilities of the financial system. These usually involve sizable changes in credit volume and asset prices, stark interruptions in financial intermediation, a reduction in the supply of external financing and massive balance-sheet problems. Claessens and Kose (2013a) defined four major types: currency crises, sudden stops in capital flows, debt crises and banking crises. Regardless of the classification, financial crises have severe implications on the real and financial sectors, resulting in recessions with significant output losses. Economic recovery, while possible, may be slow.

For their part, natural disasters may affect the financial sector directly or indirectly. Direct costs include loss of life and illnesses or injuries of people in the financial industry, and damages to fixed assets and capital, or physical infrastructure. Indirect costs, which usually constitute a large share of the total damages, pertain to the loss of economic activity and the foregone production of goods and services. Substantial reconstruction spending, together with a possible reduction in tax revenue from the disruptions in economic activity, could endanger the government's fiscal position and lead to higher government debt. Of direct relevance to the financial system, there may be deterioration of deposits, loan growth and quality, along with lower profitability of banks.

Epidemics and the more severe pandemics have a concentrated impact on the population with massive job and productivity losses. These can overwhelm a

country's health system and compound the public health problem. Trade with other countries could also be jeopardized as the highly interconnected global economy could hasten the disease transmission via the international supply chains.

Similar to natural disasters, pandemics result in a contraction in economic activity and an immediate decline in productivity. However, most natural disasters entail short-term shocks to output. Meanwhile, the impacts of pandemics on the economy, as observed in countries severely hit by COVID-19, are expected to linger for an uncertain period.

The pandemic has hit two flanks of the financial system. First, financially, with the loss of liquidity as well as a decline in asset value in light of the drag on economic activity. Second, operationally, as health risk threatens the delivery of financial services, potentially disrupting people's lives, facilities, processes and technology (Coelho and Prenio, 2020). This could undermine the stability of, and confidence in, the financial system.

To remain relevant and effective, central banks need to routinely review and update their crisis management frameworks and business continuity management plans (IMF, 2020). The COVID-19 pandemic is an unprecedented crisis in scale and duration, and should be added to the list of crises requiring contingency preparation. Indeed, to keep ahead of uncertainty, central banks must be constantly changing and evolving.



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# On Policymaking During Crises

CHAPTER  
**TWO**

Hazel C. Parcon-Santos, Cristeta B. Bagsic and Ferdinand S. Co\*



*The primary challenge that we face today is uncertainty.*

– Carmen M. Reinhart<sup>1</sup>

## 1. Uncertainty and economic activity

Uncertainty pertains to the likelihood of future events being unpredictable or incalculable (Kay and King, 2020). A host of events could induce uncertainty – political conflicts, economic recessions, wars, natural disasters and disease outbreaks. It is generally known to have a cross-cutting impact on all sectors of the economy—households, businesses and financial markets—prompting responses from authorities.

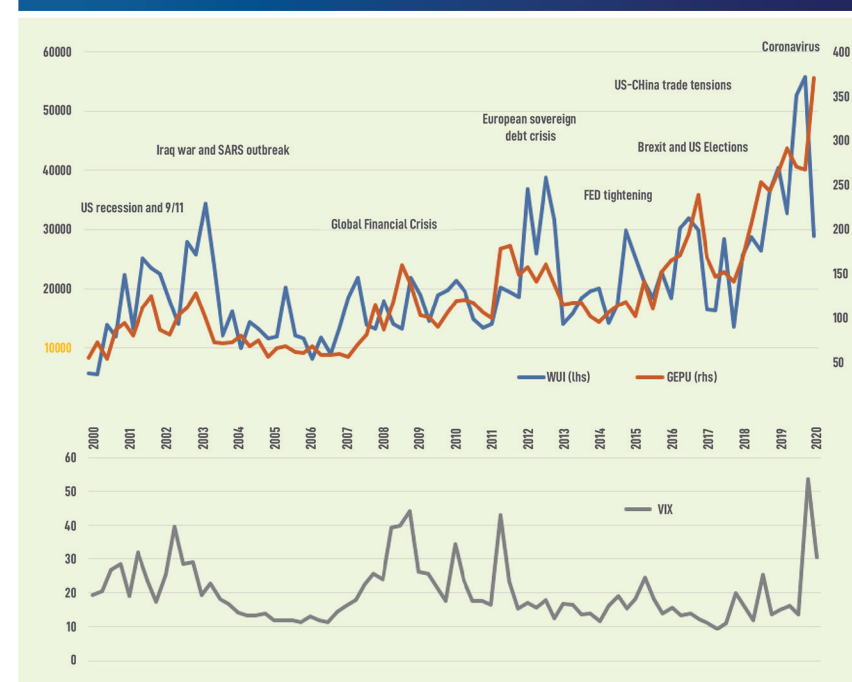
Measures of uncertainty suggest that it typically rises abruptly but declines gradually (Baker et al., 2016). Uncertainties during periods of great economic, financial and political shocks spike. Uncertainties in the early 2000s were triggered by the 9/11 attacks, Iraq war and the SARS outbreak. These were followed by the Global Financial Crisis (GFC) and Great Recession in 2008-2009 and the sovereign debt crisis in Europe in 2012. Uncertainties declined relatively after 2012 but increased again due to the US Fed tightening in 2015, Brexit and US elections in 2016, and US-China trade tensions in 2018-2019. The emergence of the coronavirus disease 2019 (COVID-19) amplified uncertainties even more (Figure 2.1).

The COVID-19 crisis has heightened uncertainties regardless of the measure used. Uncertainties associated with the COVID-19 pandemic revolve on the resolution of the spread of the coronavirus; temporariness of policy interventions and forbearance measures; speed of economic recovery; impact on business survival and bank balance sheets; and long-term shifts in consumer behavior and business models.

Since the outset of the crisis, the International Monetary Fund (IMF) has revised its global growth forecast thrice—attesting to the great uncertainty associated with the COVID-19 crisis. Baker et al. (2020) predicts that the COVID-19 disaster could cause a large output contraction, more than half of which may be due to

pandemic-induced economic uncertainty<sup>2</sup> but notes that actual impact may be larger (see also Boone et al., 2020 and McKibbin and Fernando, 2020). Jorda et al. (2020) further emphasize that the economic fallout caused by pandemics can last for decades. Indeed, there is ample evidence showing that an economy's growth trajectory is adversely impacted long after a crisis (Erken et al., 2020; Jackson et al., 2018; Kalleberg and Von Wachter, 2017; Reinhart and Rogoff, 2011).

Figure 2.1. Uncertainty as Measured by WUI, GEPU and VIX (2000-2020)



Notes:

1. The World Uncertainty Index (WUI) is a GDP-weighted average of uncertainty across 143 countries. It is computed by counting how often the word "uncertain" or its variants were used in the Economist Intelligence Unit country reports, normalized by total number of words in the report.
2. The Global Economic Policy Uncertainty (GEPU) Index is a GDP-weighted average of national EPU indices for 21 countries: Australia, Brazil, Canada, Chile, China, Colombia, France, Germany, Greece, India, Ireland, Italy, Japan, Mexico, the Netherlands, Russia, South Korea, Spain, Sweden, the United Kingdom and the United States. Each national EPU index reflects the relative frequency of own-country newspaper articles that contain a trio of terms pertaining to the economy (E), policy (P) and uncertainty (U).
3. The VIX Index is a financial benchmark reflecting market estimate of the expected volatility of the S&P500® Index. A higher number means higher uncertainty and vice versa.

Sources: Ahir et al., (2020); Bloomberg

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<sup>1</sup> From remarks in a UP School of Economics webinar entitled "Is This Time Different? Navigating the Transition to a Post-Covid World" held 9 July 2020.

<sup>2</sup> The authors show that about 60 percent of contraction in US GDP is caused by COVID-induced uncertainty.

## 2. A crisis like no other

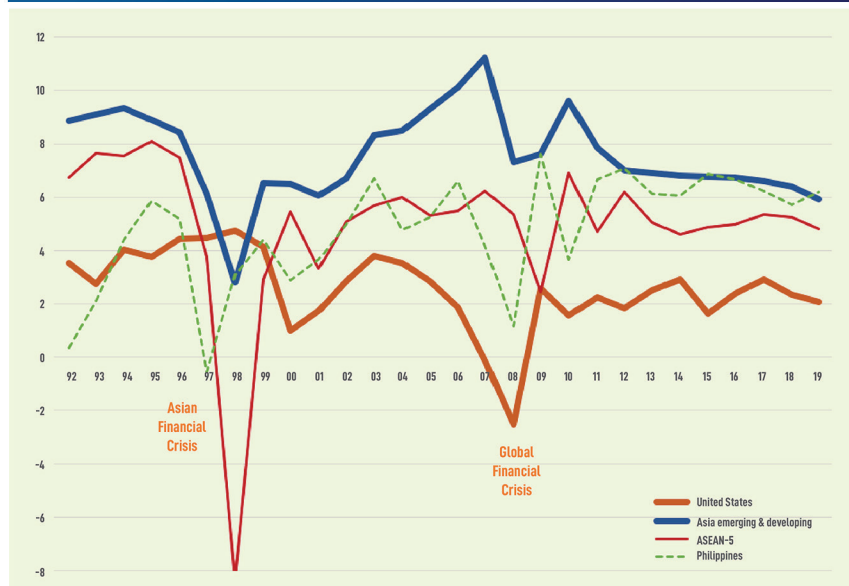
*This time it really is different.*

—Carmen M. Reinhart and Kenneth S. Rogoff<sup>3</sup>

### 2.1 Global economic impact

During the 1997 Asian Financial Crisis (AFC), the US economy was strong and helped stabilize affected economies—the ASEAN-5, in particular—towards recovery. During the 2008 GFC and the Great Recession that followed, Asian emerging market economies (EMEs) underpinned global growth (Figure 2.2). Both these crises originated from financial and economic events. By contrast, the COVID-19 crisis is a pandemic-induced one that has significant repercussions for the economy.

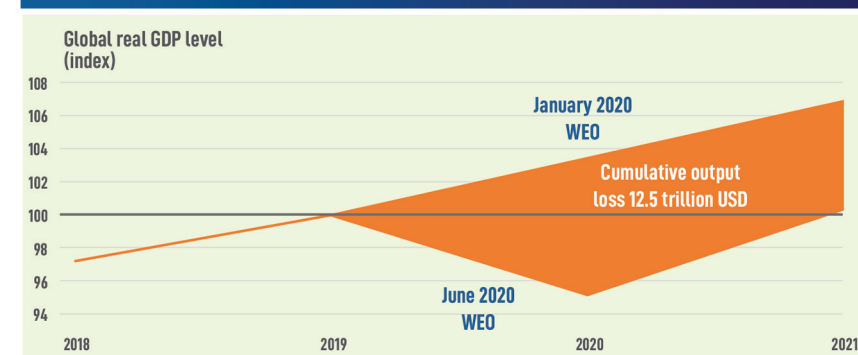
Figure 2.2. 1997 Asian Financial Crisis vs. 2008 Global Financial Crisis (% GDP growth)



Source: IMF World Economic Outlook (WEO) database

The COVID-19 shock has caused temporary and permanent business closures, reduced capacity utilization, delayed investment expenditures, reduced household earnings and consumption, and increased unemployment. ILO (2020) estimates a rise in global unemployment by 5.3 million to 24.7 million from a base level of 188 million in 2019, resulting in overall losses in labor income of US\$860 billion to US\$3.44 trillion. The International Monetary Fund (IMF) estimated cumulative output loss of around US\$12.5 trillion in 2020 and 2021 due to the Great Lockdown (Figure 2.3).

Figure 2.3. Cumulative Output Loss Due to the Great Lockdown



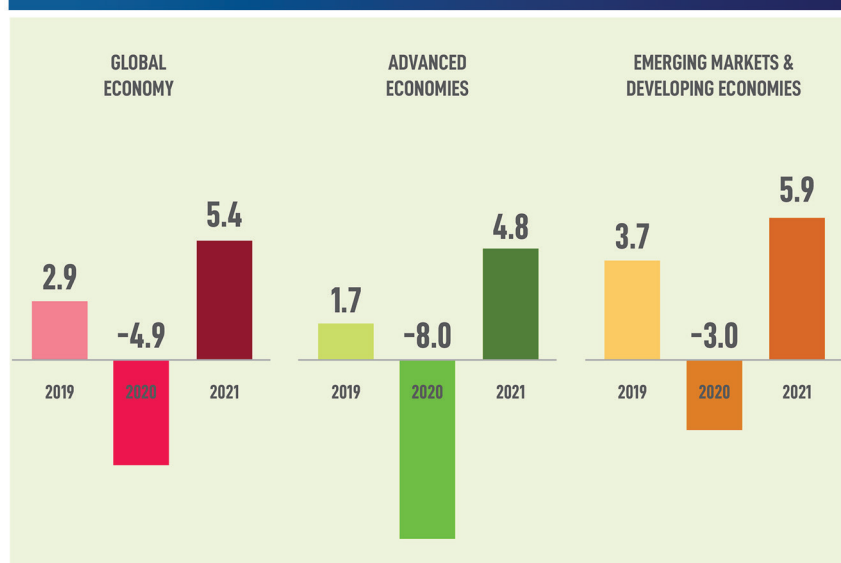
Source: IMF WEO Update June 2020

The dramatic increase in uncertainty, the abruptness and severity of economic effects, and the synchronized deep downturn expected in 2020 highlight how this crisis is different (Figure 2.4). All these imply that the global economy will be less hospitable to exports; resumption of economic activities will be more asynchronous; and the labor market will remain seriously impaired, with adverse impacts on poverty and income inequality (Guinigundo, 2020).

<sup>3</sup> From Bloomberg feature published 18 May 2020. <https://www.bloomberg.com/news/features/2020-05-18/harvard-s-financial-crisis-experts-this-time-really-is-different>

Even as this crisis is different, authorities adopted policy responses implemented in past crises, though they were quicker and bolder this time. They also devised measures that were not conventionally part of the policy toolbox.

Figure 2.4. International Monetary Fund Growth Projections (%)



Source: IMF WEO Update June 2020

## Estimating the Impact of Uncertainty on Philippine Economic Activity

Since the days of John Maynard Keynes, the role of “shifting and unreliable evidence” (Keynes, 1936) or uncertainty has been recognized to affect output and its components. Theoretical models show that increases in uncertainty can affect economic activity through several channels. Firms may delay investment and hiring due to irreversibility of investments and increase in credit spreads (Bernanke, 1983; Dixit and Pindyck, 1994) and households may reduce consumption and increase precautionary saving (Basu and Bundick, 2017). Empirical research, regardless of the econometric approach employed, supports the notion that uncertainty shocks indeed reduce economic activity through contractions in business fixed investment and durables consumption, and reductions in employment (Jackson et al., 2019; Jo and Sekkel, 2019; Baker et al., 2016; Jurado, et al., 2015).

As an exploratory investigation to assess the impact of uncertainty on Philippine economic activity, the following Vector Autoregression (VAR) model of order  $p$  was estimated:

$$\Delta Y_t = c + \sum A_p \Delta Y_{t-p} + v_t \quad (1)$$

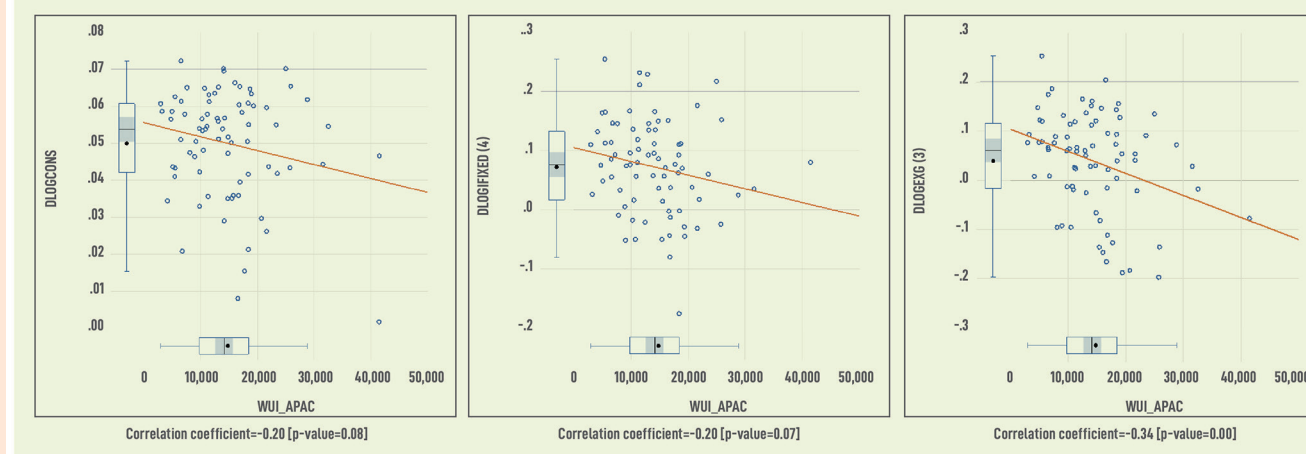
where  $Y_t$  is an  $n \times 1$  vector of endogenous variables,  $A_p$  is a matrix of coefficients to be estimated,  $c$  is the intercept vector of the VAR, and  $v_t$  is a generalization of a white noise process. The vector of endogenous variables includes the World Uncertainty Index for Asia and the Pacific (WUI-APAC) by Ahir et al. (2018),<sup>5</sup> final household consumption expenditure (DLOGCONS), exports of goods (DLOGEXG) and gross fixed capital formation (DLOGIFIXED).<sup>6</sup>

5 There are 22 countries included in the calculation of WUI-APAC, including the Philippines. WUI-APAC instead of WUI-Philippines was used as uncertainties caused by external events also have an impact on domestic economic activity.

6 Except for WUI-APAC, all variables (CONS, EXG and IFIXED) are I(1) in levels, but I(0) in DLOG form. Based on the Johansen Cointegration Test, CONS, EXG and IFIXED are not cointegrated, hence VAR is an appropriate methodology. WUI-APAC is I(0) in level. VAR ordering is WUI-APAC DLOGCONS DLOGEXG and DLOGIFIXED, estimated for the period 2001Q1-2020Q1. Based on various VAR lag order selection criteria, the optimal lag length is 1. Diagnostic tests show that the estimated VAR satisfies the stability condition, is not misspecified and has no serial correlation.

Consumption, exports and investments are all negatively correlated with uncertainty (Figure 2.5).

Figure 2.5. Correlation Between Uncertainty and Consumption, Exports and Investments



Source of basic data: Philippine Statistics Authority, Ahir et al., (2020)

Variance decomposition shows that variations in WUI-APAC are mainly manifested in changes in DLOGCONS and DLOGEXG (Table 2.1). While changes in WUI-APAC account less for changes in DLOGFIXED, changes in DLOGEXG impact changes in DLOGFIXED. Impulse response function shows that after a one-standard deviation shock in WUI-APAC, DLOGCONS immediately falls and takes about 10 quarters to go back to its pre-shock value. DLOGEXG decline on the 2<sup>nd</sup> quarter after the shock and also takes about 10 quarters to go back to its pre-shock value. Based on historical decomposition, uncertainties caused by the COVID-19 crisis may have contributed to the decline in all three indicators of economic activity, at least in the 1<sup>st</sup> quarter of 2020 (Figure 2.7).<sup>7</sup>

<sup>7</sup> Impact of uncertainties in the three economic indicators may become more apparent if the COVID-19 crisis progresses and remains unresolved.

Table 2.1. Variance Decomposition of Consumption, Exports and Investments

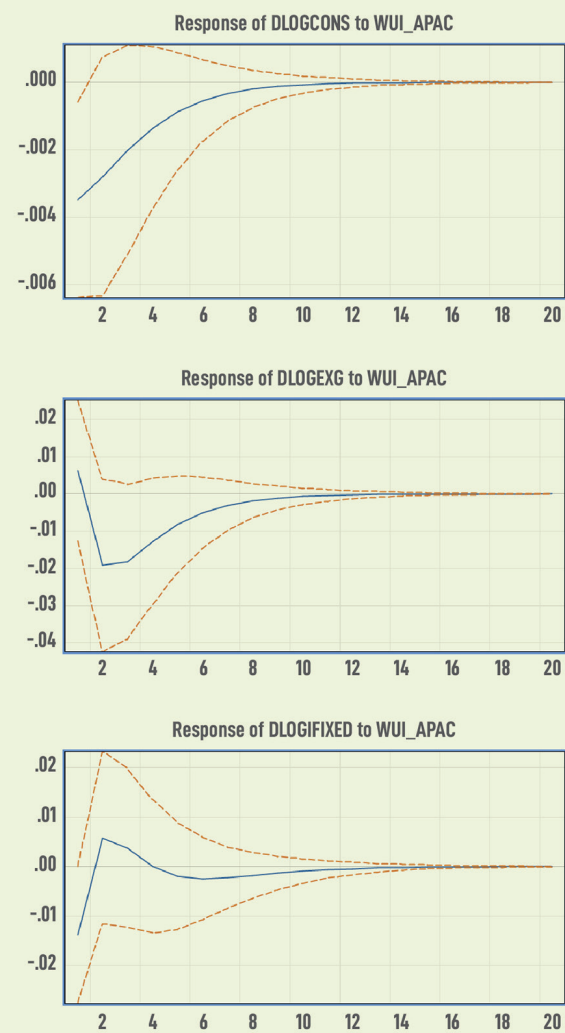
Variance Decomposition of DLOGCONS:				
Quarter	WUI_APAC	DLOGCONS	DLOGEXG	DLOGFIXED
1	7.31	92.68	0.00	0.00
4	10.53	88.87	0.58	0.00
8	10.88	88.37	0.74	0.00
12	10.88	88.36	0.74	0.00
Variance Decomposition of DLOGEXG:				
Quarter	WUI_APAC	DLOGCONS	DLOGEXG	DLOGFIXED
1	0.58	3.86	95.54	0.00
4	8.15	5.57	86.05	0.20
8	8.86	5.58	85.29	0.25
12	8.88	5.58	85.27	0.25
Variance Decomposition of DLOGFIXED:				
Quarter	WUI_APAC	DLOGCONS	DLOGEXG	DLOGFIXED
1	5.08	4.00	7.07	83.83
4	3.69	7.28	20.29	68.73
8	3.77	8.16	22.20	65.85
12	3.81	8.18	22.27	65.71

Cholesky Ordering: WUI\_APAC DLOGCONS DLOGEXG DLOGFIXED

Source: Authors' estimates

Figure 2.6. Impulse Response of Consumption, Exports, and Investments to Uncertainty Shock

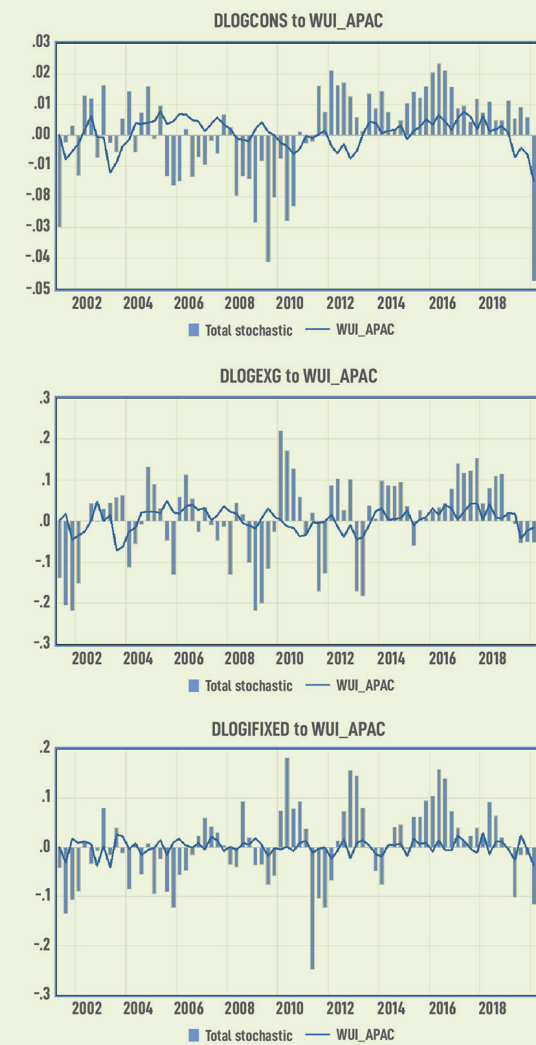
Response to Cholesky One S.D. (d.f. adjusted) Innovations  $\pm 2$  S.E.



Source: Authors' estimates

Figure 2.7. Historical Decomposition of Consumption, Exports and Investments

Historical Decomposition using Cholesky (d.f. adjusted) Weights



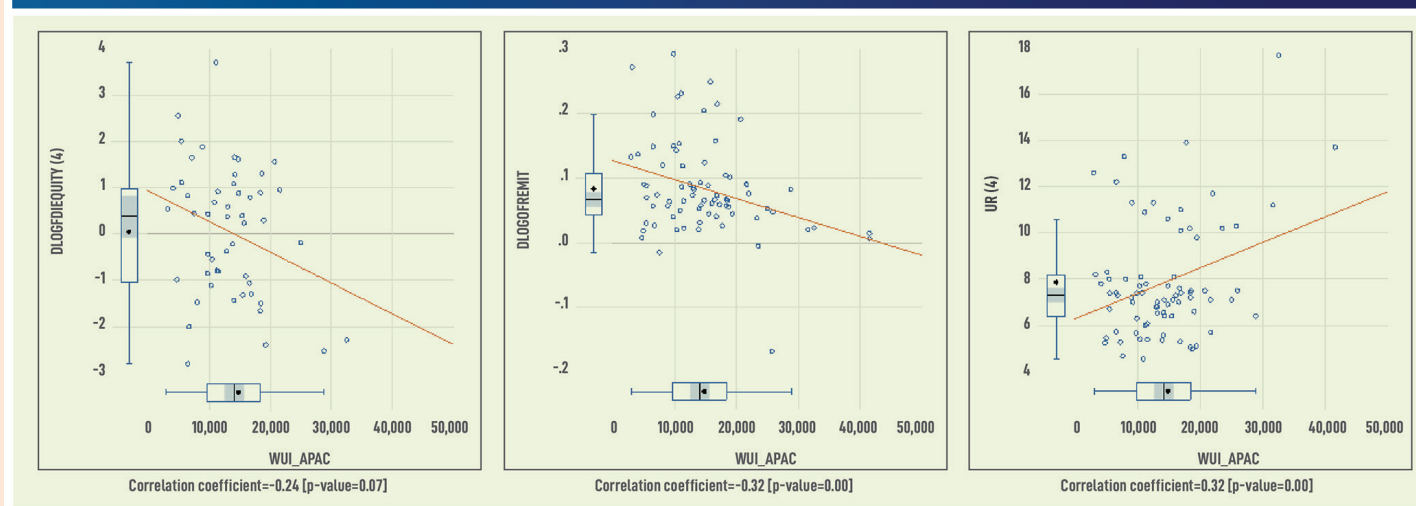
Source: Authors' estimates



Meanwhile, other economic variables are likewise significantly associated with uncertainty. Growth in foreign direct investments (DLOGFDIEQUITY) and overseas Filipino

remittances (DLOGOFREMIT) are both negatively correlated with WUI-APAC, while unemployment rate (UR) is positively correlated with WUI-APAC (Figure 2.8).

Figure 2.8. Correlation Between Uncertainty and Other Economic Variables

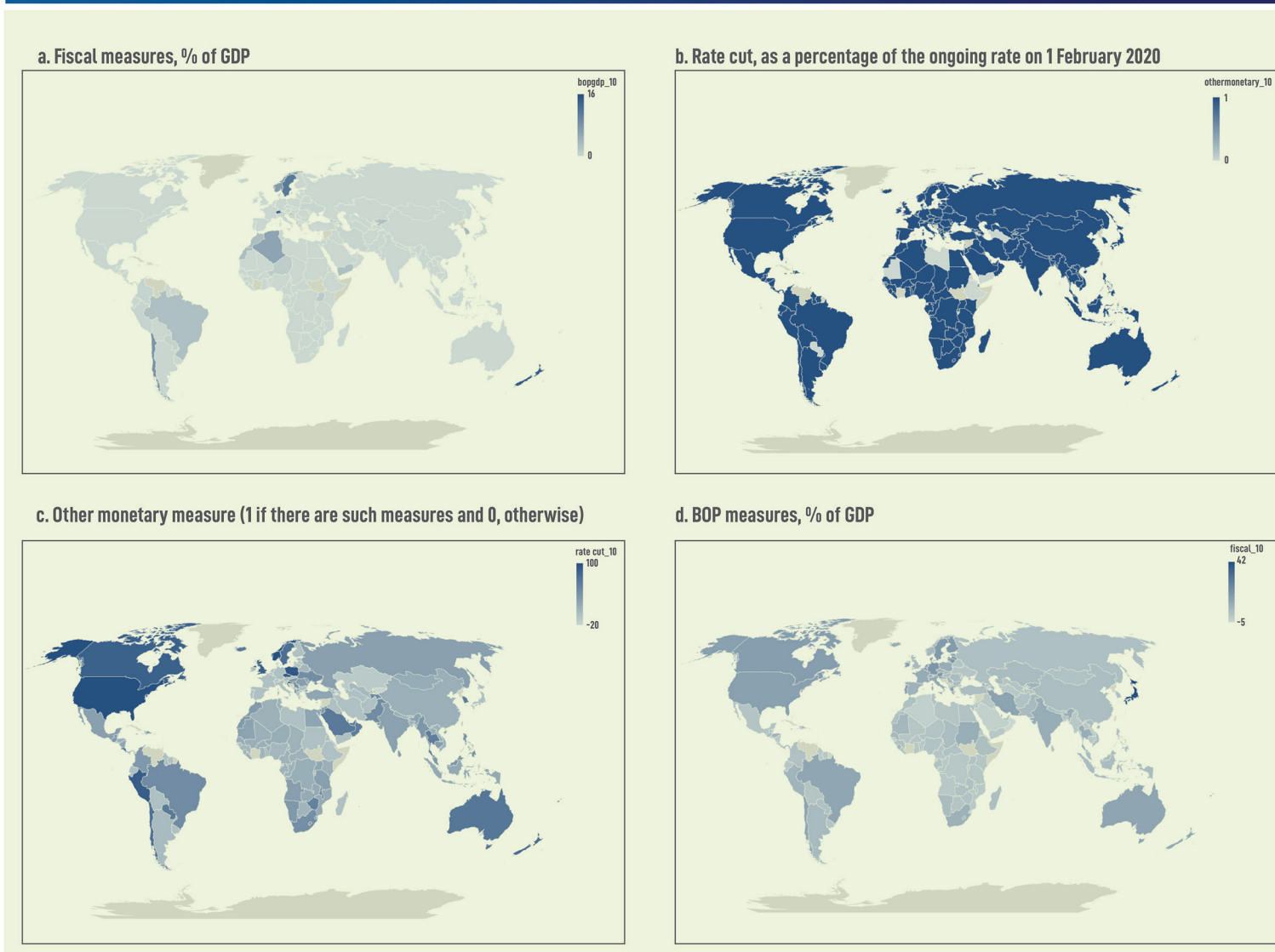


Source of basic data: Bangko Sentral ng Pilipinas, Philippine Statistics Authority, Ahir et al., (2020)

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Figure 2.9. Emergency Response Measures



Note: As of 28 July 2020. Gray indicates no data.

Source: Elgin et al. (2020)



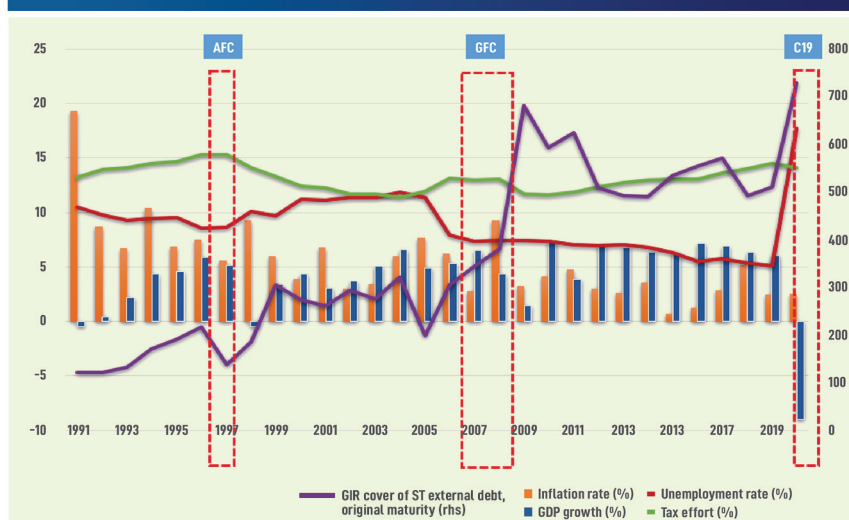
Based on the database of COVID-19 response measures<sup>7</sup> created by Elgin, Basbug and Yalaman (2020) covering 166 economies, fiscal packages were implemented by most, with Japan's at 42 percent of its gross domestic product (GDP).

Monetary authorities delivered as much as 100 percent policy rate cut vis-à-vis their 1 February 2020 level, as well as other monetary measures. About a third of the economies covered by their research implemented balance of payments (BOP) and exchange rate policy measures (Figure 2.9).

## 2.2 Impact on Philippine economic performance

Despite intermittent bouts of inflation driven by oil and rice prices, the Philippines has been able to stabilize inflation since its adoption of the inflation targeting framework in 2002. Its strong growth in recent years was accompanied by price stability, stronger banking sector, declining unemployment rate and improving tax efforts, as well as much-improved external and public debt profiles. Thus, the Philippines met the pandemic in sounder economic and institutional shape than in past crises. This is not trivial comfort because unlike in the AFC when the US and other advanced economies (AEs) buttressed global demand, no one is spared in the COVID-19 crisis. All economies are in the same stormy sea, albeit with different levels of policy space, financial resilience and global interconnectedness.

Figure 2.10. Philippine Macroeconomic Snapshot, 1991 – 1H 2020



Sources: Philippine Statistics Authority, Bangko Sentral ng Pilipinas, Bureau of the Treasury

<sup>7</sup> The economic policy package database has three categories using six policy variables. The categories are: fiscal policy, monetary policy and balance of payment/exchange rate policy. Under fiscal policy package are the adopted fiscal measures as a percentage of GDP. The monetary policy category variables are: interest rate cut (measured as percentage of rate on 1 February 2020); size of macro-financial package (as percentage of GDP); and other monetary policy measures (dummy variable with value of 1 if there are such measures and 0 otherwise). Lastly, the BOP and exchange rate policy category variables: BOP measures (as percentage of GDP); and dummy variable with value of 1 if there are other reported measures and 0 otherwise. (Elgin et al., 2020, 3-4).

The Philippines slid into recession territory in the first semester of 2020, with 16.5 percent GDP decline in Q2 2020 after falling by 0.7 percent in Q1 2020. In the first half of 2020, output dropped by 9 percent (Figure 2.10).

The pandemic-induced global weakness is particularly treacherous for economies like the Philippines that rely on migrant worker remittances. Remittances had supported the consumption, educational and medical needs of families of migrant workers not just during normal times but more so during crises (Chami, 2020; Sayeh and Chami, 2020). Overseas Filipino (OF) remittances that provided counter-cyclicality during the GFC experienced a dramatic decline as early as the first five months of 2020 in the COVID-19 crisis (Table 2.2).

Table 2.2. Philippine OF Cash Remittances and Labor Force Trends in Crisis Periods

Crisis	OF Cash Remittances	Unemployment rate (%)	Underemployment rate (%)	Labor Force Participation rate
AFC	28.3	13.3	21	68.6
GFC	13.7	8	19.8	63.2
COVID-19	-6.4	17.7	18.9	55.6

Notes:

1. AFC and GFC OF cash remittances numbers reflect cumulative year-on-year growth rates for December 1998 and December 2008. The figure for COVID-19 OF cash remittances reflects year-on-year change for January-May 2020.

2. AFC, GFC and COVID-19 labor force data reflect Labor Force Survey results for April 1998, April 2008, and April 2020, respectively.

Sources: Philippine Statistics Authority, Bangko Sentral ng Pilipinas

In April 2020, the Philippines recorded its lowest labor force participation rate at 55.6 percent and highest unemployment rate at 17.7 percent (Table 2.2). The services sector has underpinned domestic economic growth. It was more than three-fifths of the GDP in the first half of 2020, while the industry sector was almost three-tenths. Both dragged economic performance in the same period (PSA, 2020a). Nonetheless, the pandemic and the changes in social interactions it ushers can be expected to have more fundamental impact on the operation of the services sector. For instance, numerous restaurants and fast food outlets shifted to repackaging their menu as grocery items and sold these as either frozen items or meal kits for their customers to prepare at home. Dine-in service has been severely limited. As of April 2020, the services sector employs more than 57 percent of the labor force, while service and sales workers compose more than 18 percent of the total employed (PSA, 2020a).

The tourism sector, with 13.5 percent share in 2019 total employment, has been hit hard (PSA, 2020b). The Department of Labor and Employment (2020) reported in July that 95,702 repatriated Overseas Filipino Workers (OFWs) have been brought to their home provinces, while 240,583 requests for one-time cash assistance (of US\$200 or ₱10,000) under the government's Abot-Kamay ang Pagtulong (AKAP) program for repatriated OFWs were already approved.<sup>8</sup>

While more than 63 percent of workers are wage and salaried employees, those self-employed without any paid employees consist of almost 29 percent of the labor force (PSA, 2020a). Meanwhile, by the nature of the necessary policy response to cut off the transmission of the virus, the informally-employed, such as jeepney barkers and curbside parking attendants and street vendors, among others, have had to rely on government cash assistance. Even with lifting of lockdowns, the much-reduced economic activities would not immediately allow them—and many entrepreneurs—to pick up where they left off.

### 3. A multi-track policy menu: Endure. Bounce back. Thrive.

*There are no solutions; there are only trade-offs.*

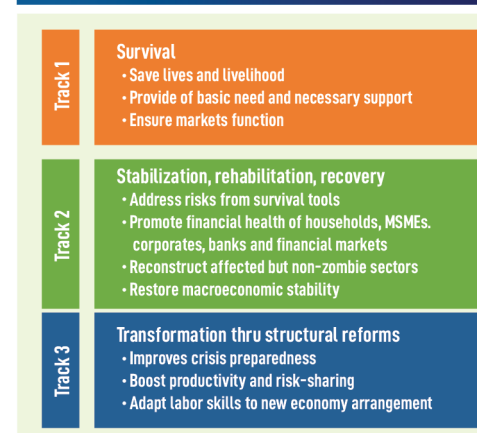
— Thomas Sowell, *A Conflict of Visions: Ideological Origins of Political Struggles*

An analogy for the COVID-19 pandemic states that we are not all in the same boat but rather in the same stormy sea where some have leaky boats, others have adequate ones, while others have boats that can outlive the storm. Policy tries to even out the chances of survival, recovery and revitalization for everyone.

In any crisis, the policy menu can be categorized along three overlapping tracks based on descending urgency of implementation. Track 1 includes **survival tools** to protect the existence of citizens, businesses and the financial system. Track 2 consists of **stabilization tools** to stabilize, rehabilitate and reconstruct the capacity of labor, capital, productivity, financial system and institutions to recover. Track 3 involves **transformation tools** to promote reforms for productivity, labor and capital and boost their capacity to thrive post-crisis.

<sup>8</sup> According to the BSP's Selected Economic and Financial Indicators (as of 7 August 2020), there were around 2 million OFWs deployed in 2017. Thus, the need for cash assistance could further increase.

Figure 2.11. Three-Track Policy



Source: BSP

#### 3.1 Track 1: Survival

When crisis roils an economy, it must have plans to ensure survival and endurance until the immediate threats are overcome. The policy toolkit must aim to provide the basic needs of vulnerable households. It must also extend necessary support to the informal sector, micro, small and medium enterprises (MSMEs) and corporations (to avoid rise in liquidity and credit risks), and the financial sector. Lastly, it should also aim to protect market functions.

**Fiscal policy.** In an economic downturn, automatic stabilizers can help ease households' financial stress by decreasing their tax bills or by boosting cash and in-kind benefits (Debrun and Kapoor, 2010). In some countries, the government provides unemployment insurance, welfare benefits and other transfers to the unemployed.

In the Philippines, public and private sector employees are covered by unemployment benefits and insurance through the Government Service Insurance System (GSIS) and the Social Security System (SSS), respectively. For the private sector, the benefit is only available to those not over 60 years old at the time of involuntary separation. Employees eligible for unemployment benefit receive 50 percent of their average monthly salary credit for a maximum of two months (SSS, 2019). For the public sector, the benefit is in the form of monthly cash payments equivalent to 50 percent of average monthly compensation. The duration of the benefit depends on the length of service and ranges from two to six months (GSIS, n.d.).

Due to the severity of most crisis episodes, automatic stabilizers are often not sufficient to mitigate adverse effects. Governments enact additional policies—called discretionary fiscal policies—specific to the recession. In the Philippines, like other EMEs, the limited role of automatic stabilizers calls for more discretionary fiscal policy (Iizuka et al., 2009; IMF, 2009).

In response to the COVID-19 pandemic, the Philippine government launched a four-pillar socioeconomic strategy with a fiscal package amounting to at least 3.1 percent of GDP to provide support to vulnerable groups and individuals and expand resources of the health sector (IMF, 2020). These were partly financed by borrowing. By end-June 2020, the national government has incurred an outstanding debt of ₱9 trillion, a 17.1 percent increase from ₱7.7 trillion at end-December 2019. Relative to GDP, debt has risen from 39.6 percent in end-December 2019 to 48.1 percent in end-June 2020 (BTr, 2020). Globally, government debt rose to 90.7 percent of GDP in the first quarter of 2020 from 87.1 percent in the same period the year before (Tiftik and Mahmood, 2020).

**Monetary policy.** During crisis episodes, central banks adopt various measures to avert the collapse of financial systems and support aggregate demand through reduction in policy rates and quantitative easing (QE). Evidence shows that monetary policy plays a key role in offsetting the negative impact of uncertainty shocks (Jackson et al., 2019; Basu and Bundick, 2017).

When monetary policy is not constrained by the zero-lower bound (ZLB), cutting interest rates may be appropriate to ease borrowing costs in an economy (Dietrich et al., 2020). However, if monetary policy becomes ineffective due to the ZLB, higher uncertainty can have even more negative effects (Basu and Bundick, 2017). Fabella (2020) warns that in a free-falling economy or in an anemic recovery, cutting interest rates to encourage investments is akin to pushing on a string as corporations prefer to batten their hatches (i.e., pay down debts, buy back shares), not invest. During periods of high uncertainty, central banks must be mindful of the possibility of a liquidity trap, as investors' liquidity preference sharply rise due to fear of capital losses, weak expectations about future profitability and uncertainty about prospective yields (Michl, 2010). The Japanese experience in the last decades provides lessons to central banks to avoid the ZLB constraint.

During the COVID-19 crisis, many central banks have cut policy rates. A number of central banks, including those in EMEs, have also resorted to QE (Hartley and Rebucci, 2020;<sup>9</sup> Arslan, 2020; Benigno et al., 2020).<sup>10</sup>

<sup>9</sup> Average developed market QE announcement effect on local 10-year government bond yields had a statistically significant -0.14% 1-day impact. EME QE announcement was significantly larger, averaging -0.37% and -0.63% over 1-day and 3-day windows, respectively. Across developed and emerging bond markets, an overall average 1-day impact of -0.27% was estimated.

<sup>10</sup> Benigno et al. (2020) argue that QE could be embraced by EME central banks to expand the policy toolkit, particularly in the time of COVID-19, provided that they are credible, have a flexible exchange rate regime, enjoy well-anchored inflation expectations, and are issuing local currency sovereign debt.

In the Philippines, the BSP undertook unprecedented measures to ensure adequate domestic liquidity, shore up market confidence and sustain the flow of credit to support growth (Glindro et al., 2020). The BSP measures are estimated at about ₱1.3 trillion, equivalent to 6.4 percent of the country's GDP (Diokno, 2020).

#### **Foreign exchange intervention (FXI) and capital flows measures (CFMs).**

Participation in the foreign exchange market and CFMs can create more policy space for the central bank, especially in the presence of volatile capital flows. Adrian et al. (2020) demonstrate in their simulations of COVID-style crisis scenario that the systematic use of FXI and CFMs could reduce risks to output and inflation, stabilize private borrowing spread, lower the path of the risk premium and reduce the likelihood of large real exchange rate depreciations. Economies with less well-anchored inflation expectations, significant foreign currency mismatch and weak initial conditions<sup>11</sup> can potentially benefit from using FXIs or CFMs in the short term. They find that when regulations are credible, "very small adjustments are needed for outflow CFMs." Furthermore, the exchange rate depreciation induced by FXI could help address a liquidity trap by stimulating exports if the central bank does not raise policy rates in response to the resulting inflation, and, for an EME, if it has healthy debt levels.

**Regulatory relief and forbearance measures.** To further ensure continuous flow of credit and liquidity in the economy and provide relief to the financially constrained, central banks and financial system regulators have responded to crisis episodes through regulatory relief<sup>12</sup> and forbearance measures<sup>13</sup>. Examples include the utilization of available bank capital and liquidity buffers, relaxation of prudential accounting measures, restructuring of loans of heavily affected borrowers and temporary payment moratoria. For the Philippines, the BSP enacted a broad set of regulatory relief and forbearance measures that were larger in magnitude and scope than it had implemented in previous crises (Glindro et al., 2020).

### **3.2 Track 2: Stabilization**

Within the second track are policies that aim to stabilize, rehabilitate (the financial health of households, MSMEs, corporates, promote financial resilience of banks and financial markets), and reconstruct affected but non-zombie sectors so that changes can take root in fertile soil and allow the economy to bounce back. Not only are individual policies important but their sequencing need to be well-timed.

<sup>11</sup> Such as high debt levels

<sup>12</sup> Regulatory relief refers to easing of macroprudential policy or temporary relaxation of financial requirements (Metrick, 2020).

<sup>13</sup> Forbearance measures are concessions provided by a bank to a counterparty experiencing financial difficulty (BCBS, 2016).

Authorities ought to boost confidence in financial markets by clearly signaling that they stand ready to intervene in the resolution of failing banks. Confusion and panic should be prevented. These require well-crafted communication strategies. The prevention of illiquidity, insolvency, credit distress and financial crisis are important in both the survival and stabilization tracks. While adverse solvency effects in the financial system will most likely not be immediate, appropriate and precautionary responses should be prepared at the earliest opportunity. As former Intel chairman Andy Grove used to say, “complacency breeds failure.” (Ibarra, 2016)

**Recognition of inter-sectoral effects is crucial.** The GFC highlighted the importance of macrofinancial linkages, i.e., the interactions between the real economy and the financial sector. The importance of these interactions has resurfaced in light of the developments involving the COVID-19 crisis. Slow economic activity reduces profits of businesses and incomes of households, magnifying default probabilities that weaken balance sheets of banks and other financial institutions. When households have a lot of debt, their spending decreases. When firms become highly indebted, hiring and investing slow down. The confluence of these events not only weakens financial and macroeconomic conditions but also hurts the growth potential of the economy.

**Hasty removal of stimulus must be avoided but exit strategies must be defined.** Blinder and Zandi (2015) caution fiscal policy not to swing from stimulus to austerity until it is clear that the economy is enjoying self-sustaining growth. Until the labor market is clearly approaching full employment, confidence and economic recovery will remain fragile and vulnerable to almost anything that goes wrong. The same is true for monetary policy. Kohn (2013) highlights that the decision to exit easing should depend primarily on economic and financial conditions rather than calendar time. Easing might be scaled down and stopped when the central bank can see reasonable prospects that the economy is on a sustainable path of higher levels of resource utilization, with inflation moving within target. These exit strategies must be communicated well to anchor expectations.

**Delayed withdrawal must also be resisted.** Timely withdrawal of policies that assisted the financially constrained during the survival track and stimulated demand during the stabilization track is necessary for several reasons:

*First, borrowings incurred during the survival track can result into a debt trap.* If debt rises faster than economic output, it becomes unsustainable as future debt servicing can weigh on future aggregate demand (Mian et al., 2020).

*Second, having too low rates for too long may lead to financial instability.* Households and corporates may be encouraged to take on more debt, and low returns on safe assets may prompt a leveraged search for yield and increase financial vulnerabilities (Bean et al., 2017). This is true also for regulatory relief and forbearance measures: their effects will only become apparent over time in various forms, including deterioration of asset quality and compression of profit. Inevitably, a higher proportion of stressed households and corporates will affect banks’ financial strength. As Warren Buffett said, “It’s only when the tide goes out that you learn who has been swimming naked.” Hence, it is important for banks to exercise due diligence. Delaying recognition of losses until the tide goes out will leave banks and supervisors with fewer options for dealing with the repercussions (Coelho and Zamil, 2020). Authorities need to be proactive. As such, a framework on how to clean up balance sheets would be useful. In the Philippines, the proposed creation of Financial Institutions Strategic Transfer (FIST) corporations to acquire and manage non-performing assets (NPAs) and to restructure debt of financial institutions aims to moderate the spillover effects on the real economy (HOR, 2020).

*Third, while FXI and CFMs can create more policy space for central banks, the costs of the use of these policies over the medium- to long-term need to be accounted for.* Such costs may include the slowdown in the development of derivative markets and the emergence of greater currency mismatches (Adrian et al., 2020).

*Fourth, while limiting business closures in the short run may be necessary to preserve employment, long-run support based only on size or sector rather than productivity generate misallocation* (Restuccia and Rogerson, 2017). Policymakers should avoid creating ‘zombies’<sup>14</sup> that limit the growth of new, higher-productivity businesses (di Mauro and Syverson, 2020). This task may be challenging especially if there are many medium and small firms. A sorting mechanism would be needed to differentiate the firms that have no prospect and will fail from those that have a chance (Rey, 2020).

### 3.3 Track 3: Transformation

The words of an ancient Roman general ring true in thinking about policies under the third category: “*Si vis pacem, para bellum.*” (“If you want peace, prepare for war.”) To

<sup>14</sup> Zombies are firms that in normal circumstances would exit because of poor performance.



thrive and flourish in the post-crisis environment, unwavering and necessary reforms pay great dividends. The post-AFC track of reforms provides convincing evidence. The need for structural reforms to address fissures that became apparent during the GFC and during this current pandemic must be pursued. For good or bad, the post-COVID world — as with other post-crisis landscape — would require refocusing of resources and fine-tuning of goals. However, basic principles need not change. The effectiveness of policymakers and decision makers to scan the horizon and meet incipient risks and opportunities remains critical. In prosperity and in peril, the ability to leverage the information from “scanning the horizon” is the best tool of central bankers and regulators.

**Address shortcomings revealed by the COVID-19 crisis.** While a bit of a cliché, authorities must remember to “never let a good crisis go to waste.” A crisis uncovers what is wrong with, and what needs to be fixed in, society and the economy, including what was or could not be done before the crisis hit (Sheng, 2009).

The COVID-19 crisis revealed a number of weak policies or actions. *First*, greater investment in healthcare is required. *Second*, the increased use of online services and digitization during the COVID-19 pandemic has accentuated technology and connectivity disparities, highlighting the need to invest in digital technology and cybersecurity. Policies and regulations also need to keep up. *Third*, automatic stabilizers must be reviewed and strengthened. Ideally, they should be timely and tied to the extent and duration of the downturn (Leiserson, 2020). *Fourth*, on the labor front, the pandemic has exposed a significant portion of the labor force that cannot work from home. At the same time, from a business continuity perspective, enterprises would be remiss not to explore which of the functions performed physically in the workplace could be augmented or even replaced by technology and artificial intelligence. Government policies on education and training/retooling, as well as information technology, will have to be ahead of the curve on this.<sup>15</sup> *Fifth*, policies to empower citizens to acquire adequate housing to provide a conducive environment for work-from-home arrangements and students’ learning are desirable to enhance both physical safety and productivity.

Sheng (2009) emphasizes that there may be “only a short window of opportunity of reform before memory fades and vested interests again capture the need for reform. If we do not reform whilst the sun is shining, crisis, like the next tsunami, is an inevitable consequence.”

<sup>15</sup> It might be helpful to assess the mapping of the distribution of the workforce according to functions and their risk of being replaced by technology vis-à-vis development and retooling/retraining policies.

**Seek windows of opportunity.** Crisis events change mindsets and institutions. Schumpeter’s “creative destruction” highlights how a crisis dismantles long-standing practices and ushers innovation. Behavioral changes and government protocols caused by the COVID-19 crisis were disruptive for some businesses, but others were able to find and create opportunities from them. For instance, the increased preference for online activities have prompted businesses to shift to online platforms to promote and sell their products. Likewise, social distancing rules have increased the demand for delivery services. Social planners must take advantage of the potential of information technology, digital retail and logistics to contribute to poverty alleviation and growth inclusion.

**Prepare for black swans.** A black swan, such as the COVID-19 crisis, is a highly unpredictable event, often with catastrophic effects. What it is and when it happens are difficult to predict. Thus, one cannot fully prepare for it. While authorities cannot possibly identify all possible scenarios, one can prepare for them by building resilience. Vulnerable spots should be identified and addressed early on. Contingencies can be put in place to deal with the most damaging eventualities.

One must not wait for the next crisis to occur before preparing for it. Candidates for the next crisis include those caused by debt overhang, massive cyberattacks, geopolitical events, climate change or even another pandemic.

## 4. Conclusion

Trust in policymakers result to more effective policy in normal times but more so during crises. Trust is a function of credibility, which takes time to build. Credibility rests on effectiveness. Effective policymaking rests on superior capacity to scan the horizon. Effectiveness also rests on resilience; and thus, while efficiency is desirable, it is important to balance it with resilience. Nonetheless, a credible policymaker can enhance efficiency, e.g., by complementing open market operations with open mouth operation.

In the context of the COVID-19 crisis, a multi-track framework that integrates the needs for survival, stability, rehabilitation and recovery of the economy with aspirations to thrive in the post-COVID economy—by leveraging on the strengths

and addressing the weaknesses of the economy that emerged as the different sectors dealt with the crisis—is useful for rebuilding the economy into a more robust one.

**Strategic use of data and science aid the paramount role of expert judgment.**

While an important element in formulating crisis policies is to ensure that immediate concerns are addressed, it is critical to understand how these policies might shape the economic landscape in the years and even decades to come. Uncertainty that delays investments and changes consumer behavior can have important implications not just on current output, but on productivity and potential output. The immediate economic effects are already apparent. Results of stress tests, early warning indicators, quantitative models and machine learning help inform decision makers on possible policy responses. Given the complexity of economic relationships, however, judgment plays an important role in assessing the output of models. The presence of uncertainty further increases the value of judgment because authorities must make decisions without knowing the probability distribution of the choices under consideration. As Kay and King (2020) point out, the management of uncertainty cannot be delegated to models and risk professionals, but rather rests on answering the question “What’s going on here?” This pandemic and similar crises like this generate uncertainty that requires expert judgment from decisionmakers. This judgment can be assisted by scientific methods that could help them understand the risks because if risks can be controlled, uncertainty might be more ably managed.

**Governance matters.** Credibility of policy rests on the governed trusting their policymakers. Trust can be enhanced by speed but more so by perception that interventions are coordinated, targeted and well-communicated.

**Coordinated policy responses are essential.** Pro-active and integrated measures across all policy areas are necessary to make strong and sustained impacts. Baldwin and Weder di Mauro (2020) and Blinder and Zandi (2015) highlight that policy coordination is the most effective action during a crisis. Following a large shock, the confidence effects of a coordinated fiscal and monetary support can compound the power of policies (OECD, 2019; Boone and Buti, 2019). Each has

mandates where they are more effective than the other, as well as limits rooted in economic theory and empirical evidence. Coordination enhances the power of chosen policies while addressing their limits.

**Targeted measures are favored.** In any crisis, policymakers must resist the temptation of “throwing money around,” and should aim to protect those liable to suffer in the short run and likely to gain from waiting out the end of the crisis (Fujita et al., 2020). For instance, small- and medium-sized businesses are among the most exposed to liquidity issues, thus special facilities to keep lending to small businesses are appropriate. Likewise, workers affected by income shortfalls may be given subsidies in the short run. Balisacan (2020) emphasized that crisis measures must be well-targeted, transparent and fair, efficiently administered and time-bound. These are necessary considerations to ensure that assistance and stimulus measures could deliver their intended results even with limited resources. Given the uncertainty on the resolution of the COVID-19 crisis, targeted measures are necessary to ensure that government resources are not wasted.

**Communication and transparency mitigate uncertainty and anchor expectations.** Confidence- and trust-boosting tools could amplify the effectiveness of crisis interventions. Communicating goals and commitments to the public increases trust and market confidence, which enhances the effectiveness of policy tools. Transparency is critical because without it, markets, consumers and businesses would always be guessing the true state of the financial system. For instance, Cecchetti and Schoenholtz (2020) raised the possibility of bank runs if depositors do not have sufficient information on the true state of banks.

**In summary,** while the medium- to long-term effects are still uncertain, the policies that will be deployed by authorities would influence the size and persistence of the effects of the crisis, i.e., the scars of the crisis. Furthermore, by adhering to the principles of collaboration (among policymakers and stakeholders), accuracy (in identifying the targets of the measures), agility (to self-correct in a timely manner when emerging circumstances require) and transparency in implementing policies, uncertainty may be lessened.

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# **Turning Crises into Opportunities: How Crises Shaped the Reform Agenda in the Philippines**

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## CHAPTER **THREE**



*... while all these (global) risks are severe, none is as threatening as the specter of a virulent, deadly global pandemic ... In terms of likelihood and potential damage that may be caused, pandemics pose a significant risk to both global health and economic stability.*

— Ian Goldin, *Future Opportunities, Future Shocks: Key Trends*

## 1. Shaping the global economy and society

The COVID-19 pandemic is like no other crisis that the Philippines previously experienced. The fundamental difference lies in the origin and nature of these crises. While earlier crises were primarily monetary, financial and fiscal in nature, COVID-19 is essentially a public health crisis. The impact of these crises on the Philippine economy as well as their breadth and depth differed. The crisis response policies and measures implemented also varied across crises.

This chapter presents the policy interventions that were put in place to mitigate the adverse effects of the COVID-19 pandemic as well as the initiatives and measures being proposed to bring the economy on the road to recovery. Context is given to these measures through a discussion of the policy responses to previous crises, including natural disasters like earthquakes and typhoons. The chapter likewise highlights the lessons learned from earlier crises and how these helped shaped the reform agenda in the Philippines after each crisis.

## 2. Turning the tide: crisis to reforms

Developments over the past decades show that the Philippines is able to turn adversities and crisis into reform opportunities. Thus, over the decades, the Philippines managed to build a resilient economy through policy and structural reforms that were, in part, adopted in response to previous financial and economic crises, and natural disasters.

### 2.1 Financial and economic crises

In the early 1980s, the country experienced what is arguably its worst crisis after World War II.<sup>1</sup> In 1981, the country's domestic financial sector experienced a crisis of confidence which led to substantial withdrawals by domestic and international investors from the local capital market (Intal and Llanto, 1998). The financial crisis was eventually followed by a BOP crisis in 1983. It resulted in a deep economic recession in 1984–1985.<sup>2</sup> Following sharp devaluations, the Central Bank of the Philippines performed its lender-of-last resort function to avert the collapse of the domestic banking system. However, this action impaired the CBP's balance sheet and constrained its ability to institute credible monetary policy (Guinigundo and Cacio, 2019).

The critical lesson from this crisis is that debt-fueled growth requires adroit debt management especially with respect to external debt. The debt-driven projects did not lead to productivity gains and thus failed to contribute to significant structural change in the economy. This would have mitigated the exposure of the economy to commodity price shocks that subsequently helped trigger a balance of payments crisis.

Following the crisis, the Philippines undertook important reforms to strengthen the banking and financial sectors. There was a shift from a fixed exchange rate regime to a managed float. The BSP likewise adopted monetary aggregate targeting as framework for monetary policy. This helped bring double-digit inflation down to more manageable rates.

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<sup>1</sup> The twin crisis of the early 1980s started with a crisis of confidence in 1981, which severely affected the country's banking sector. The banking crisis was eventually followed by a debt crisis in 1983.

<sup>2</sup> The crisis likewise had a political dimension in that in 1983 former Senator Benigno S. Aquino, Jr. was assassinated, setting off a widespread political unrest.

The restoration of a functioning democracy in the mid-1980s after decades of authoritarian rule provided further impetus for the implementation of key economic reforms in the country (Appendix A provides a list of selected policy and structural reforms in the Philippine economy). Starting in the 1980s until 1990s, the Philippines undertook important policies and reforms geared towards liberalization, deregulation and removal of barriers to competition. Key reforms implemented during this period include the removal of tariffs and non-tariff barriers in the trade sector; enactment of Republic Act (RA) No. 7042 (Foreign Investment Act of 1991); passage of RA No. 7721 allowing the entry of foreign banks in the country; liberalization of the telecommunications industry; privatization of water services; and deregulation of the oil industry. These measures were aimed at facilitating the efficient allocation of resources, factor mobility and growth of industries to ensure sustained growth and rapid poverty alleviation.

A crucial reform instituted in 1993 was the restructuring and recapitalization of the central bank.<sup>3</sup> Under RA No. 7653, the Central Bank of the Philippines was reconstituted into the CB – Board of Liquidators and a new monetary authority, the *Bangko Sentral ng Pilipinas*, was created pursuant to the stipulation of the 1987 Constitution for an independent monetary authority. This gave the BSP the freedom to define its policy tools, without influence of the government or other institutions of authority. Price stability was established as the overriding objective of the BSP. An important provision of the new central bank act is the granting of fiscal and administrative authority to the BSP.

The structural and key reforms implemented over these decades put the Philippines at a stable macroeconomic foothold. Thus, in 1997, when the Asian Financial Crisis (AFC) hit the East Asian region, the country's economy suffered less compared to its Asian peers. Nonetheless, the AFC provided Asian economies vital insights in safeguarding economic stability. One crucial lesson from the AFC is that sound macroeconomic policies are not sufficient to ensure economic stability. Economic resiliency entails strong financial and external positions as well. Thus, authorities in Asia adopted a more proactive and thorough approach to banking supervision. This is to ensure that idiosyncratic risks are closely

monitored and preemptively addressed. Macroprudential policies likewise became standard tools in the policy kits of Asian central banks. These are deployed to address emerging systemic risks in the financial sector.

Lessons from the AFC shaped many of the key economic, financial and structural reforms that were implemented in the 2000s. These, in turn, provided the Philippines with the strong economic foundation that allowed it to withstand the severe shocks that emanated from advanced economies during the 2009 Global Financial Crisis.

In the post-GFC period, the Philippines continued to carry out policy reforms that further enhanced the various sectors of the economy.

## 2.2 *Natural calamities and disasters*

The Philippines is situated in both the Pacific Ring of Fire and Typhoon Belt. As a result, natural disasters such as earthquakes, volcanic eruptions and typhoons have made their mark on the history and economy of the country. Throughout its history, the Philippines sustained countless human toll and immeasurable economic damages from these natural calamities. In 2016, the United Nations put the Philippines as third most vulnerable country to natural hazard risk in the World Risk Index.

In the face of these calamities, the National Government (NG) responds through disaster relief and mitigation. Additionally, the NG undertakes the reconstruction of the physical damages (especially of public infrastructure) sustained from such calamities. For its part, the BSP has been vigilant in monitoring the effects of natural disturbances on prices, the banking sector and the general economy. Periods of calamities that did not inflict significant costs to the economy<sup>4</sup> were associated with noticeably lower inflation rate compared to periods of destructive natural calamities (See Appendix B, Figure 3.1).

<sup>3</sup> Republic Act No. 7653, also known as the New Central Bank Act, was passed on 10 June 1993.

<sup>4</sup> Damages from these natural disturbances that did not cause significant economic losses are valued in this chapter to be below US\$50 million. (EM-DAT, 2020)

Higher prices that result from natural disasters are considered as exogenous shocks to the economy and they are temporary. These types of higher prices are attributed to the supply side<sup>5</sup> of the economy, which mainly fall outside the purview of monetary policy (Abenoja et al., 2010). In cases of supply-side shocks, the BSP supports government measures designed to address these shocks and it engages in credible communication to the public. In 2004, when supply-side pressures pushed inflation beyond the government's target, the BSP coordinated with other government agencies, such as the Department of Agriculture and Department of Trade and Industry, in identifying measures to fill in gaps in the country's food supply (BSP, 2005). An example of central bank communication regarding a breach in the inflation target due to supply-side pressure was provided in 2018, wherein the BSP informed the public that the rise in prices was a result of cost-push forces and that monetary policy was limited in countering inflation in such cases (BSP, 2019).

Recognizing the potential impact of natural disasters on financial institutions, the BSP deployed temporary regulatory relief to banks in regions and provinces devastated by various typhoons and earthquakes (e.g., the 7.2-magnitude earthquake that rocked Central Visayas, particularly Bohol province in 2013. Bayangos et al. (2020) confirmed the BSP's observation that extreme weather conditions can adversely affect financial intermediation, particularly through growth of loans and deposits, loan quality and profitability.

To assist in the recovery efforts after natural calamities, temporary regulatory reliefs are extended by the BSP to affected parts of the country. These include:

- Excluding existing loans of borrowers in affected areas from the computation of past-due ratios;
- Reduction of general loan-loss provisions;
- Non-imposition of penalties on legal reserves deficiencies of said banks;
- Moratorium on monthly payments to BSP for banks with ongoing rehabilitation programs;
- Booking of allowance for probable losses on a staggered basis (subject to BSP approval);

<sup>5</sup> Supply-side shocks are events or disturbances that either cause increases in the cost of producing goods and services or reduce the supply of the same good and services available in the economy (BSP, 2005).

- Non-imposition of monetary penalties for delays in the submission of supervisory reports;
- Allowing banks to provide financial assistance to employees;
- Granting of grace periods to settle outstanding rediscounting obligations; and
- Allowing banks to restructure outstanding rediscounted loans.

Among the most vulnerable sector during natural calamities is the micro, small and medium enterprises (MSMEs). They have limited access to coping strategies and are generally unprepared to confront these adverse events (Ballesteros and Domingo, 2015). MSMEs play a significant role in the economy. They comprise 99.5 percent of the total number of enterprises in the Philippines as well as provide 63.2 percent of total employment in 2018.<sup>6</sup> Cognizant of their economic contribution, the BSP extends assistance to allow MSMEs to survive the after effects of natural calamities. These include regulatory relief such as excluding loans of affected borrowers from computations of past-due loan ratio and reduction of general loan-loss provisions.

Keen and Pakko (2007) observed that the monetary authority should increase its nominal interest rate in the wake of a natural disaster.<sup>7</sup> However, historical data shows that despite the effects of natural disasters, particularly typhoons, the BSP usually does not adjust its monetary policy stance as a result of these natural events alone.<sup>8</sup> Nonetheless, the impact of unfavorable weather conditions (including El Niño and La Niña) and other natural calamities on prices is part of the BSP's assessment of the country's inflation environment.<sup>9</sup> It should be noted that, since the BSP adopted the inflation targeting framework in 2002, both inflation and policy rates have been broadly stable even in the midst of natural calamities (See Appendix B, Figure 3.2).

<sup>6</sup> Department of Trade and Industry's (DTI) 2018 MSME Statistics, available at <https://www.dti.gov.ph/resources/msme-statistics/>

<sup>7</sup> Keen and Pakko (2007) studied the appropriate monetary policy stance after Hurricane Katrina hit parts of the United States in 2005.

<sup>8</sup> In 1972, following the strong typhoons that hit the country in August and September, the Central Bank of the Philippines (CBP) adopted a more restrictive monetary policy stance via restricting the growth of bank credit and money supply (CBP, 1972).

<sup>9</sup> Based on various BSP inflation reports (i.e., 3rd quarter 2010, 4th quarter 2013, and 2nd and 3rd quarters 2015).

The Philippines recognized the importance of timely, quick and collective response to natural disasters and calamities. Thus, in 2010, RA No. 10121 Philippine Disaster Risk Reduction and Management Act of 2010 was passed into law. The act provided for the strengthening of “capacity of the national government and the local government units (LGUs), together with partner stakeholders, to build the disaster resilience of communities, and to institutionalize arrangements and measures for reducing disaster risks, including projected climate risks, and enhancing disaster preparedness and response capabilities at all levels.” Moreover, the act established the National Disaster Risk Reduction and Management Council (formerly the National Disaster Coordinating Council) which coordinates efforts towards disaster risk reduction and management. The NDRRMC is also responsible for safeguarding the safety and welfare of the people in times of calamities, disasters and emergencies.

### 3. Dealing with the COVID-19 pandemic

Some experts have pointed out that the COVID-19 pandemic is more of a “pink flamingo” (Hoffman, 2015) event than a “black swan” (Taleb, 2007).<sup>10</sup> In 2014, a global outbreak of the dreaded Ebola virus was averted with prompt action from authorities and health workers. Gates (2015) raised the possibility of another pandemic happening in the near future. He discussed the need to think about good ideas and solutions that could be put in practice for scenario planning, vaccine research and health worker training.

While significant progress has been made since the Ebola epidemic in West Africa, health systems around the world remain under-prepared for significant outbreaks of other emerging infectious diseases such SARS, ZIKA and MERS (World Economic Forum, 2020). In 2019, the Global Health Security (GHS) Index released its inaugural comprehensive assessment of the global health security capabilities of 195 countries. One stark finding is the fundamental weakness in national health security worldwide—no country is fully prepared for epidemics or pandemics (GHS Index, 2020). At the same time, the group behind the GHS Index observed that collective vulnerability to the economic and societal impacts of infectious diseases is increasing (World Economic Forum, 2019).

<sup>10</sup> According to Taleb (2007), a black swan is an event or situation which is unpredictable and for which the consequences could not be measured. Meanwhile, Hoffman (2015) described a pink flamingo as a predictable event that is ignored due to cognitive biases of a senior leader or a group of leaders trapped by powerful institutional forces.

Goldin (2014) observed that while supply chain risk, cyber security and risks to physical infrastructure, natural disasters and climate change are severe global risks, “... none is as threatening as the specter of a virulent, deadly global pandemic... In terms of likelihood and potential damage that may be caused, pandemics pose a significant risk to both global health and economic stability (pp. 12 and 76).” In 2020, the world came to know the significant costs of global pandemics.

The COVID-19 global pandemic has put considerable strain on national and global health systems. While it is primarily a public health crisis, its dire repercussions reverberated in economies across the world. Countries implemented community quarantines and lockdowns to prevent the coronavirus from further spreading among the populace (i.e., flatten the curve). This also intended to ensure that health systems are not overwhelmed. However, lockdowns brought economies to a virtual standstill with both production and expenditure sides of the trade of goods and services coming to an unexpected halt. COVID-19 plunged the global economy to its deepest recession since the Great Depression (1929–1933).<sup>11</sup> The IMF projects the global economy to shrink by 4.9 percent in 2020.

In the Philippines, the lockdowns in Luzon and in most parts of the country have disrupted economic production and dampened private sector demand. These resulted to a decline of 9 percent in the domestic economy in the first semester of 2020. The Development Budget Coordination Committee (DBCC) sees the economy contracting by 4.5 percent to 6.6 percent in 2020, and growing again by 6.5 percent to 7.5 percent in 2021.<sup>12</sup>

#### 3.1 Policy responses and interventions to COVID-19 pandemic

Previous crises have shown that their depth and persistence can be significantly alleviated with appropriate policies. The Philippines entered the COVID-19 pandemic with ample space to adopt necessary monetary and fiscal measures. These allowed the NG to implement needed policy interventions to assure markets and restore confidence in the financial system. Significant initiatives from the NG include the Bayanihan to Heal as One Act of 2020, Bayanihan to Recover as One (Bayanihan II) and the Philippine Program for Recovery with Equity and Solidarity (PH-PROGRESO).

<sup>11</sup> IMF World Economic Outlook, June 2020.

<sup>12</sup> Revised GDP growth assumptions adopted by the DBCC on 28 July 2020.



**Bayanihan to Heal as One Act of 2020.** RA No. 11469 or the “Bayanihan to Heal as One Act” of 2020 was signed on 24 March 2020. The act provided the President additional authority to combat the COVID-19 global pandemic. It allowed the President to reallocate a budget of almost ₱275 billion from the 2020 national budget in response to the pandemic. The realigned amount is about 1.4 percent of GDP. The act expired on 24 June 2020.

**Bayanihan to Recover as One (Bayanihan II).** On 11 September 2020, the “Bayanihan to Recover as One” bill (i.e., Bayanihan II) was signed into law. The measure sets aside ₱140 billion to support the NG’s COVID-19 pandemic response with an additional ₱25.5 billion in standby funds. These resources are to be allocated to various government programs that will help Filipino households and businesses recover from the adverse effects of COVID-19.

**Philippine Program for Recovery with Equity and Solidarity (PH-PROGRESO).** PH-PROGRESO is the Duterte administration’s 4-pillar socioeconomic strategy against COVID-19.<sup>13</sup> The strategy requires a total funding of ₱1.7 trillion or 9.1 percent of the country’s gross domestic product. The fiscal and monetary responses are largely financed domestically, combined with loan agreements with various multilateral and bilateral agencies.

Pillar 1. Emergency support for vulnerable groups (₱595.6 billion)

Pillar 2. Expanded medical resources to fight COVID-19 and ensure the safety of frontliners (health insurance coverage for all COVID-19 patients; special risk allowance, hazard pay and personal protective equipment (PPE) for frontline health workers; increased testing capacity; etc.) amounting to ₱58.6 billion.

Pillar 3. Fiscal and monetary actions to finance emergency initiatives and keep the economy afloat (₱610 billion, which includes standby financing for Pillar IV or the economic recovery plan, and ₱233 billion liquidity infusion into the economy) amounting to ₱1.1 trillion

Pillar 4. An economic recovery plan to create jobs and sustain growth

<sup>13</sup> <https://www.dof.gov.ph/the-duterte-administrations-philippine-program-for-recovery-with-equity-and-solidarity-ph-progreso/>

**BSP initiatives to mitigate impact of COVID-19.** While health and fiscal measures were seen as frontline responses to the pandemic, the BSP implemented measures to ascertain sufficient liquidity in the system amid the sustained uncertainty brought about by the COVID-19 pandemic (Table 3.1). The BSP’s prompt and unprecedented actions during the crisis were “to ensure adequate domestic liquidity, shore up market confidence, and sustain the flow of credit to support growth amid stronger headwinds” (Glindro et al, 2020).

**Table 3.1. BSP Initiatives During the COVID-19 Pandemic**

Objectives	Initiatives
To shore up market confidence and ensure adequate liquidity and credit	<ul style="list-style-type: none"> <li>• Cut the policy rate by a cumulative 175 basis points since February 2020 (RRP rate at 2.25 percent as of June 2020)</li> <li>• Reduced the reserve requirement ratios of universal and commercial banks (UKBs) and non-bank financial institutions with quasi-banking functions (NBQBs) by 200 basis points</li> <li>• Suspended the term deposit facility auctions for particular tenors</li> <li>• Lessened the daily overnight reserve repurchase volume offering</li> <li>• Lowered term spread of peso rediscounting loans relative to the overnight lending rate to zero</li> </ul>
To complement government programs through extraordinary liquidity measures	<ul style="list-style-type: none"> <li>• Entered into a P300 billion (around US\$5.9 billion) purchases of government securities (GS) from the National Government under repurchase agreement with a term of three months, which can be extended by another three months subject to Monetary Board (MB) approval.</li> <li>• Opened a window for purchases of government securities in the secondary market</li> <li>• Remitted P20 billion in advance dividends to the National Government</li> </ul>
To provide forward guidance	<ul style="list-style-type: none"> <li>• BSP is prepared to use its full range of monetary instruments and to deploy regulatory relief measures as needed</li> </ul>
To extend financial relief to borrowers	<ul style="list-style-type: none"> <li>• Temporary exclusion of loans of affected borrowers from the past-due and non-performing classification</li> <li>• Allow banks to stagger booking of allowance for credit losses for loans extended to affected borrowers</li> <li>• Banks with outstanding rediscounting obligations with the BSP are entitled to either a grace period for their payments, or restructure the rediscounted loans</li> </ul>
To incentivize lending	<ul style="list-style-type: none"> <li>• Reduction of credit risk weights of loans granted to MSMEs</li> <li>• Allow peso-denominated loans to MSMEs and certain large enterprises as forms of alternative compliance with banks’/quasi-banks’ reserve requirements against deposit liabilities and deposit substitutes</li> <li>• Temporarily raised the Single Borrower’s Limit</li> <li>• Deferred the implementation of the revised risk-based capital framework for stand-alone thrift banks (TBs) and rural and cooperative banks (R/CBs)</li> <li>• Temporarily reduced the minimum liquidity ratio of stand-alone TBs and R/CBs</li> <li>• Banks/quasi-banks were allowed to utilize capital conservation and Liquidity Coverage Ratio buffers during the crisis situation</li> </ul>

Table 3.1. BSP Initiatives During the COVID-19 Pandemic (Cont)

Objectives	Initiatives
To promote continued access to financial services	<ul style="list-style-type: none"> <li>• Relaxed Know Your Customer requirements to facilitate access to formal financing channels</li> <li>• Urged BSP-supervised financial institutions (BSFIs) to suspend fees and charges on use of online banking or e-money, including fees imposed on the use of InstaPay, PesoNet, other fund transfer services and ATM interbank transactions</li> <li>• Waived fees related to the grant of license or authority to provide electronic payments and financial services (EPFS)</li> <li>• Temporarily waived transaction fees charged for fund transfer instructions made with PhilPass</li> <li>• Issued guidelines and reminders to augment existing capabilities of BSFIs and enable them to implement appropriate strategies to address the increasing demand for digital channels and effectively manage the attendant risks such as increasing financial crimes and cyber-attacks</li> <li>• Granted operational relief measures for foreign exchange transactions</li> <li>• Encourage BSFIs to extend financial assistance to their officers</li> </ul>
To support continued delivery of financial services	<ul style="list-style-type: none"> <li>• Eased the BSP reporting requirements</li> <li>• Suspended monetary penalties imposed for delay in the submission of reports</li> <li>• Relaxed notification requirements related to changes in banking hours and temporary closure of bank, branch, branch-lite units and BSFI offices, service units</li> <li>• Temporary approval on the non-imposition of penalties on legal reserve deficiencies</li> <li>• Provided accounting relief measures to reduce the impact of mark-to-market losses on the financial condition</li> <li>• Temporarily eased the exposure limits for the Unit Investment Trust Fund (UITF)</li> </ul>

Source: BSP

Prior to the implementation of the Enhanced Community Quarantine (ECQ), the BSP already reduced its policy rate by 25 basis points (bps). Cumulatively, the BSP has reduced its policy rate by a total of 175 bps since February 2020 with the policy rate settling at 2.25 percent by June 2020. The BSP likewise reduced reserve requirement (RR) ratio of universal and commercial banks (UKBs) and non-bank financial institutions with quasi-banking functions (NBQBs) by 200 basis points. Further 200 bps cuts in the reserve requirement have been announced for 2020.

In an unprecedented move, the BSP utilized a tool included in its arsenal by Section 89 of the New Central Bank Act.<sup>14</sup> The BSP undertook a ₱300 billion (around US\$5.9 billion) purchases of government securities (GS) from the National Government under a repurchase agreement with a term of three months, which can be extended by another three months subject to Monetary Board (MB) approval. Additionally, the BSP remitted ₱20 billion in advance dividends to the National Government.

The BSP also performed targeted liquidity and lending operations with the reduction of the reserve requirement ratio (RRR), temporary reduction of term spread on rediscounting loans and temporarily cancelling the term deposit facility (TDF) auction.

Recognizing the importance of MSMEs in the economy, the BSP implemented measures to encourage banks to continue lending to these industries. The BSP adopted regulatory relief measures specifically designed to support MSMEs survive the pandemic (BSP, 2020). These measures include, among others, temporary reduction in the credit risk weight of MSME loans and assignment of zero percent risk weight for MSME loans covered by guarantees.

A significant increase in the use of digital facilities for fund transfers and settlement transactions was observed during the ECQ period. This is in view of the limited physical mobility for most people. To encourage BSP Supervised Financial Institutions (BSFIs) to offer safe, efficient and reliable digital channels, the Monetary Board in April 2020 approved the waiving of fees related to the provision of electronic payment and financial services (EPFS). This will be in effect for a period of six months from 8 March 2020, the date of declaration of the

<sup>14</sup> Section 89 provides that "the Bangko Sentral may make direct provisional advances with or without interest to the National Government to finance expenditures authorized in its annual appropriation x x x" (italics supplied).

President of the state of public health emergency under Presidential Proclamation No. 922. This period may be extended depending on the development of the COVID-19 situation.

**Legislative measures to support economic recovery.** Legislative measures have been proposed that would provide stimulus to mitigate the impact of the economic fallout from the COVID-19 pandemic on the Philippine economy and financial system. These are:

- Government Financial Institutions (GFIs) Unified Initiatives to Distress Enterprises for Economic Recovery (GUIDE) Act

The bill mandates government financial institutions (GFIs) to expand their credit programs in order to assist affected micro, small and medium enterprises (MSMEs) to meet their liquidity needs.

- Financial Institutions Strategic Transfer (FIST) Law

The bill aims to ensure that distressed financial institutions have a mechanism to strengthen their balance sheet. The FIST Law encourages the private sector, government financial institutions (“GFIs”) and government-owned-or-controlled corporations (“GOCCs”) to help in the rehabilitation of distressed businesses.

### 3.2 Reform imperatives and opportunities post-COVID-19

While the COVID-19 pandemic is still an ongoing concern, it has shined a light on reform imperatives in some sectors of the economy as well as opportunities for transformative changes.

One of the Duterte administration’s 10-point socioeconomic agenda calls for investing in human capital development, including in health and education systems. The country’s experience with the COVID-19 pandemic has revealed the vulnerabilities in the Philippine health sector. Regional and socioeconomic disparities in the availability and accessibility of resources have affected the delivery of health services in the country (Dayrit et al, 2018). There is

disproportionate distribution of infrastructure and human resources across regions. While there is high concentration in NCR and other major cities, other regions have barely enough. Moreover, the Philippines finds it challenging to ensure adequate availability of health-care professionals as they prefer to work outside the country (Dayrit et al., 2018). Such conditions, which have existed prior to the COVID-19 pandemic, became more pronounced as the crisis put considerable pressure to the health system of the country.

Moreover, while the Philippines ranked 53<sup>rd</sup> out of 195 countries in the 2019 GHS Index, it scored zero in five health security indicators.<sup>15</sup> It was also observed that the country has yet to establish health protocols relating to potential pandemics.<sup>16</sup> These are some of the concerns that the Philippine health sector need to address going forward.

There is also the need to provide better social safety nets for vulnerable members of society including the elderly, children and young people. The elderly are some of the most affected by the pandemic, not just for health reasons, but also because they tend to have weaker social ties than younger ones (Hyman et al., 2020). Special programs may be needed for them, particularly during periods when risks prohibit them from leaving their premises (Ducanes et al, 2020). Children and young people are mainly affected by closures of schools. This would, however, vary depending on socioeconomic status of those from low-income families most likely be affected. Online courses and classes will be difficult to access for poorer students (Hyman et al., 2020). Policymakers need to take these into consideration when they design social programs.

Meanwhile, for the BSP, the experience with COVID-19 highlighted the increasing importance of digital transactions. It was observed that the volume and value

<sup>15</sup> These include i) biosafety; ii) dual use research and culture of responsible science; iii) linking public health and security authorities; iv) communications with healthcare workers during a public health emergency; and v) completion and publication of a Joint External Evaluation (JPE) and Performance of Veterinary Services (PVS).

<sup>16</sup> The Department of Health (DOH)’s Health Emergency Management Bureau Manual of Operations on Health Emergency and Disaster Response Management released in 2015 does not contain protocols relating to potential pandemics. Health Emergency Management Bureau of the Department of Health of the Philippines. 2015. “Manual of Operations on Health Emergency and Disaster Response Management.” <https://hospitalsafetypromotionanddisasterpreparedness.files.wordpress.com/2015/11/complete-manual-20150129.pdf> (Accessed: 16 August 2020).



of the combined transactions of PESONet and InstaPay during the Enhanced Community Quarantine (ECQ) period surged. The combined transactions of the two payment networks climbed by over 70 percent in volume and 42 percent in value in the two-and-a-half months when Metro Manila and Luzon were under ECQ (17 March – 31 May) compared to the same duration prior to ECQ (1 January to 16 March). On the other hand, the volume and value of check payments and ATM withdrawals declined over the two periods. These numbers suggest that the utilization of e-payment services rose during the ECQ when people needed these services the most.

The BSP envisions an accelerated uptake of e-payment services through digital platforms such as InstaPay and PESONet in the Philippines over the next three years. The adoption of the national QR code standard as well as the use of online payment facilities for government transactions are significant strides in this direction.

#### 4. Conclusion

Crisis episodes often expose the weaknesses and vulnerabilities of economic systems. As such, crises can provide possible directions for policy reforms. The Philippines has managed to turn lessons from previous crises into reforms that helped enhance the economy's resiliency. Compared to previous crises, the COVID-19 pandemic is different in terms of its origin and nature. Nonetheless, it required a prompt and collective response to mitigate its adverse consequences. While it is still an ongoing concern, COVID-19 has underscored some reform imperatives and opportunities that warrant consideration from policymakers.

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## Appendix A. Selected Structural and Policy Reforms in the Philippine Economy

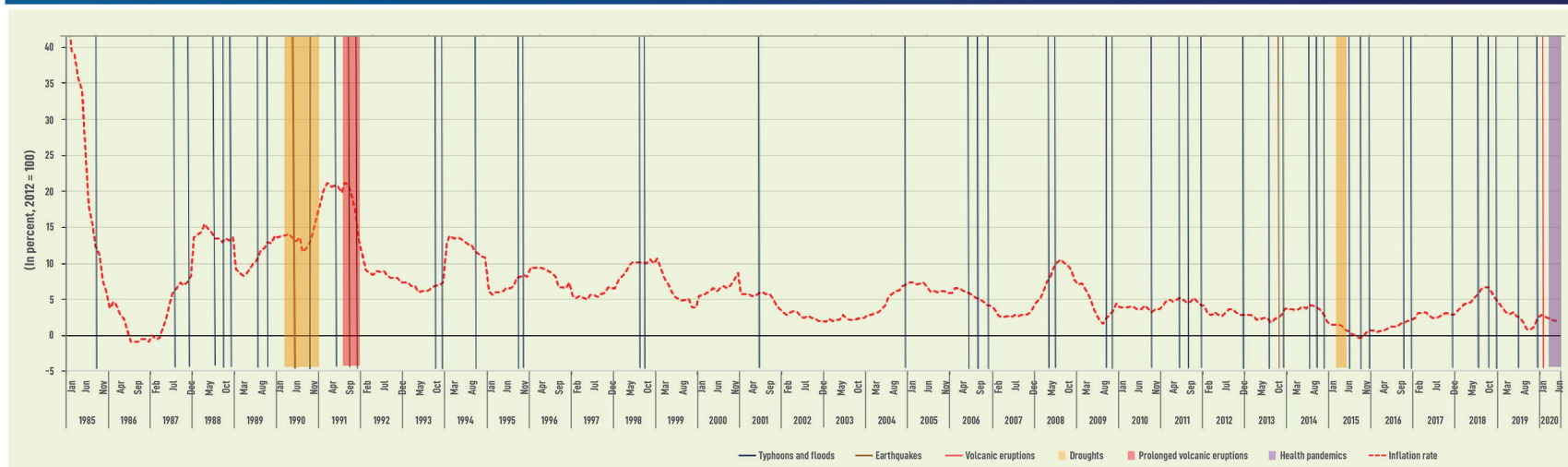
Year	Structural/Policy Reforms
1980	Orienting the financial system along a universal banking concept
1981	Establishment of the Central Bank of the Philippines as the Central Monetary Authority (Presidential Decree No. 1801)
1983	Deregulation of interest rate with lifting of remaining ceilings on short-term loans
1984	Adoption of monetary aggregate targeting as framework of monetary policy Shift from a fixed exchange rate regime to a "managed float"
1986	Changes in the composition of the Monetary Board for greater harmony and coordination of monetary and fiscal policies (Executive Order (EO) No. 16)
1993	Creation of the Bangko Sentral ng Pilipinas (RA No. 7653)
1994	Liberalization of foreign bank entry (RA No. 7721)
1995	Liberalization of the telecommunications industry (RA No. 7925)
1996	Further liberalization of foreign investments (RA No. 8179)
1997	Privatization of MWSS water distribution and sewerage operations (RA No. 8041)
1998	Deregulation of the oil industry (RA No. 8479); Adoption of consolidated bank supervision
2000	Approval of a law to govern Philippine e-commerce (RA No. 8792)
2001	Liberalization and reform of the electric power industry (RA No. 9136)
2002	Adoption of inflation targeting framework; Approval of law on special purpose vehicles (RA No. 9182); Passage of law reforming government procurement (RA No. 9184)
2004	Approval of securitization act; Adoption of Basel 2; Creation of the Financial Sector Forum (FSF)
2005	Passage of the expanded value-added tax (E-VAT) law (RA No. 9337); Creation of the fixed income exchange
2006	Establishment of the Wholesale Electricity Spot Market (WESM)
2007	Introduction of risk-based bank supervision
2008	Approval of the credit information system act (RA No. 9510)
2009	Privatization of National Transmission Corporation (TransCo) and National Power Corporation's (NPC) assets

Year	Structural/Policy Reforms
2011	Signing of EO No. 29 promoting open skies policy; Adopted phased immigration to Basel III Approval of government-owned-and-controlled corporations governance act of 2011 (RA No. 10149)
2012	Approval of amendments to sin tax law (RA No. 10351); Approval of amendments to the anti-money laundering law (RA No. 10365)
2013	Approval of a law allowing the infusion of foreign equity in the capital of rural banks (RA No. 10574)
2014	Signing of the comprehensive agreement on the Bangsamoro Approval of the ladderized education act (RA No. 10647) Approval of a law allowing full entry of foreign banks in the Philippines (RA No. 10641)
2015	Approval of the Philippine competition act (RA No. 10667) Enactment of a law creating the Department of Information and Communications Technology (RA No. 10844) Approval of the tax incentives management and transparency act (RA No. 10708)
2016	Approval of amendments to the Philippine Deposit Insurance Corp. law (RA No. 10846) Passage of the customs modernization and tariff act (RA No. 10863) Relaxation of investment restrictions for adjustment, lending and foreign companies and investment houses (RA No. 10881)
2017	Approval of the universal access to quality tertiary education act (RA No. 10931) Passage of amendments to the anti-money laundering act (RA No. 10927) Approval of the tax reform for acceleration and inclusion law or TRAIN (RA No. 10963)
2018	Approval of the ease of doing business act (RA No. 11032) Approval of the Philippine identification system act (RA No. 11055) Approval of the Bangsamoro Organic Law (RA No. 11054) Approval of the National Payment Systems Act (RA No. 11127); BSP (central bank of the Philippines) as overseer of the national payments system)
2019	Approval of amendments to the BSP charter (RA No. 11211) Passage of the universal health care act (RA No. 11223) Passage of the social security act of 2018 (RA No. 11199) Approval of the law to strengthen the country's gross international reserves (GIR) (RA No. 11256) Approval of a law providing for the regulation and organization of Islamic banks (RA No. 11439) Approval of a law institutionalizing the Pantawid Pamilyang Pilipino Program (RA No. 11310) Approval of a law providing for the Revised Corporation Code of the Philippines (RA No. 11232)
2020	Approval of the Bayanihan to Heal as One Act of 2020 to deal with the COVID-19 pandemic Approval of the Bayanihan to Recover as One to help mitigate the adverse effects of COVID-19 pandemic on businesses and households Passage of the Anti-Terrorism Act of 2020

Source of data: PSA, BSP and The International Disaster Database

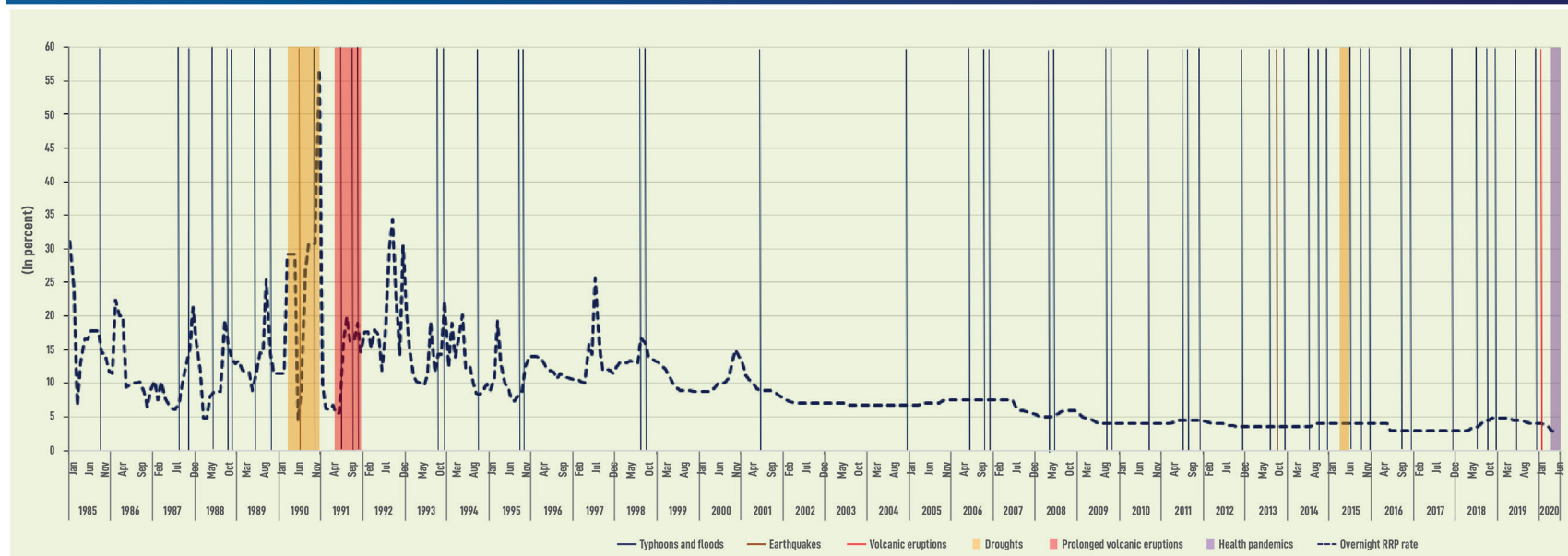
## Appendix B. Natural Calamities, Inflation and RRP Rates in the Philippines

Figure 3.1. Natural Calamities and Headline Inflation in the Philippines, 1985-2020



Source of data: BSP and The International Disaster Database

Figure 3.2. Natural Calamities and CBP-BSP Overnight RRP Rates, 1985-2020



Source of data: BSP and The International Disaster Database

# Leveraging Monetary Tools to Maintain Macroeconomic Stability

Eduard Joseph D. Robleza, Charday V. Batac, Paul Reimon R. Alhambra, Jasmin E. Dacio,  
Jan Christopher G. Ocampo, Lara Romina E. Ganapin and Dennis M. Bautista\*

CHAPTER  
**FOUR**



One of the key lessons the BSP has learned from previous crises is that crafting appropriate and effective policy responses requires a clear understanding of the nature of the shock. The COVID-19 pandemic is mainly a public health crisis. Hence, the primary response of policymakers should be towards containing the virus and providing adequate care for the infected.

However, deliberate policy choices to slow the spread of infections and arrest a full-blown health disaster inadvertently drove economies into an induced coma. Containment measures disrupted global and domestic supply chains, halting production and hindering the delivery of services. At the same time, restricted mobility and activity resulted in revenue losses especially for smaller enterprises, in turn causing layoffs and dampening household spending. Meanwhile, uncertainty surrounding the scale and duration of the pandemic also shook financial markets and led to some tightening of liquidity.

In the Philippines, the shock on both the demand and supply sides of the economy has been palpable. In the first quarter of 2020, real GDP declined by 0.7 percent year-on-year, the first recorded contraction in output since after the Asian Financial Crisis in 1998. By the second quarter of the year, the economy had fallen into a technical recession, with real GDP contracting by 16.5 percent during the period.

The unprecedented shock called for a bold and coordinated response from the National Government (NG), with both fiscal and monetary policy authorities playing distinct yet complementary roles in mitigating the adverse economic impact of the pandemic. Fiscal policy has been geared primarily towards alleviating supply bottlenecks and providing income support to vulnerable enterprises and households, while monetary authorities' role has been to ensure the proper functioning of credit and financial markets while supporting demand.

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This chapter maps the BSP's quick and decisive monetary responses to safeguard macroeconomic stability amid the COVID-19 pandemic. A preliminary assessment of their impact shows that these measures have helped calm market sentiment and ease financial conditions. The monetary easing, in particular, could also lead to improved growth prospects and slightly higher inflation over the policy horizon, although their impact on the real sector has yet to manifest fully. The chapter closes with directions for future policy responses by the BSP in its mission to help stabilize the economy amid an unprecedented crisis.

## 1. Mapping the BSP's monetary responses

With the onset of the pandemic in the country in February, the BSP observed some financial market volatility and a tightening in liquidity as prospects for domestic economic growth dimmed. On 17 March 2020, a total lockdown took effect over Luzon and Metro Manila, with the rest of the country following suit shortly thereafter, further dampening market sentiment.

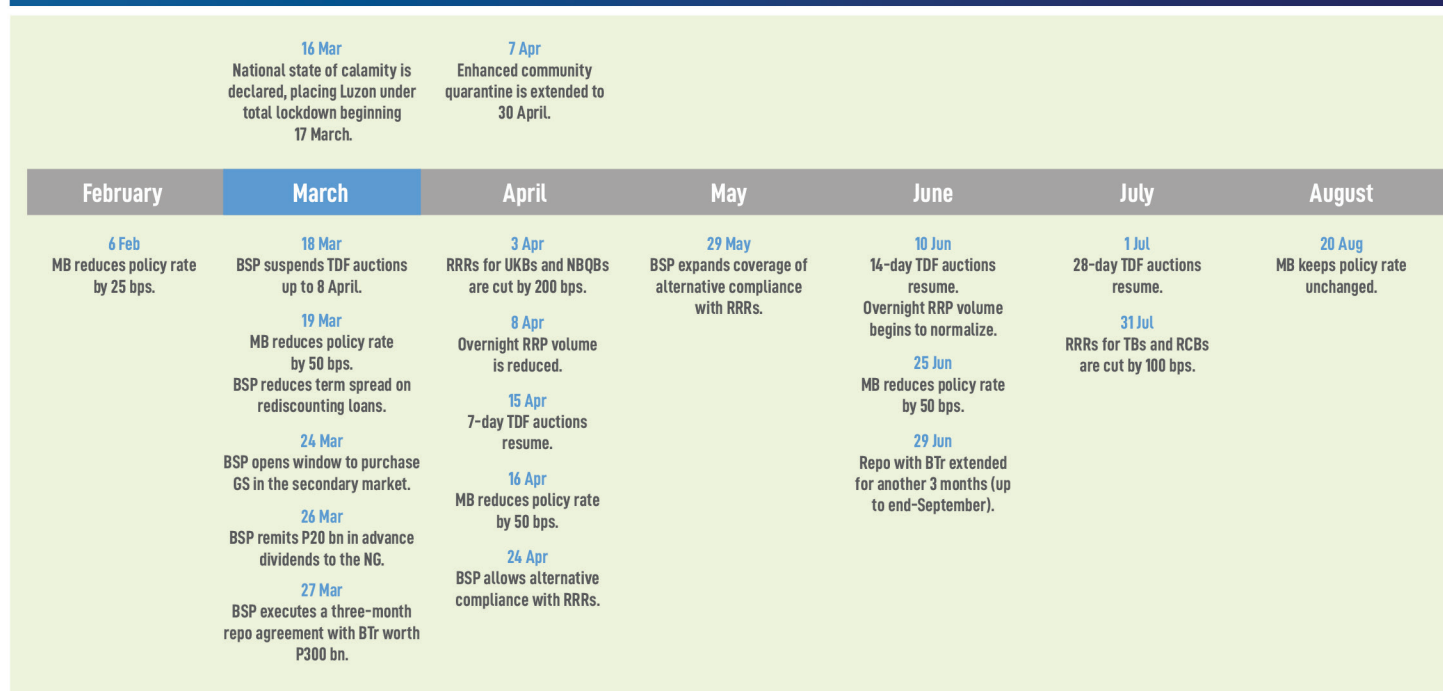
While the BSP saw that Philippine financial institutions continued to be sound with adequate capital and liquidity buffers, it also recognized the need to shore up market confidence to ensure the proper functioning of the financial system and prevent serious scarring of the economy over the medium term.

Therefore, guided by its mandate as the country's central monetary authority, and in accordance with the provisions of its Charter, the New Central Bank Act,<sup>1</sup> the BSP deemed it necessary to act decisively and take extraordinary measures to complement the National Government's health and fiscal programs in mitigating the impact of COVID-19 (Figure 4.1). By ensuring sufficient liquidity and the proper functioning of financial markets, the BSP aimed to assist the country's financial intermediaries in responding to the needs of Filipino households and businesses amid challenging times.

<sup>1</sup> Republic Act (RA) No. 7653 approved on 14 June 1993, as amended by RA No. 11211 on 14 February 2019



Figure 4.1. Timeline of the BSP's Monetary Responses, February to August 2020



Source: BSP

### 1.1 Monetary policy easing

From February to June 2020, the BSP reduced the interest rate on the overnight reverse repurchase (RRP) facility by a total of 175 basis points (bps) from 4 percent at the start of the year to an historic low of 2.25 percent. The series of aggressive and decisive policy rate cuts included a decision by the Monetary Board (MB) to reduce the policy rate by 50 bps during an off-cycle meeting on 16 April 2020, substituting for the scheduled monetary policy meeting on 21 May 2020.<sup>2</sup>

The benign inflation environment afforded the BSP the scope to ease its monetary policy stance considerably. Baseline inflation forecasts hovered firmly within the inflation target range of 3 percent  $\pm$  1 percentage point for 2020

up to 2022, reflecting mainly the impact of the pandemic on global demand, domestic economic conditions and commodity prices. Moreover, the balance of risks to the inflation outlook leaned toward the downside owing largely to potential disruptions to domestic and global economic activity. Meanwhile, inflation expectations remained well within the target range over the two-year policy horizon.

At the same time, the BSP noted a considerable slowdown in domestic economic activity with the enforcement of necessary lockdown measures. Prospects for the global economy also deteriorated amid considerable uncertainty surrounding the extent of the health crisis. Even as economies began to reopen by June 2020, global recovery was seen likely to be protracted and uneven.

<sup>2</sup> The Monetary Board decided to reduce the policy rate by 25 bps on 6 February, and by 50 bps each on 19 March, 16 April and 25 June.



Given these considerations, the BSP saw enough scope for monetary policy to help cushion economic activity and support financial conditions. Keeping the monetary stance sufficiently accommodative amid a benign inflation environment would help mitigate the strong downside risks to growth and boost market confidence. Even with the improvement in domestic liquidity and market function owing to the BSP's suite of liquidity-enhancing measures, the policy rate cuts during the first semester of 2020 were also expected to reduce the cost of borrowing further and ensure ample credit and liquidity in the financial system.

### 1.2 Reserve requirements

The BSP also reduced reserve requirement ratios (RRRs) to ward off any potential liquidity constraints. The move also aimed to encourage banks to continue lending to both retail and corporate sectors, especially amid the lockdowns imposed beginning in mid-March.

Effective on the reserve week beginning 3 April 2020, universal and commercial banks (UKBs) and non-banks with quasi-banking functions (NBQBs) shall maintain reserves equivalent to 12 percent of their deposit and deposit-substitute liabilities, down 200 bps from the prevailing ratio of 14 percent prior to the pandemic.<sup>3</sup> Meanwhile, the equivalent ratios for thrift banks (TBs) as well as rural and cooperative banks (RCBs) were reduced by 100 bps to 3 percent and 2 percent, respectively, effective on the reserve week beginning 31 July 2020.<sup>4</sup>

In addition, to further incentivize bank lending to businesses affected by severe economic disruptions, the BSP allowed alternative modes of compliance with reserve requirements. Prior to the pandemic, required reserves are kept only in the form of non-remunerated deposits maintained by banks and NBQBs in their demand deposit accounts (DDAs) with the BSP. Beginning 24 April 2020, new peso-denominated loans granted to micro, small and medium enterprises (MSMEs) after 15 March 2020 would be eligible forms of compliance with RRRs against deposits and deposit substitutes.<sup>5</sup> Beginning 29 May 2020, the BSP expanded the coverage to include new loans to large enterprises as well as loans that were renewed and restructured after 15 March 2020.<sup>6</sup> This mode of alternative compliance is available to banks and NBQBs up to 30 December 2021.

<sup>3</sup> Circular No. 1082, dated 31 March 2020

<sup>4</sup> Circular No. 1092, dated 27 July 2020

<sup>5</sup> Circular No. 1083, dated 22 April 2020.

<sup>6</sup> Circular No. 1087, dated 27 May 2020. The policy excludes loans granted to other banks and NBQBs that may otherwise meet the prescribed definition of MSMEs or large enterprises.

## Views from the Trading Desk

Ma. Mediatríz M. Boelsch, Richard S. Jadulan and Kashmirr I. Camacho

Uncertainty over the severity of the COVID-19 outbreak weighed heavily on market sentiment at the onset of the lockdown. Jittery market participants preferred to hold cash and aggressively sold their GS holdings. Consequently, GS yields rose sharply, with the five-year rate increasing by around 90 basis points in March 2020. Further, daily trading volumes fell to as low as ₱4 billion on 24 March 2020 from the ₱34-billion average prior to the imposition of the quarantine.

This lack of buying interest in the debt paper market was also reflected in the poor market participation in the BTr's regular auctions during the first two weeks of the lockdown. The auctions held from 23 to 30 March 2020 were mostly undersubscribed and submitted bid rates were 60 bps–163 bps above market rates, prompting the BTr to reject all bids. Said premium over market rates was substantially higher than the two-basis-point average premium from 6 January to 16 March 2020

In response to the pandemic-related uncertainty plaguing the financial markets, the BSP actively injected liquidity into the system to calm market sentiment. First, four TDF auctions were cancelled and outstanding TDF placements were allowed to mature. The suspension of the TDF auctions ensured adequate short-term peso liquidity in the financial system to sustain the smooth flow of funding to businesses and households during the quarantine.

Secondly, the BSP Financial Market Operations Sub-Sector (FMOSS) opened a one-hour GS purchase window starting on 24 March 2020 to support the local debt market. The BSP's GS purchases are in line with Section 91 of the BSP

### 1.3 Financial market operations

The BSP also reduced the scale of its liquidity absorption through its open market operations (OMO) to smoothen the flow of funding to businesses and households amid the lockdown. By limiting the volume offerings for the BSP's OMO, the BSP aimed to encourage counterparties to lend in the interbank market or to rechannel their funds towards other assets such as government securities (GS) or loans.

Immediately after the lockdown began, the BSP suspended the auctions for all tenors of the term deposit facility (TDF) scheduled between 18 March and 8 April 2020. The BSP also scaled back the overnight RRP volume offerings beginning on 8 April 2020. The BSP aimed to urge counterparties with maturing deposits to deploy their funds towards servicing their clients' funding requirements.

Charter, which allows the BSP to buy and sell such securities for its own account to “achieve the objectives of the national monetary policy.”

The operation of said window was challenging given the reduced number of office personnel working during the quarantine and the lack of automated trading and settlement systems for straight-through-processing.

Given resource constraints, FMOSS limited its initial purchases to the three most traded securities to ensure liquidity and the availability of a price. On 8 April 2020, the Monetary Board expanded the list of eligible securities to include all Treasury bills, Treasury bonds and retail Treasury bonds. By then, FMOSS had already established procedures that enabled it to cope with the expanded list. These procedures included setting up Bloomberg price pages for easy reference on market levels, and the use of Bloomberg confirmations as a basis for the details of done trades. The transactions are encoded on the domestic operations system, an electronic platform that captures trade data for settlement by the back office.

To protect the health and safety of personnel, the FMOSS workforce was equipped to work from home while a minimum number of onsite staff operated the most critical processes. Departments were split into teams on rotating schedules to guarantee continuous operations during the pandemic. Meanwhile, those who worked from home were given the necessary technological support, such as BSP-issued laptops with proper security features to eliminate cybersecurity and operational risks, and offsite access to the BSP’s systems and databases via virtual private networks (VPNs) and remote desktop protocols (RDPs). The enabling but secure technological infrastructure empowered FMOSS personnel to operate efficiently within a reliable and safe environment that allowed the seamless transfer of data between onsite and offsite staff.

Market functioning and liquidity improved in the succeeding weeks, as indicated by oversubscriptions in the TDF and RRP auctions. Hence, guided by its liquidity forecasts, the BSP found scope to slowly reconfigure its OMO. The 7-day TDF auctions resumed on 15 April 2020, with the 14-day and 28-day TDFs following shortly on 10 June 2020 and 1 July 2020, respectively. Meanwhile, the BSP also began to gradually normalize its overnight RRP volume offerings in June. These incremental changes were operational adjustments aimed at reinforcing previous liquidity-enhancing measures and allowing better policy traction on short-term interest rates while preserving the overall accommodative stance of monetary policy.

#### **1.4 GS purchases in the secondary market**

On 24 March 2020, the BSP opened a daily one-hour window between 9:30 AM and 10:30 AM within which it could purchase only selected series of highly-traded and liquid GS from banks at market prices. Beginning 8 April 2020, the BSP expanded the range of eligible securities to cover all peso-denominated GS issuances. The measure was aimed at reassuring market participants of demand for GS should they need to liquidate their holdings, thus encouraging participation in the primary GS auctions. The window was set to remain open until June 2020, or until market conditions returned to normal.

#### **1.5 Rediscounting**

As a form of standing credit facility available to qualified financial institutions, the BSP’s rediscounting windows also help banks meet their temporary liquidity needs by refinancing the loans they extend to their clients using the eligible papers (i.e., credit instruments such as promissory notes, or drafts or bills of exchange) of their end-user borrowers as collateral.

On 19 March 2020, the BSP approved a temporary reduction in the term spread on rediscounting loans relative to the overnight lending rate to zero, effective up to 19 May 2020. The effectivity of the relief measure has been extended up to 30 September 2020.

For the period covering 1 January to 31 July 2020, total availments under the Peso Rediscount Facility stood at ₱20.7 billion. There had been no availments under the Exporters Dollar and Yen Rediscount Facility (EDYRF) over the same period.

#### **1.6 Extraordinary liquidity measures**

The BSP also implemented extraordinary liquidity measures in support of the NG’s efforts to soften the impact of the pandemic on the economy, in line with the provisions of its Charter.

**Remittance of dividends.** The BSP's newly amended Charter stipulates that any and all dividends declared by the BSP in favor of the NG shall be released and disbursed for the payment of the increase in the BSP's capitalization. While the BSP is no longer mandated to remit its dividends to the NG, the crisis prompted the Monetary Board to defer the application of the BSP's dividends for 2019 to the BSP's capital and instead remit ₱20 billion in advance/partial dividends to support the NG's COVID-19 response programs. The funds were directly credited to NG's deposit account maintained with the BSP, or the treasury single account (TSA), on 26 March 2020.

**Provisional advances.** Section 89 of its Charter allows the BSP to directly extend funds to the NG, with or without interest, to finance public expenditures authorized in the NG's annual appropriation—akin to a cash advance. On 27 March 2020, the BSP extended provisional advances to the NG through a repurchase (repo) transaction with the Bureau of the Treasury (BTr). This was the first time since the BSP's inception in 1993 that a provisional advance was requested by the NG and subsequently granted by the BSP.

Under the repo agreement, the BSP purchased GS from the BTr amounting to ₱300 billion. The NG, in turn, committed to buy back the GS and repay the BSP within three months after the disbursement of the funds. Prior to maturing on 29 June 2020, the repo was extended by another three months to 29 September 2020, the maximum duration allowed under the BSP Charter.

Because of its temporary and time-bound nature, the ₱300-billion repo agreement with the BTr should not be seen as a quantitative-easing (QE) measure. Unlike the QE programs implemented by other central banks such as the US Federal Reserve and the European Central Bank, the BSP's repo arrangement with the NG is not aimed at bringing down market interest rates over the medium term through large-scale asset purchases. Rather, it is a short-term relief measure intended primarily to give the NG the added fiscal flexibility to finance its programs to counter the impact of the COVID-19 pandemic.

At the same time, the provisional cash advance to the NG, or any of the BSP's money-creation tools, is not a long-term source of financing for government spending. The Charter expressly stipulates a ceiling on the amount of provisional advances the BSP can extend to the NG—provisional advances should not, in

their aggregate, exceed 20 percent of the NG's average annual income in the last three preceding years, estimated at around ₱560 billion. Moreover, the cap on the duration of the provisional advance—i.e., a period of only three months, extendible to a maximum of another three months—should ensure that the transaction would not result in a long-term or permanent expansion in the monetary base or the BSP's balance sheet, which could otherwise feed adversely into the public's inflation expectations.

## 2. Analyzing the potency of monetary measures

The policy response of the BSP aimed to provide sufficient monetary support to the banking sector and financial markets to help credit expansion keep pace with the overall growth and funding requirements of the economy. The BSP reduced its policy rate by a cumulative 175 bps to a historic low of 2.25 percent in the first half of 2020. The RRRs of UKBs were also lowered by 200 bps to 12 percent. In addition, the auction volumes in the overnight RRP window and TDF were temporarily reduced, bringing the weighted monetary operations rate (WMOR) closer to the floor of the interest rate corridor, which currently stands at 1.75–2.75 percent.

Tracing the potential impact of the BSP's monetary policy adjustments suggests that monetary easing could result in higher growth prospects and a slightly higher, but still within target, inflation path over the policy horizon. Meanwhile, financial market sentiment and activity appear to have improved in the weeks following the deployment of the BSP's monetary measures. However, bank lending remains tepid as constrained economic activity has also dampened demand for credit. Nevertheless, the BSP expects credit conditions to improve as the economy gradually reopens, and as the monetary measures continue to work their way through the usual transmission channels of monetary policy.

### 2.1 Examining the potential impact

As reductions in the RRP rate and RRRs are estimated to affect key macroeconomic variables with long and variable lags based on standard theories of monetary policy transmission, the actual impact of these policy measures is

likely to be felt fully in 2021, even as their initial effects continue to work their way through the economy. For instance, monetary policy rate adjustments by the BSP are estimated to impact inflation with a lag of six months, with the peak occurring after 15-21 months. It should be noted that the policy actions may have a short-term impact on the economy through market expectations, which are not fully captured by the models.

An indirect way to examine the potential impact of policy measures is to assess how the forecast paths of key macroeconomic variables have changed due to the said adjustments. In order to assess the impact of the BSP's policy adjustments on the projected path of major economic variables over the forecast horizon, a counterfactual exercise can be performed using the BSP multi-equation model<sup>7</sup> (MEM) and the policy analysis model for the Philippines<sup>8</sup> (PAMPh). In this exercise, a scenario without policy actions (i.e., baseline case) can be compared to scenarios that incorporate the actual policy rate easing and reduction in RR ratios. Specifically, the forecast path used for the February 2020 monetary policy meeting represents the baseline case. All other assumptions on exogenous variables, such as fiscal policy, world GDP growth, foreign interest rates and global crude oil prices, were held constant in order to isolate the impact of policy adjustments on the forecast path.

In the BSP MEM, changes in the policy rate affect the economy through the standard transmission channels of monetary policy, i.e., interest rate, credit, exchange rate and expectations. An easing of the policy rate is projected to result in lower market interest rates, faster domestic liquidity growth, a depreciation in the exchange rate and higher GDP growth and inflation. Meanwhile, a reduction in the RR ratio leads to a corresponding increase in the money multiplier which raises domestic liquidity and inflation via the standard quantity theory of money identity. The estimated impact of these policy adjustments affects the major macroeconomic variables with a lag, with the peak impact occurring after about 4–6 quarters.

<sup>7</sup> The MEM is the BSP's workhorse model for forecasting and policy analysis. It consists of 23 identities and simultaneous equations estimated largely through the error-correction mechanism (ECM) approach.

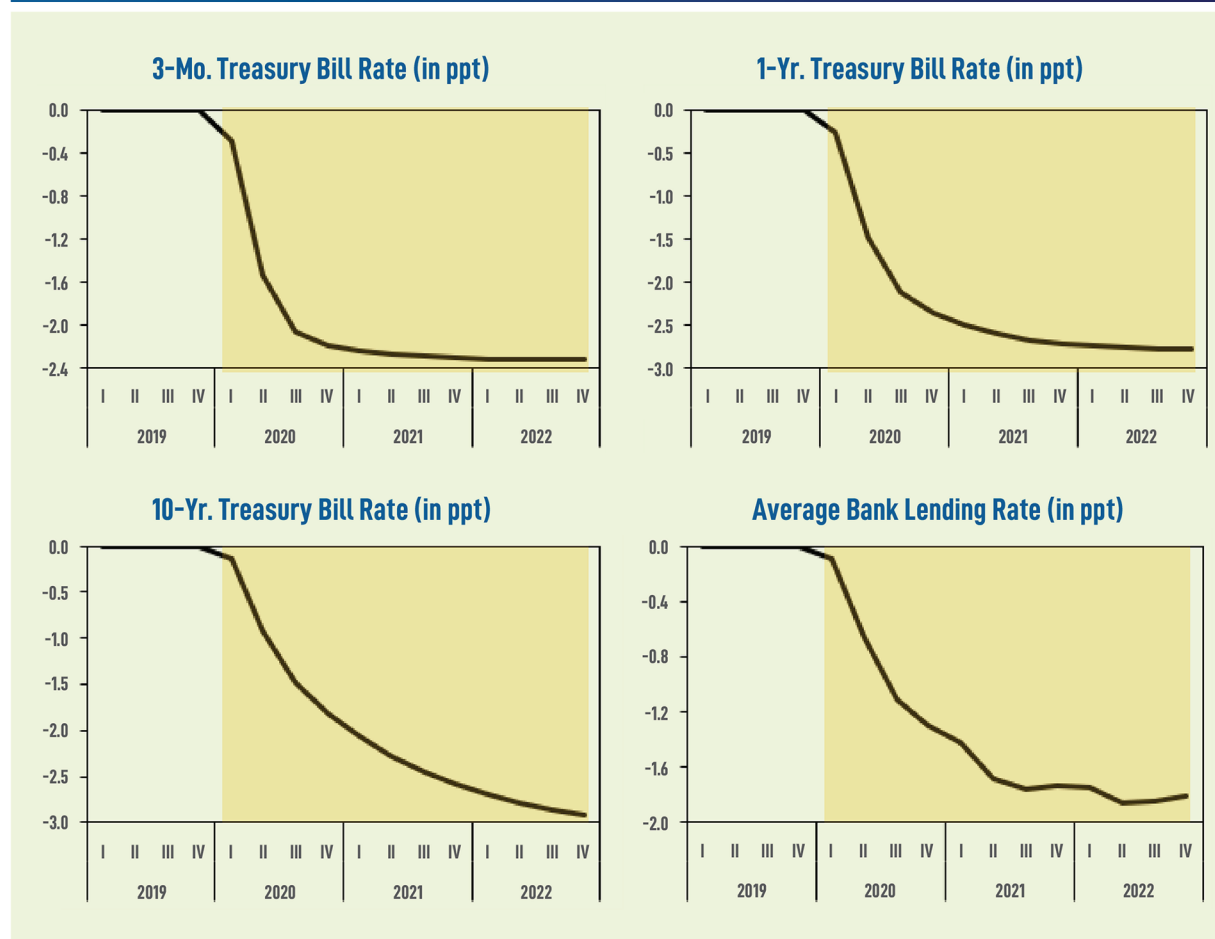
<sup>8</sup> The PAMPh is a New Keynesian semi-structural gap model for analyzing monetary transmission mechanism of key macroeconomic variables and generating their medium-term forecast path.

In the BSP PAMPh, a change in the BSP's policy rate influences the market interest rate, which subsequently determines the real interest rate. The real interest rate then feeds these variations back to the real economy. A monetary policy rate adjustment enters the output gap equation in real terms as a gap relative to long-term interest rates. Holding the neutral rate constant, a policy rate cut is expected to support aggregate demand as households and firms consume as well as invest more given lower opportunity cost of funds. Meanwhile, headline inflation is estimated as a composite of core, volatile food and energy inflation. A higher output gap, reflecting the impact of a lower RRP rate, consequently leads to higher core inflation, other things being equal. However, a reduction in reserve requirements cannot be directly captured in the PAMPh. Nonetheless, to the extent that the WMOR, instead of the headline RRP rate, and interbank call loan (IBCL) rates are used in the model, the impact of other BSP liquidity-easing measures, including the cut in RRRs, is implicitly considered in the analysis.

The counterfactual exercise in the PAMPh was implemented by fixing the WMOR at actual levels as of the second quarter of 2020, instead of using the endogenous monetary policy rule in the model. Meanwhile, all assumptions on exogenous variables were held constant. The baseline case was likewise represented by the forecast path considered in the February 2020 monetary policy meeting.

**Impact of BSP policy-rate easing on forecast path.** Using the BSP MEM, the reduction in the BSP RRP rate was contemporaneously reflected in the secondary market yields of government securities as well as in the average lending rate of UKBs. However, the reduction in market rates was estimated to be higher than the 175-bp reduction in the policy rate over the forecast horizon (Figure 4.2). This reflected elevated levels of excess liquidity in the financial system due primarily to other liquidity-enhancing measures of the BSP, which pushed short-term interest rates closer to the floor of the BSP interest rate corridor, as well as improved confidence in the primary and secondary GS markets.

Figure 4.2. Impact of Policy Rate Easing on Market Interest Rates (BSP MEM)

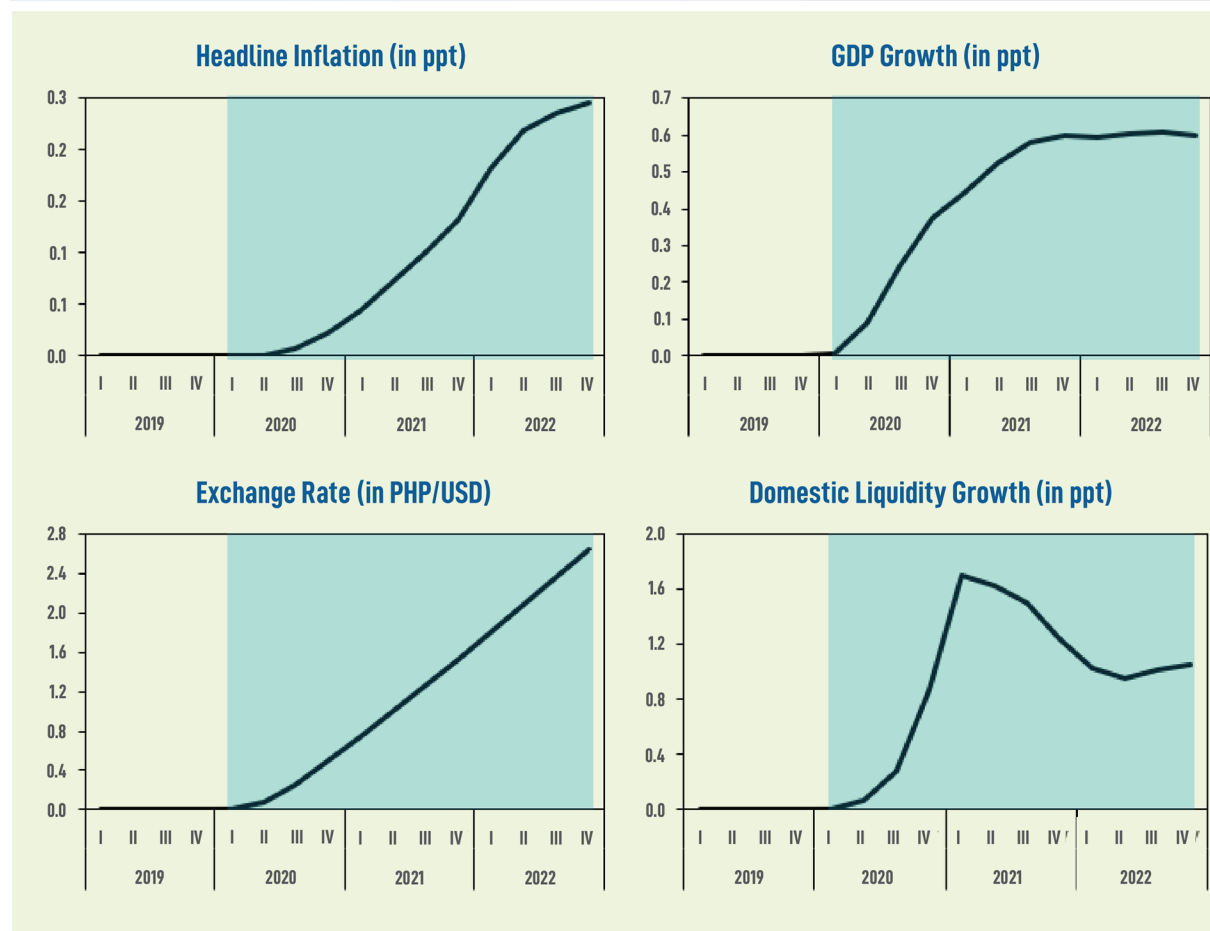


Source: BSP Staff Calculations

Meanwhile, the exchange rate was projected to depreciate over the forecast horizon through the standard interest rate and purchasing power parity relationships (Figure 4.3). However, other developments in the economy, which were not captured by the model, affected the demand and supply of foreign currency and resulted in the actual appreciation of the peso in recent months.

These factors included the significant decline in corporate demand for dollars given lower import volumes, as well as foreign exchange inflows owing to foreign borrowings by the government partly to finance social and health measures to address the pandemic.

Figure 4.3. Impact of Policy Rate Easing on Major Macroeconomic Variables (BSP MEM)

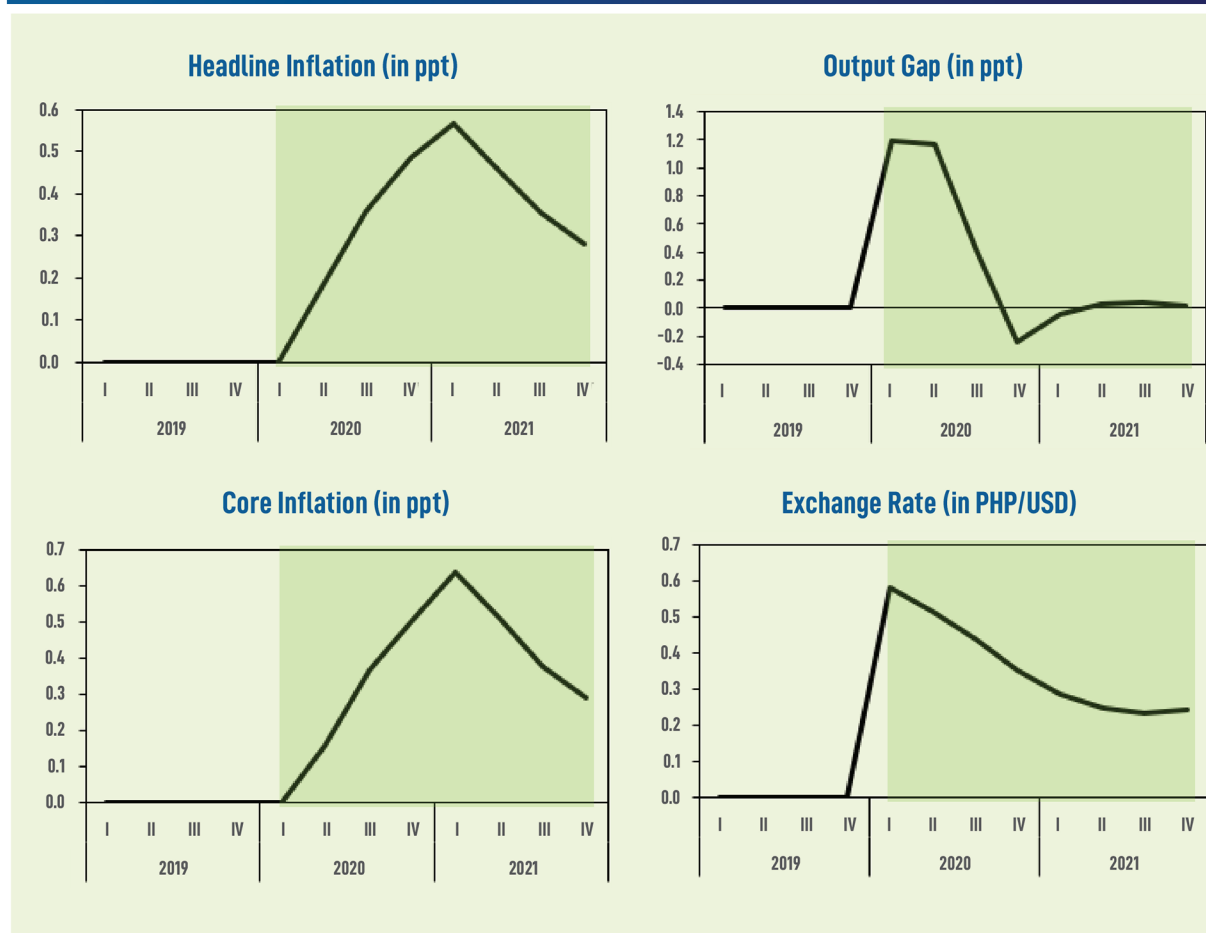


Source: BSP Staff Calculations

Not surprisingly, projections of lower market rates, higher domestic liquidity growth and the depreciation of the exchange rate following the RRP rate cut resulted in the upward adjustment of the GDP growth forecasts by half a percentage point (ppt) on average for 2021 and 2022. Similarly, the inclusion of policy rate reduction in the scenario generated higher inflation projections of 0.1 ppt for 2021 and 0.2 ppt for 2022, relative to the baseline case. Nevertheless, inflation remains within the announced target range in the scenario with lower policy rates.

Results of the counterfactual exercise using the PAMPh pointed to a similar narrative. The lower policy rates resulted in a more depreciated currency over the forecast horizon, along with higher forecasts of GDP growth and inflation (Figure 4.4). The projection for output gap was revised upward by 0.6 ppt in 2020, while the forecasts for headline inflation were higher by 0.3 ppt and 0.4 ppt in 2020 and 2021, respectively.

Figure 4.4. Impact of Policy Rate Easing on Macroeconomic Variables (BSP PAMPh)



Source: BSP Staff Calculations

**Impact of reduction in the RR ratio on the forecast path.** The liquidity released from the 200-bp reduction in the RRR in April 2020 is assumed to raise domestic liquidity as banks are expected to accelerate lending for production activities. The lagged effect is consistent with the historical episodes of reductions in the RRR wherein credit activity started to expand 6–8 months after the RR cut implementation in the absence of other shocks.

The extent by which banks can lend out free reserves is determined largely by the money multiplier (MM).<sup>9</sup> The reduction in required reserves is expected to raise the MM if the public's demand for cash holdings remains broadly stable. Based on the BSP's calculations, the MM as of June 2020 is estimated to range from 4.2 to 4.7. This implies that an additional peso released to the financial system from the BSP's liquidity-enhancing measures (net of BSP monetary operations) can potentially generate up to ₱4.30–₱4.70 in additional credit.

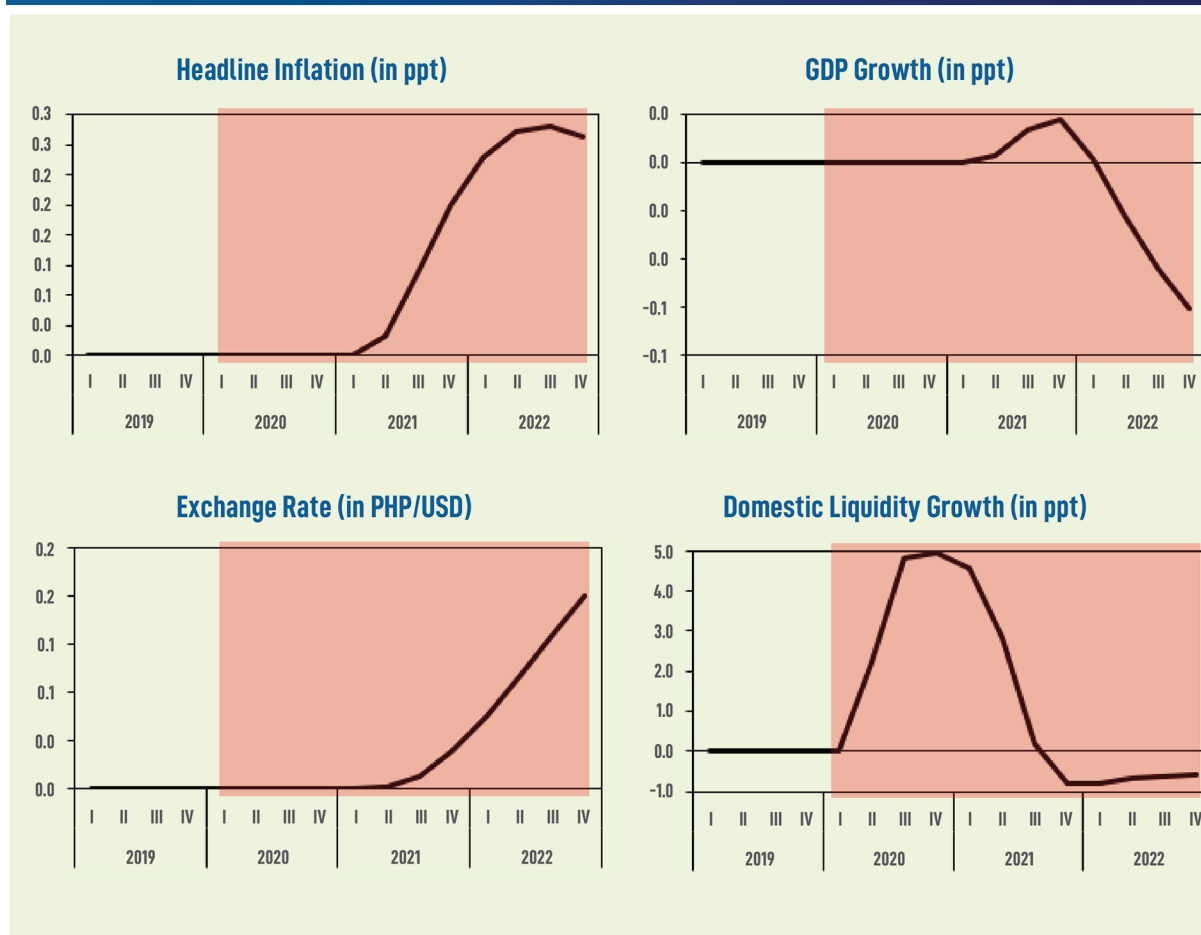
<sup>9</sup> The MEM does not incorporate any assumption on possible supply constraints that could influence lending activities of banks.



The lower RRR has resulted primarily in double-digit M3 growth rates following the slower M3 expansion noted in 2019. Domestic liquidity growth is projected to be higher by 3 ppts in 2020 and 2 ppts in 2021 (Figure 4.5). Meanwhile, the impact on growth prospects will be seen largely in the second half of 2021

following the assumed lags in the impact of reduced RR on credit activity. On the whole, the cut in reserve requirements resulted in the upward adjustment in the inflation forecasts of 0.1 ppt in 2021 and 0.2 ppt in 2022. Inflation also remains within the announced target range in the scenario with lower RRRs for UKBs.

Figure 4.5. Impact of RRR Reduction on Macroeconomic Variables (BSP MEM)

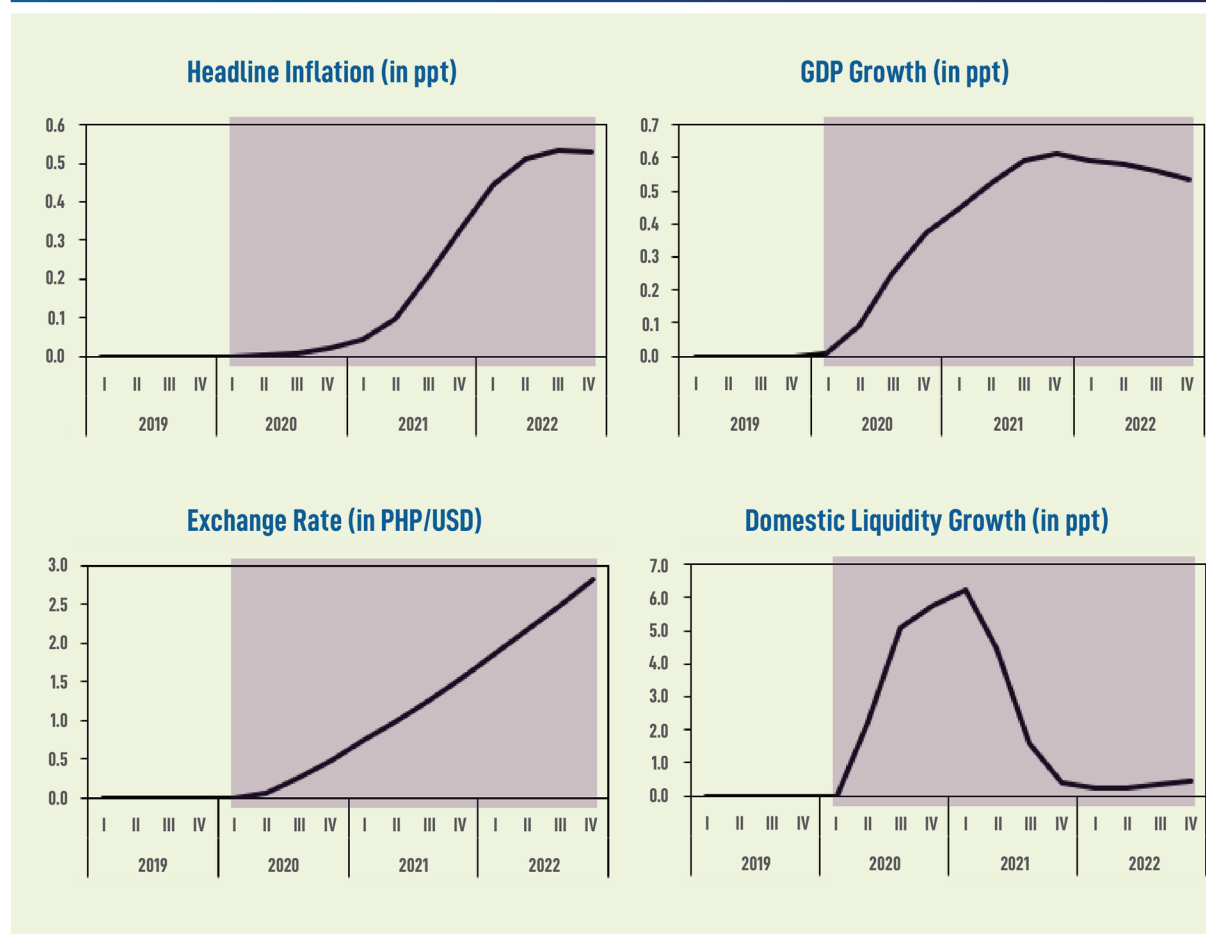


Source: BSP Staff Calculations

In summary, the combined reductions in the policy rate and RR ratio are seen to contribute to lower market interest rates, faster domestic liquidity growth and a depreciation of the exchange rate compared to the scenario without policy actions. These factors could lead to slightly higher inflation and improved growth

prospects over the policy horizon. Nonetheless, the BSP projects that inflation is likely to remain firmly anchored within the government's target range following these policy adjustments (Figure 4.5).

**Figure 4.6. Total Macroeconomic Impact of Policy Rate and RR Ratio Adjustments (BSP MEM)**



Source: BSP Staff Calculations

## 2.2 Analyzing emerging trends

As the impact of the monetary measures continue to work their way through the economy via the usual transmission channels of monetary policy, it remains too early to confirm any tangible impact on output and inflation, as well as on actual bank lending. Nevertheless, there have been incipient signs of their potency, particularly on market sentiment and interest rates.

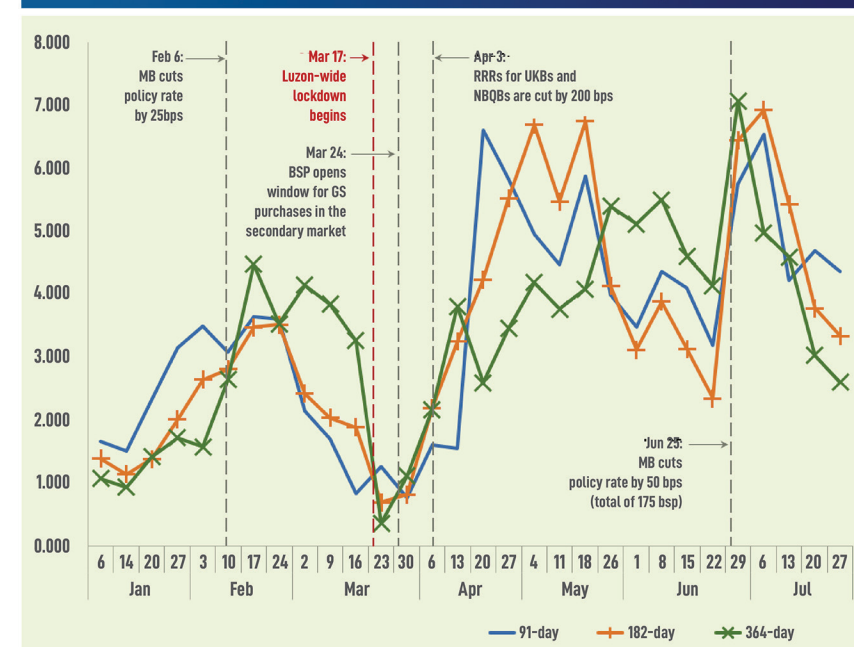
As the previous section demonstrates, interest rates are among the first variables to respond to monetary policy adjustments, with reductions in the policy rate translating to a nearly contemporaneous decline in market rates.

A cursory look at the results of the government's primary auctions for Treasury bills (T-bills) reveals how market sentiment has responded to the government's measures to contain the outbreak and mitigate its potential adverse economic effects. Figure 4.7 shows that bid-to-cover ratios, which measure the strength of demand in an auction for government papers, in the primary GS market for T-bills had been on a steady rise at the start of 2020 up until mid-February owing to ample liquidity as well as to buoyant market sentiment. However, market sentiment quickly deteriorated in March as the medical authorities confirmed the local transmission of the virus and as the NG mulled imposing strict lockdown measures to arrest it. Market participants turned risk-averse and participation in the primary auctions for T-bills sank, as indicated by the sharp decline in bid-to-cover ratios for all offered tenors.

Shortly after Luzon was placed under lockdown on 17 March 2020, the BSP deployed a suite of monetary measures to shore up market confidence and ensure ample liquidity in the financial system. Among these was a decision to open a daily window to purchase GS in the secondary market beginning on 24 March 2020 to reassure market participants of demand for GS should they need to liquidate their holdings. Together with subsequent measures to reduce the policy rate and RRRs, the BSP's actions helped encourage and restore participation in the primary GS auctions.

Meanwhile, in the secondary market for GS, yields have been on a downward trend since the BSP began deploying monetary measures in March 2020, with notable drops typically observed following reductions in the BSP policy rate.

Figure 4.7. Bid-to-Cover Ratios in the Primary Government Securities Market, January to May 2020



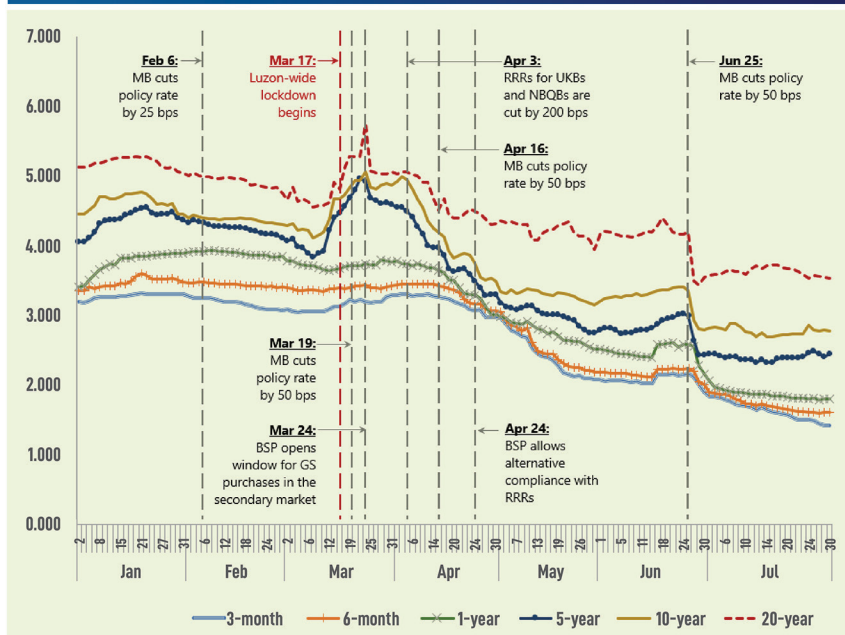
Source: BSP Staff Calculations, based on data from BTr

This supports the notion that the BSP's measures have helped shore up market sentiment and ensure the smooth functioning of the GS market, thereby facilitating the stabilization of broader domestic liquidity conditions (Figure 4.8).

More importantly, to the extent that banks use the BSP policy rate and GS yields as benchmarks for their lending rates, the BSP expects this development to eventually translate to lower borrowing costs for households and enterprises in the coming months. A special survey by the BSP on monthly quoted lending rates of UKBs for the period January to June 2020 showed some early evidence of a decline in lending rates, suggesting that the BSP's policy actions are starting to gain some traction.<sup>10</sup>

<sup>10</sup> The special survey was conducted by the Supervisory Policy and Research Department (SPRD). It may be recalled that, as part of the BSP's regulatory relief measures, the submission of some regulatory reports by BSP-supervised financial institutions (BSFIs) that fell due between March and May 2020 was temporarily suspended.

Figure 4.8. Secondary Government Securities Market Yields, January to July 2020



Source: Philippine Dealing & Exchange Corp. (PDEX)

At the same time, given the lags associated with monetary policy adjustments, it may be too soon to see any evidence on the impact of these measures on actual bank lending. Preliminary data as of end-July 2020 show that growth in outstanding loans of UKBs, net of RRP placements with the BSP, has broadly decelerated relative to its pace in 2019, reflecting constrained domestic economic activity and weaker demand for credit amid the ongoing health crisis. Nonetheless, domestic liquidity, as measured by M3, continues to expand at double-digit rates as of end-July 2020.

### 3. Looking towards new economic realities

The COVID-19 pandemic required the BSP to mobilize its monetary instruments and other extraordinary measures to avert liquidity strains and to prevent long-lasting scarring on the Philippine economy. The measures have contributed to calming market sentiment and easing financial conditions, although the full impact of their transmission through the economy has yet to be realized. This suggests that there remains room for monetary policy and liquidity measures to provide potent support to the economy.

The BSP ensures that it administers only carefully considered prescriptions in nursing the economy back to health. As the end of the pandemic remains highly uncertain, the BSP continues to monitor economic developments and data to gauge the evolving needs of the economy. The BSP has far from exhausted the instruments in its policy toolkit, and it stands ready to recalibrate or deploy additional measures to maintain macroeconomic stability. The BSP reiterates its continued support for the NG's broader efforts to mitigate the socioeconomic impact of the pandemic on Filipino households and businesses.

Nevertheless, the BSP has always been aware of the limits of its interventions, especially with regard to monetary policy and its instruments. As the Philippine economy slowly recovers, most of these monetary interventions will need to be scaled back, if not reversed entirely, even as other instruments of the central bank may have to be utilized. Moreover, fiscal policy, together with structural reforms, will also continue to share in the heavy lifting to quicken the recovery by supporting incomes and employment, thus rousing sentiment and demand. However, the growing overlap between monetary and fiscal policy will need to be kept in check to ensure the central bank's independence and credibility (Carstens, 2020). Transitioning towards new economic realities, therefore, will entail some challenges for the BSP in the pursuit of its mandate as the country's sole monetary authority.

### 3.1 Maintaining price and financial stability

The transition to new normal conditions may yet require the BSP to continue to enforce and deploy measures in aid of the NG's ongoing efforts to address the socioeconomic impact of the COVID-19 pandemic. As the BSP continues to coordinate with fiscal authorities, the challenge lies in ensuring that the BSP's policy actions remain in line with its mandate to maintain price and financial stability.

**Price stability.** The BSP's policy responses thus far have been consistent with its primary objective to maintain price stability conducive to a balanced and sustainable growth of the economy and employment. As shown in the previous section, inflation is likely to remain within target over the policy horizon, even amid significant monetary easing, in the absence of further shocks.

Looking ahead, there remains a scope for monetary policy to be accommodative in support of domestic economic activity, to the extent that the inflation environment remains benign. Baseline forecasts since the start of 2020 have indicated that inflation is likely to remain within the government's target band of 3 percent  $\pm$  1 percentage point up until 2022. Meanwhile, inflation expectations have also been broadly consistent with the inflation target.

BSP staff has also assessed that the risks to the inflation outlook lean toward the downside from 2020 until 2022, consistent with the emerging view that potential disruptions to domestic and global economic activity amid the ongoing pandemic are likely to exert downward pressures on prices and inflation. Banerjee et al. (2020), for example, find that a collapse in economic output has increased downside risks to inflation in both advanced and emerging market economies. Blanchard (2020) also posits that it is unlikely for inflation to pick up any time soon, as high unemployment would temper pressures on wages; an increase in precautionary saving would lead to weak consumption; and uncertainty would dampen investment. He adds that "the challenge for monetary and fiscal policy is thus likely to be to sustain demand and avoid deflation than the reverse."

**Financial stability.** The BSP also recognizes the need to continue to support market confidence and to ensure that liquidity is more actively mobilized while being mindful of the potential buildup of risks to the financial system. The BSP, therefore, will continue to carefully calibrate its various regulatory relief and supervisory measures to ensure financial intermediation while keeping potential systemic risks at bay. As Restoy (2020) observes, the policy responses of central banks to the pandemic highlight how "macroprudential tools do matter, for both financial stability and economic stability."

As the economy gradually reopens, the challenge for supervisory authorities lies in deciding how and when to withdraw the regulatory relief measures that have been deployed (Ehrentraud & Zamil, 2020). On one hand, an early exit may take away much needed support or incentives to lending, and thus to economic activity and growth. On the other hand, waiting too long could foment systemic risks, especially amid a prolonged environment of low interest rates—as demonstrated by the Global Financial Crisis.

On balance, it must be noted that monetary adjustments directly affect liquidity and credit dynamics, which in turn influence banks' profitability and appetite for risk. At the same time, supervisory and macroprudential policies also drive consumption and investment decisions by households and firms—i.e., aggregate demand—and, therefore, the outlook for growth and inflation (Restoy, 2020). Therefore, as the BSP looks toward a post-pandemic environment, monetary and financial supervision policies will need to be closely coordinated, just as they have always been under normal conditions.

### 3.2 Recalibrating monetary instruments

From the perspective of monetary policy implementation and liquidity management operations, the measures that the BSP has deployed are temporary and time-bound adjustments directly linked to the COVID-19 pandemic. As such, most have fixed durations (e.g., alternative compliance to RRRs is valid until end-2021) although the BSP does retain some flexibility to adjust or extend some measures as necessary.

Nevertheless, recent improvements in domestic liquidity dynamics and market functioning have allowed the BSP to begin to slowly recalibrate some of its monetary tools.<sup>11</sup> As of July 2020, the BSP has resumed the auctions for all tenors of the TDF while daily offerings for the overnight RRP facility have been rescaled and are now back to pre-lockdown levels. These operational adjustments are intended to help prior monetary policy easing measures gain better traction on market interest rates and, ultimately, on credit activity.

**GS purchases.** GS purchases in the secondary market would also eventually need to be recalibrated as liquidity conditions have stabilized considerably in order to ensure their consistency with the BSP's liquidity management operations. Amid ample liquidity, the bulk of the BSP's monetary operations remain oriented towards liquidity absorption with the resumption of TDF auctions and the increase in daily RRP volume offerings. Hence, the continued purchases of GS in the secondary market would have to be gradually normalized to avoid conflicting signals and policy confusion when the majority of the BSP's operations are on the absorption side, impeding the effective transmission of monetary policy to market interest rates. This will also help foster active liquidity management by banks as well as encourage counterparties to exhaust all other possibilities before going to the BSP.

As with the other COVID-19 measures, however, the challenge lies in determining the precise timing for winding down the GS purchasing window, given the continuing need to provide support to domestic economic activity. Going forward, it will be prudent for the BSP to maintain its outright purchase and sale of GS as part of the IRC framework to enhance flexibility of BSP monetary operations and as part of the BSP's operational readiness to respond to various financial market developments.

**BSP securities.** Looking further into the horizon, the BSP also continues to lay down the groundwork for the issuance of BSP securities. As an instrument for liquidity management, BSP securities will further the BSP's initiative to shift to more market-based instruments for monetary operations under the interest rate corridor (IRC) framework. Within the context of the pandemic, having an

additional tool for liquidity absorption could aid the BSP in stabilizing broader domestic liquidity dynamics.

On 1 July 2020, the BSP and the BTr signed a Memorandum of Agreement (MOA) to link the BSP's Monetary Operations Systems (MOS) and the BTr's National Registry of Scripless Securities (NRoSS). The linkage will facilitate the seamless auction process of BSP-issued securities as well as the registry and recording of these securities, which will enable primary market issuances and secondary market trading. The initial issuance of BSP securities is set within September 2020, once all requirements and support systems are put in place.

### 3.3 Preserving independence and credibility

Finally, while the BSP continues to have ample monetary space and a wide range of monetary instruments and regulatory measures to support the economy, it recognizes that the COVID-19 pandemic is still mainly a public health crisis, and that medical and macroeconomic interventions should go hand in hand to protect public welfare.

The need for a multisectoral approach underscores a growing overlap between monetary and fiscal policy. In response to the COVID-19 pandemic, some central banks have launched various monetary responses to help shield their respective economies from the macroeconomic fallout. These include standard monetary responses such as reductions in policy rates amid a benign inflation environment as well as unconventional measures such as large-scale purchases of government bonds (i.e., quantitative easing programs).

**A brief comment on debt monetization.** Some central banks have also taken a radical approach by providing direct funding support to the government, either through direct provisions or purchases of government bonds (i.e., debt monetization). Nevertheless, debt monetization remains strongly discountenanced in the central banking community. Even if the stigma can be set aside, the main challenge, aside from its legality, pertains to its implications on central banks' independence, integrating it into the central bank's operational and communications frameworks, as well as governance and coordination issues between the central bank and the legislature and executive branches (Bernanke, 2016).

<sup>11</sup> The Monetary Board, via MB Resolution No. 703, dated 4 June 2020, approved the gradual unwinding of liquidity-easing measures implemented by the BSP beginning on 10 June 2020, covering both the RRP window and Term Deposit Facility.



Although debt monetization appears far from being the normative central bank response to the pandemic, Blanchard and Pisani-Ferry (2020) still see no reason to worry, given that large-scale purchases of government bonds have become an integral part of many central banks' toolkits even prior to the pandemic. They comment, "[W]orries cannot be about the principle of central banks buying government bonds. They must be about them buying too many of them and for the wrong reasons—what one might call excess monetization, motivated by public finance sustainability objectives rather than price or macroeconomic stability objectives." What should be more concerning is what the behavior of central banks is expected to be when the time comes to unwind the measures. Against the context of the pandemic, such a situation may arise when the economic recovery has gathered sufficient pace and therefore warrants an increase in interest rates.

For central banks, this situation brings to the forefront the importance of staying committed to their primary mandate. Public perception that the central bank might be amenable to keeping interest rates low over a prolonged period—and thus to tolerating overheating pressures—in order to alleviate the national debt burden risks dislodging inflation expectations, to the potential detriment of the central bank's price stability objective. For Carstens (2020), central banks' interventions in government debt markets may not be sustainable, and that "eventually, the natural boundaries between fiscal and monetary policy will need to be fully restored."

Central banks must therefore continue take every effort to preserve their independence and credibility in pursuing their mandates. For an inflation-targeting central bank like the BSP, this entails carefully articulating the

intentions behind its policy actions. In its various communications to market participants and analysts, the media and the general public, the BSP has made it explicitly clear that its extraordinary actions to assist the National Government in its funding requirement are considered critical and necessary, as any delay in the funding resources needed by the NG could hamper the ability of the government to address the ill effects of the pandemic and thus impede the recovery of the economy. Nevertheless, the BSP has reiterated that these measures are not intended to provide a long-term source of funding for government expenditures. Rather, they are a short-term, temporary relief measure that should not result in a permanent expansion in the monetary base or in the BSP's balance sheet. This is why the BSP has consistently reiterated that its policy actions are and will continue to be in line with its primary mandate to maintain price stability conducive to sustainable economic growth. It is also why the BSP continues to prudently recalibrate its monetary instruments amid evolving domestic liquidity conditions.

#### 4. Conclusion

While the monetary measures deployed amid the health crisis have just begun to demonstrate their potency, the limits of central banking interventions in general must also be recognized. Under normal circumstances, maintaining macroeconomic stability has always relied on an effective mix of monetary and fiscal policy, as well as prudent reforms. Amid a crisis such as the COVID-19 pandemic, it is just as true that central banking is not the only game in town.

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# How Philippine Banks are Holding Up Amid the Pandemic

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CHAPTER  
**FIVE**



## 1. Introduction

The unique character of the coronavirus disease 2019 (COVID-19) pandemic poses uncharted challenges for financial institutions. On the demand side, lockdowns and social distancing have made consumer spending muted. On the supply side, containment measures have affected both local and global supply chains (Beck et al., 2020). These disruptions could induce permanent effects on the economy, particularly if these lead to considerable layoffs and bankruptcies. The pandemic also shook financial markets in the early stages, leading to some tightening in financial conditions. As the regulator of financial institutions, authorities have to deal with the impact and challenges of the interaction among economic agents and the pandemic on supervised institutions (Eichenbaum et al., 2020).

Coelho and Prenio (2020) argued that financial sector authorities need to deal with the impact of the pandemic on the financial and operational performance of the banking institutions. On the financial side, banks have to address and mitigate the sharp drop in the value of financial assets or loss of liquidity, deterioration of credit quality, erosion of profitability and weakening of capital position. On the operational side, banks need to address the risk of failure of resources (people, processes, technology, facilities and information) to deliver business services.

Although supported by high capital and liquidity buffers since the Great Financial Crisis (GFC), bank loan quality has weakened while profitability fell significantly in many jurisdictions following the COVID-19 outbreak. Financial authorities should then prevent any risks from being magnified during the pandemic. Banks should benefit from the swift and strong actions of the central banks to increase domestic liquidity, provide regulatory relief measures and more operational flexibility to address these challenges and maintain the flow of credit to the economy.

Episodes similar to COVID-19 have happened in the recent past such as SARS in 2002–2003 and Swine Flu in 2009–2010. The affected jurisdictions, including the Philippines, already have guidance in place on how financial institutions can maintain business continuity. (Coelho and Prenio 2020). At the international level, the Basel Committee on Banking Supervision's *Principles for the sound management of operational risk* explicitly mentions a pandemic as one of the

scenarios to consider in business continuity planning. More recently, supervisory discussions have shifted towards achieving operational resilience more broadly. However, these discussions are driven largely by the challenges and vulnerabilities brought about by technological change and an increasingly hostile cyber environment.

This chapter examines the impact of the pandemic so far as well as the prudential and regulatory relief measures on the financial and operational performance of the Philippine banking system. As the supervisor and regulator of financial institutions, the BSP has a critical role in understanding the impact of the pandemic on the financial system and the real sector. The next section looks back at policy developments prior to the pandemic. Section 3 briefly enumerates the prudential and regulatory measure introduced by the BSP while Section 4 analyzes the impact of the pandemic on the Philippine banking system. Section 5 concludes.

## 2. Looking back at policy developments prior to the pandemic<sup>1</sup>

The aftermath of the Great Financial Crisis (GFC) in 2008 paved the way for central banks to stabilize the macroeconomy and financial system to steer economic development in the face of globalized finance. In the Philippines, major components of these operational policies in the markets include the reforms in the foreign exchange regulatory framework in 2007 and the formal shift in the monetary operations of the BSP to an interest rate corridor (IRC) system in June 2016.<sup>2</sup>

Eleven waves of foreign exchange liberalization reforms have been introduced since 2007. In November 2014, Republic Act (RA) No 10641 was approved, providing the legal basis for BSP to regulate and supervise the entry and operation of foreign banks in the country. Moreover, RA No. 10574 was implemented to allow infusion of foreign equity in rural banks' capital. As of end-June 2020, there are 29 foreign banks that were approved and authorized to operate by the BSP in the Philippines. Since the implementation of RA No. 10641, the BSP has approved 12 foreign bank applications (10 branches and 2 subsidiaries). There are also four foreign banks which entered in the Philippines in the form of representative office. In December 2019, the BSP approved an

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1 Discussions in this section are largely patterned after Bayangos and De Jesus (2020).

2 The IRC is a system for guiding short-term market rates towards the BSP policy interest rate which is the overnight reverse repurchase (RRP) rate. The primary aim of the adoption of the IRC is to improve the transmission of monetary policy.

application to establish a rural bank with a purely digital platform and majority owned by a foreign non-bank financial institution (NBFI).

Against these developments, bank business models in the Philippines have also evolved. As of end-December 2019, the BSP-supervised financial institutions (BSFIs) comprise 547 banks, 46 of which are universal and commercial banks (U/KBs), 50 are thrift banks (TBs) and 451 rural and cooperative banks (R/CBs) with their combined assets approximating the size of the domestic economy.<sup>3</sup> The number of NBFIs has risen to 1,233 units, majority of which are without quasi-banking functions such as pawnshops, money services businesses and non-stock savings and loan associations.

Cross-border activities of financial institutions expanded by an annual average of 11.6 percent while liabilities by 8.2 percent from December 2016 to December 2019. Growth in domestic total bank deposits has climbed since 2015 following the surge in overseas remittances, BPO receipts and cross-border liabilities but dropped to 7.8 percent as of December 2019. In turn, year-on-year (YoY) growth in total resources of the financial system averaged 10.4 percent from December 2015 to December 2019 due to expansion in loans, securities and other equities of banks. Annual growth of total loan portfolio climbed from 13.0 percent in June 2011 to 19.6 percent in September 2017, before it dropped to 10.1 percent in June 2019. Consumer loan growth reached its peak in March 2015 and steadily went down to 11.7 percent in June 2019.

As banks continued to adhere to sound credit underwriting standards set by the BSP through the issuance of Guidelines on Sound Credit Risk Management Practices in October 2014, loan quality remains satisfactory with the non-performing loan (NPL) ratio of banks at around 2.1 percent during the past five years. Likewise, banks continued to set aside adequate provisioning for credit losses with the NPL coverage ratio above 100 percent. The NPL definition was also aligned with international standards as the BSP adopted the Philippine Financial Reporting Standards (PFRS) 9 that prescribed the use of expected credit loss model starting January 2018.

Moreover, the BSP pushed for a broad set of strategic reforms in the financial system to better promote financial stability, preserve the institutional safety and soundness of individual banks, and protect the public. These included, first, the

<sup>3</sup> U/KBs have the ability to underwrite securities and take equity positions in manufacturing, agricultural and other enterprises. These banks are also encouraged to make equity investments, to promote longer-term lending and to inject competition into the financial system. By contrast, TBs and R/CBs, which are largely stand-alone banks, play a pivotal role in promoting inclusive development particularly in the countryside by providing credit to the agriculture, forestry and fishing industries.

adoption of risk-based supervision to keep up with the growing complexity of the banking business. In turn, the BSP gradually redirected its supervisory thrust toward the measurement and management of banks' risk exposures. Second, driven by the emergence of complex banking groups and mixed conglomerates, the BSP adopted consolidated supervision.

More capital-based measures and disclosure standards have been implemented since 2008 due in part to the implementation of the Basel III requirements. The BSP adopted the Basel III capital rules for U/KBs and their subsidiary banks on 1 January 2014. U/KBs were required to comply with the 10-percent total capital adequacy ratio (CAR),<sup>4</sup> the leverage ratio of 5 percent in July 2018 and the framework on the countercyclical capital buffer in December 2018. However, simpler standards were applied to TBs and R/CBs that are not subsidiaries of commercial banks. Finally, the BSP adopted the international framework for dealing with domestic systemically important banks (D-SIBs), requiring staggered implementation of higher capital buffers starting in January 2017 and enhanced the framework in 2019. As of end-December 2019, bank capital ratios were stable despite a pick-up in risk-weight assets and well above the minimum thresholds set by BSP (10 percent) and the Bank for International Settlements (8 percent).

These measures were complemented by an increase in the risk weight on non-deliverable forward (NDF) transactions in 2013, and the conduct of the real estate stress test (REST) on banks' property development sector exposures starting from 2014.

A liquidity coverage ratio (LCR) rule was issued in March 2016 to promote short-term resiliency of the liquidity risk profile of banks. A net stable funding ratio (NSFR) rule was issued in June 2018 to promote resiliency over the longer term by creating additional incentives for banks to fund their activities with more stable sources. The banking system maintains sufficient buffers to meet liquidity and funding requirements as the LCR and NSFR are way above the BSP's current regulatory threshold of 100 percent. Banks also hold sufficient high-quality liquid assets (HQLAs) that can be easily converted into cash to service liquidity requirements over a 30-day stress period. In March 2019, stand-alone TBs, R/CBs and non-banks with quasi-banking functions (NBQBs) were required to adopt the minimum liquidity ratio (MLR). As a result, banks opted to increase their issuances of fixed-income securities, including bonds and long-term negotiable certificates of time deposits (LTNCTDs) to better manage their funding costs. Such an

<sup>4</sup> The BSP also adopted the 6.0 percent common equity Tier 1 (CET1), 7.5 percent Tier 1 and the capital conservation buffer (CCB) of 2.5 percent.

increase can be attributed to the enhanced rules for the issuance of bonds and commercial papers.

Prior to the COVID-19 outbreak, the FSS has embarked in crafting dynamic and forward-looking assessment frameworks to strengthen risk governance. The BSP approved the guidelines on the adoption of PFRS 9 - Financial Instruments for BSFIs. These guidelines set out the supervisory expectations in classifying and measuring financial instruments and in recognizing impairment to promote prudence and transparency in financial reporting. The PFRS 9 required the adoption of the expected credit loss (ECL) model in recognizing impairment. The model requires early recognition of allowance for credit losses even before the default or non-payment of the borrower. This approach has been adopted by the BSP as embodied in the Guidelines on Sound Credit Risk Management. The BSP's earlier issuance amending the definition of past-due and non-performing loans paved the way for the implementation of the ECL methodology in booking allowance for credit losses.

In 2018, the BSP conducted the first Banking Sector Outlook Survey (BSOS) which gathered the sentiments within a two-year horizon of the Presidents/ Chief Executive Officers/Country Managers of all the U/KBs, TBs and top 20 R/ CBs. The conduct of BSOS aims to provide a cohesive and pro-active supervisory approach to address potential build-up of systemic risk which will serve as a complementary tool in validating the assessments of banking supervisors. In 2019, the Monetary Board approved the adoption of a Supervisory Assessment Framework (SAFr) to help supervisors in coming up with a supervisory rating.<sup>5</sup> It is more business-model centric and facilitates a dynamic assessment of the systemic importance, risk profile and quality of governance of BSFIs.

The FSS also laid down the proactive financial surveillance and reporting towards a dynamic banking system such as in supervision of conglomerates, cross-border risks and vulnerabilities tools as well as enhanced reports. These developments were complemented by the passage of key legislative reforms during the recent past to enhance systemic stability, institutional safety and soundness, and protection of the public.<sup>6</sup> These included RA No. 11211 which amends the New Central Bank Act; RA No. 11127, or the The National Payment Systems Act, which

promotes the safe, secure and efficient operation of payment systems in the Philippines; and RA No.11439, or the Islamic Banking Act, which provides for the organization, regulation and powers of Islamic banks to be established in the Philippines.

Indeed prior to the COVID-19 outbreak, the Philippine financial system has become more resilient following the adoption of enhanced and forward-looking supervisory frameworks, regulatory and financial sector reforms.

### 3. Swift, strong and time-bound prudential and regulatory relief measures

Following the COVID-19 outbreak, many central banks in developed and emerging markets around the world engaged in quantitative easing as well as relaxed prudential and regulatory standards. We have compiled and classified these measures adopted by 11 Asian central banks in Figure 5.1 into those that provide (a) liquidity and funding support to keep level of domestic liquidity afloat; (b) market functioning; (c) lending and credit support; (d) support to operational resilience during the lockdown period; and (e) other measures.

From the third week of March to the last week of July 2020, there were 411 prudential and regulatory measures issued by these economies, 38.9 percent of which were meant to support operational resilience followed closely by 29 percent for liquidity and funding support. Australia, Japan, South Korea and Singapore issued the highest number of measures largely to support operational resilience and liquidity and funding. In the case of the Philippines, there were 31 measures adopted so far by the BSP, majority of which were meant to support operational resilience.

The BSP issued timely complementary measures to assist the BSFIs survive the health crisis as well as to support households and business enterprises. Six measures were meant to provide liquidity and funding support to keep level of domestic liquidity afloat mainly through adjustments in the rates of the BSP facilities and reduction in reserve requirements.

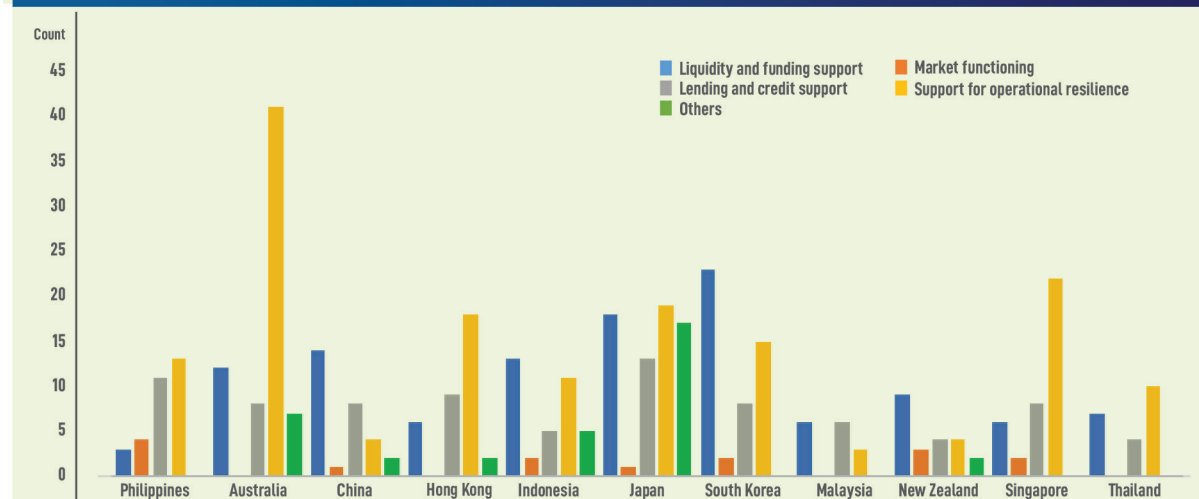
Nine measures enabled BSFIs to extend financial relief to their borrowers in the

<sup>5</sup> SAFr will replace CAMELS rating. The SAFr incorporates three major elements – the BSFI's impact on financial system, BSFI's risk profile and supervisory intensity.

<sup>6</sup> BSP Annual Report 2019.



**Figure 5.1. Number of Prudential and Regulatory Relief Measures Issued by Financial Regulators to Address COVID-19 Pandemic Across Asian Economies, March-July 2020**



Source of basic data: Lucela, D. (SPRD).

form of more flexible and favorable lending terms, including loan restructurings. For banks availing regulatory relief, loans of affected borrowers are excluded from the past-due and non-performing classification from 8 March 2020 until 31 December 2021. Likewise, banks can stagger the booking of allowance for credit losses for a maximum period of five years subject to existing regulations and based on BSP approval. Banks with outstanding rediscounting obligations with the BSP are entitled to a 30-day grace period on the settlement of outstanding obligations from 8 March 2020, without penalty charges, or the restructuring of rediscounted loans of end-user borrowers on a case-to-case basis.

The BSP's prudential measures were also eased to incentivize credit particularly to micro, small and medium-sized enterprises (MSMEs) and large enterprises to allow them to carry on with their business during the pandemic.<sup>7</sup> These measures include the reduction in credit risk weights until end-December 2021 of loans granted to MSMEs that are current in status to 50 percent from 75 percent (qualified MSME portfolio) and 100 percent (non-qualified MSME portfolio).<sup>8</sup> In addition, the BSP allowed the assignment of a zero-percent risk weight to loans that are guaranteed by the Philippine Guarantee Corporation, the Agricultural Guarantee Fund Pool (AGFP) and the Agricultural Credit Policy Council (ACPC). Moreover, peso-denominated loans to MSMEs and certain large enterprises that were critically impacted by the pandemic shall be recognized as forms of alternative compliance with banks/QBs' reserve requirements against deposit

liabilities and deposit substitutes. The single borrowers limit (SBL) was temporarily raised to 30 percent from 25 percent for six months starting March 2020.<sup>9</sup> The minimum liquidity ratio (MLR) of stand-alone TBs and R/CBs was also reduced from 20 percent to 16 percent until end-December 2020. Lastly, banks and QBs were allowed to use capital conservation and liquidity coverage ratio (LCR) buffers during the crisis.

Thirteen initiatives were adopted to ensure access to formal financing channels by retail clients during the ECQ. Immediately after the adoption of an ECQ, the BSP relaxed the Know Your Customer (KYC) requirements. It encouraged BSFIs to temporarily suspend all fees and charges imposed on the use of online banking platforms or electronic money, including those imposed on the use of InstaPay or PESONet electronic fund transfers and waived the fees related to the grant of license or authority to provide Types A<sup>10</sup> and B<sup>11</sup> advanced electronic payments and financial services (EPFS). The BSP also temporarily waived the transaction fees charged for fund transfer instructions made with *PhilPass*, and granted operational relief measures for foreign exchange (FX) transactions to facilitate the public's access to FX resources of the banking system to finance legitimate transactions.

<sup>9</sup> The relaxation also covers the increase in the 25 percent SBL for project finance loans to finance initiatives that are in line with the priority programs of the government.

<sup>10</sup> This applies to BSFIs that can be assessed against the prudential criteria provided under the Policy and Regulations on Licensing.

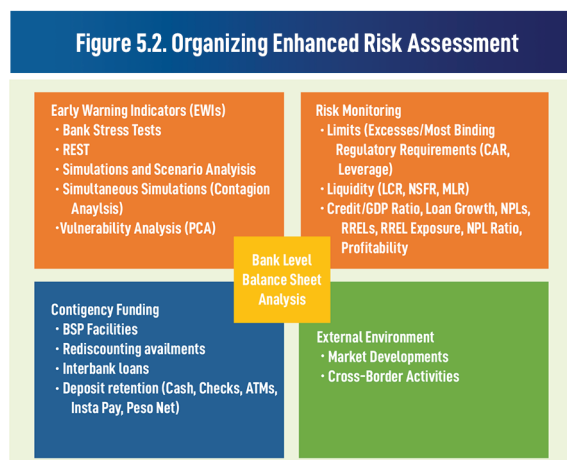
<sup>11</sup> This applies to proponents that cannot be assessed against the prudential criteria provided under the Policy and Regulations on Licensing. These include newly-established BSFIs and new applicants for an authority to operate as "Electronic Money Issuer-Others".

<sup>7</sup> For the Philippines, the matrix does not include two relief measures to ease real estate loan limits and requirements for large enterprises critically affected by the pandemic. If these will be added, measures to support lending and credit will be the same as to support operational resilience.

<sup>8</sup> A qualified MSME portfolio is diversified with at least 500 borrowers over a number of industries.

This section shows that indeed the menu of prudential and regulatory relief measures adopted from March to July 2020 by most Asian economies, including the Philippines are strong, time-bound and swift.

#### 4. What has been the impact so far on the financial system



Source: SPRD-Quantitative Research Staff

Section 3 highlights that prior to the COVID-19 outbreak, the Philippine financial system was stronger than in past crises following the adoption of enhanced supervisory frameworks, regulatory and financial sector reforms. Nevertheless, the BSP-Financial Supervision Sector conducted weekly monitoring of financial and operational developments of the BSFIs, including the domestic systemically important banks. These were formalized in more offsite supervision tools by Financial Supervision Departments (FSDs) as part of SAfr and separate thematic assessments such as the Liquidity Report (TAMSD), PESONet and InstaPay, The New Norm in Payments (PSOD), Surveillance Report on COVID-19 Themed Cyber-Attacks (TRISD), Remit Express (FSD IX), Analysis on Bank Exposures (SPRD), The Anti-Money Laundering/Countering the Financing of Terrorism Surveillance Report (FSID) and Weekly Banking Sector Highlights (SPRD). More stress-testing exercises were conducted during the pandemic. These are then used to analyze emerging risks and vulnerabilities that could warrant supervisory actions and are consolidated in the Banking Sector Risk Analysis (BSRA, SPRD). To identify

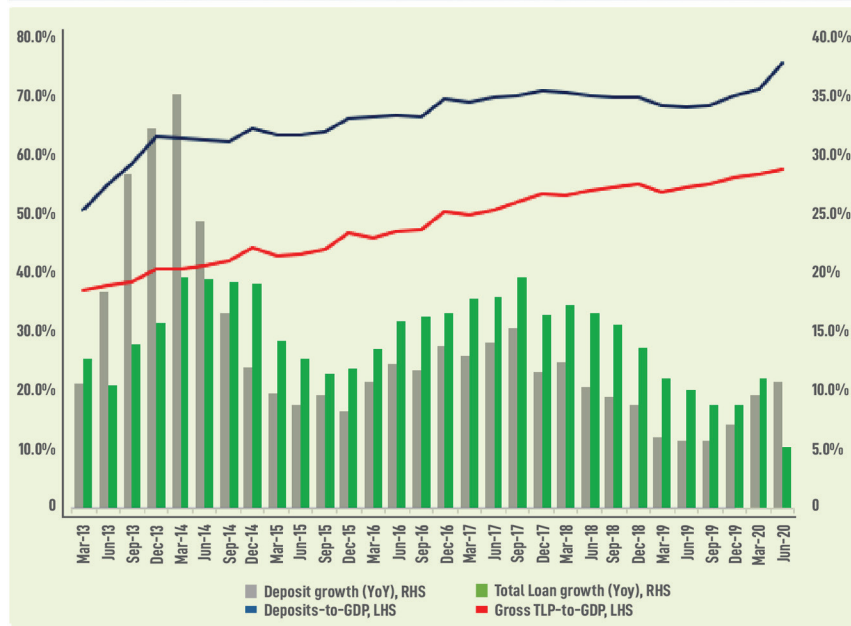
possible supervisory actions, the FSS rolled out a Comprehensive Baseline Survey of BSFIs to assess the financial and operational impact of the COVID-19 pandemic on the financial and operational performance of banks, particularly on asset quality, liquidity position, profitability and capital position as well as digital payments and cyber resilience.

Figure 5.2 shows the organizing framework for enhanced risk assessment during the pandemic using the major sections of Quarterly BSRA. Discussions on the top two red boxes – Risk Monitoring and Early Warning Indicators (EWIs) – are the main focus areas of the BSRA. The two sections help identify the banks, sectors in the economy or type of exposures which need closer monitoring and assess the supervisory actions that are needed. Discussions on the external environment such as macroeconomic and market developments as well as cross-border activities are also assessed to see any emerging impact on the banking sector (green box). The left-bottom box (violet box) covers contingency funding, particularly banks that availed of additional funding through the BSP facilities, rediscounting as well as interbank loans during the pandemic. The discussion includes the movements of deposits, including cash and checks, as well as through automated teller machines (ATMs) and payments channels such as InstaPay and PESONet to see how banks retain deposits particularly during the pandemic.

Based on the organizing risk framework, the impact so far of the pandemic on the Philippine banking system can be summarized along seven major themes.

First, the pandemic has significantly affected the banking system's activities as the ECQ and social distancing pushed banks to adjust their daily operations while the slowdown in economic activity affected their borrowers' capacity to pay. Based on the FSS Baseline Survey, banks employed proactive control measures to support the continued delivery of financial services to the general public and at the same time, protect the welfare of their personnel. Business continuity plans (BCP) enabled banks to immediately respond to the situation. Majority of the banks' board members and senior managers continued their oversight function and addressed emerging concerns through the use of technology. The survey also shows that the top priorities of BSFIs are the pursuit of digitization initiatives and management of possible deterioration in asset quality.

Figure 5.3. Total Loan Portfolio and Deposits of the Banking System (%)



Source: SPRD-Quantitative Research Staff

Second, growth of bank deposits remained firm as consumers shift to digital payments while funding cost declined following the decisive reduction in reserve requirements (RR). Driven by growth in current and savings deposits, total deposits grew YoY by 10.7 percent to reach ₱14.2 trillion as of June 2020. Time deposits however, registered a minimal increase as a result of falling rates. In turn, deposits relative to nominal gross domestic product (GDP) climbed to 75.6 percent in June 2020, the highest ratio since March 2013 (Figure 5.3).

Annual growth in bonds payable complemented growth in deposits as it shot up in December 2018 to 150.4 percent but steadily declined to 48.9 percent in June 2020. In turn, bank funding cost, defined as the ratio of total annualized interest expense over average interest-bearing liabilities, slid to 1.60 in June 2020 from a peak of 1.99 in September 2019 following the reduction in RR.

Meanwhile, an apparent shift in the use of digital financial platforms was observed following the ECQ announcement. From the third week of March 2020 to end-April 2020, FSS data showed that around 4.1 million digital accounts were opened among banks and non-bank electronic money issuers while the volume and value of check payments and ATM withdrawals significantly declined. Around

this time, the value of InstaPay and PESONet transactions rose by 330.4 percent and 76.1 percent YoY, respectively. Relative to annualized nominal household spending, InstaPay and PESONet values have been trending upwards until the second quarter of 2020.

Third, banks have become “shock absorbers” as loans slowly expanded. Following the decline in funding cost, average annualized quoted rates on bank loans, particularly the lower limit, fell from 8.51 percent in March 2020 to 8.37 percent in June 2020.<sup>12</sup> However, YoY growth of bank loans went down to 5.2 percent in June, the lowest since March 2013 (Figure 5.3). By economic activity, loans to manufacturing, mining and quarrying as well as scientific, professional and technical activities dropped in June 2020. Modest growth was seen in loans to construction and wholesale and retail trade. But loans to real estate activities and human health and social work activities rose during the same period. Relative to nominal GDP, bank loans slightly rose to 57.4 percent but was slightly lower than the estimated trend. Banks expect borrowers to have muted appetite for borrowings following the lockdown. In ADB (2020), results of the enterprise survey show that the restrictions during the ECQ had a significant impact on business activity, liquidity and credit access of 2,481 firms as well as employment and wage payment of enterprises’ regular and part-time workers. As to operations, 65.9 percent or 1,634 businesses closed temporarily while 29.1 percent or 722 enterprises reduced operations. Of these, 78.4 percent or 566 enterprises operated at half or less capacity, 4.7 percent or 34 enterprises maintained full operations, and only 1.1 percent closed permanently. These findings are not unique. Using survey responses across nearly 500 listed firms in 10 emerging markets from early April, Beck et al. (2020) found that vast majority of firms were negatively affected by COVID-19.

Among banking groups, only the TB industry recorded lower loans, posting a decline of 15.6 percent in June 2020 from the same period the previous year due to the merger of two savings banks with their parent banks. In contrast, the R/CB industry’s loan portfolio climbed by 2 percent from a year ago following the rise in loans to real estate activities and for household consumption. Based on latest data, the R/CB industry lent out a total of ₱53.2 billion to MSMEs as of end-April 2020, higher than the ₱42.1 billion registered as of end-December 2019. The R/CB’s total MSME exposures accounted for 35 percent of the industry’s

<sup>12</sup> Lower limit rates for agri-agra loans, microenterprise loans, motor vehicle loans, private corporations credit card receivables, SME loans, government loans and housing loans fell in June 2020.

total loan portfolio of ₱151.9 billion as of end-April 2020. Meanwhile, the top R/CBs continued to generate new MSME loans amounting to ₱783 million during the ECQ period.<sup>13</sup> Moreover, loans to MSMEs for compliance with the RRs have increased from ₱9.3 billion average balance during the reserve week ending 30 April 2020 or, following the effectivity of the relief measure, to ₱106 billion during the reserve week ending 20 August 2020, an indication that outstanding MSME loans will continue to rise moving forward.

Fourth, loan quality manageably weakened across banking groups. The PBS' NPL ratio climbed to 2.5 percent in June 2020, higher than the 1.9 percent average during the past five years (2015-2019). In turn, the NPL coverage ratio went up to 109.8 percent following the 49.1 percent increase in allowance for credit losses. By economic activity, loans to individuals for consumption purposes recorded the highest NPL ratio at 4.9 percent for U/KBs and 5.6 percent for TBs. Some banks disclosed that they have yet to adjust to the computation of PDLs and NPLs to consider the mandatory grace period provided under the "Bayanihan to Heal as One Act." Other banks confirmed that the growth in NPL was the combined effect of the pandemic, African swine flu (ASF) and Rice Tariffication Law. By industry, the NPL ratio of the U/KB industry rose to 2.1 percent in June 2020 from the 1.4 percent five-year average, while its NPL coverage ratio increased to 123.2 percent. The NPL ratio of the TB industry at 5.7 percent was slightly higher than the five-year average of 5 percent, while its NPL coverage ratio increased to 60.4 percent. The R/CB industry's NPL ratio of 11.2 percent was also marginally higher than the 11.1 percent five-year average, while the NPL coverage ratio rose to 73.7 percent. Meanwhile, the estimated probability of default on new loans dropped from a peak in March to June 2020 based on a proxy indicator for the PBS and 46 U/KBs from December 2019 to June 2020 following the modest loan take-up.

Fifth, financial assets take a hit as well. Financial assets refer to the sum of Financial Assets Measured at Fair Value Through Other Comprehensive Income and Financial Assets Measured at Amortized Cost. The annual growth in financial assets, which significantly slid from 20.8 percent in May 2019 to 9.4 percent in December 2019, reversed course in June 2020, when financial assets fell by 2.8 percent as banks opted to reduce treasury activities to be liquid. Based on the FSS survey, BSFIs will maintain their strategy as the duration of their investments is reduced to maximize portfolio returns. The top U/KBs did not introduce major changes in the composition of their portfolios as they assess liquidity risk. Exposures are concentrated in highly-liquid and investment grade instruments.

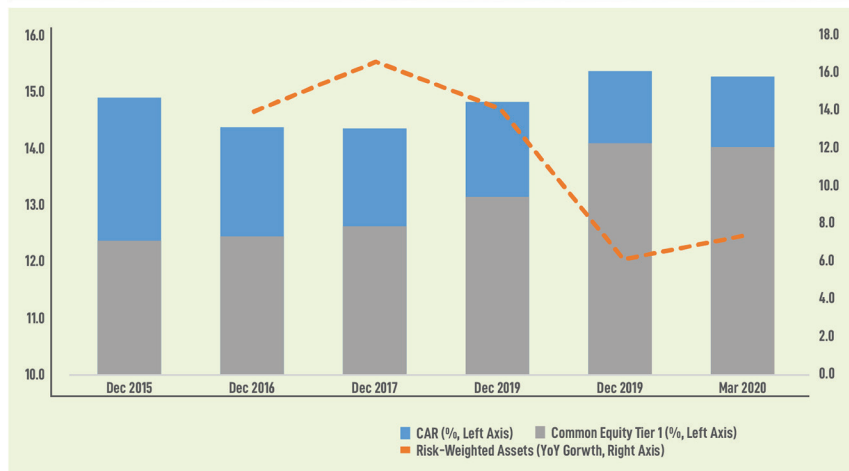
Sixth, banks' net income dives as additional provisioning rises. Profitability or net income of the banking system fell by 22.5 percent YoY in June 2020. This marks a sharp reversal compared to the 27.7 percent growth in earnings recorded in the same period a year ago. Net interest income still grew by 15.5 percent while trading income rose by 115.6 percent. However, provisions on credit losses for loans and financial assets significantly increased, weighing heavily on bank profitability. Other income sources are expected to slow down due to lower volume of transactions, waiver of interbranch and interbank fees as well as the 30-day moratorium on bank fees and charges. Net income for the whole year of 2020 is expected to decline from 2019. To mitigate the adverse impact of the pandemic on profitability, banks plan to impose cost-cutting measures (e.g., deferred capital spending and freeze hiring of non-critical positions), intensify loan collection activities, step up loan monitoring, exercise prudence in loan releases, reduce cost of funds and boost marketing campaigns for new loans and deposits. U/KBs also intend to reduce their exposures to vulnerable sectors and to increase ancillary or fee-based business while TBs and R/CBs plan to fast track digitization initiatives to reduce operating expenses.

Seventh, liquidity and capital buffers remain intact. Liquidity buffers of U/KBs and subsidiary banks and quasi banks remain ample as LCR, NSFR and MLR remain above thresholds as of end-March 2020. The HQLA of U/KBs are the most liquid and high-quality assets. Although lower than previous quarters, the overall structural liquidity position of banks, after considering short-term liquidity requirements and projected lending activity, was estimated at ₱1 trillion. This means that banks have sufficient liquidity to pursue their business operations. Contingency Funding Plans (CFPs) of most banks were not activated during the community quarantine period. Nonetheless, some banks have borrowed from existing credit lines (interbank loans) and tapped the BSP rediscounting facility to ensure ample liquidity.

The banking system remains well-capitalized with a risk-based CAR of 15.3 percent on solo basis as of end-March 2020 (Figure 5.4). The industry's leverage ratio also stood at 9.2 percent (solo basis) higher than its threshold of 5 percent for the same period. The banking system's capital is made up of Common Equity Tier 1 (at 14 percent), the highest quality among instruments eligible as capital. It is also resilient to credit and market risk shocks, based on the BSP's stress test exercise. All U/KBs complied with the required 10 percent minimum CAR on solo basis.

13 Based on a survey conducted by the BSP of top 10 banks across banking categories.

**Figure 5.4. Solvency Metrics (CAR, Common Equity Tier1, Risk-Weighted Assets)  
December 2015–March 2020**



Source of data: DSA, SPRD estimates

Mainly driven by loans extended to the corporate sector, credit risk-weighted assets continued to dominate U/KBs' total risk-weighted assets (RWA) at 88.9 percent as of end-March 2020. Figure 5.4 shows that YoY growth of the PBS' RWAs has been falling since December 2015 until December 2019 as banks have become progressively less risky over time. The market risk-weighted assets, which made up 2.6 percent of the total industry's risk assets, went up by 5.9 percent mainly due to rising interest rate risk and foreign exchange risk exposures. Even in times of market fluctuations, the U/KBs remained resilient given their active capital-raising activities and robust earnings margins, enabling them to maintain adequate buffers against unexpected losses. Operational risk-weighted assets also climbed by 7.5 percent YoY following the rise in earnings of banks.

On the whole, discussions in Section 4 reveal that while the PBS has been relatively in a strong position during the pandemic, there are challenges to banks moving forward.

## 5. Conclusion: Uncertainties and impact on supervision and prudential policy

This chapter examined how banks are holding up amid the pandemic. From March to July 2020, 31 prudential and regulatory relief measures were adopted, majority of which are meant to support operational resilience as well as lending and credit. Banks adjusted their daily operations while off-site surveillance and monitoring of risks and vulnerabilities of BSFIs have become more intense. Growth of bank deposits remained relatively firm as consumers shift to digital payments while funding cost declined following the RR reduction. Except for TBs, U/KBs and R/CBs have acted more as "shock absorbers" as loans slowly kept flowing. Loan quality across banking groups has manageably weakened as allowance for credit losses picked up. Net income fell due to additional loan provisioning. There are large banks that availed themselves of rediscounting facilities while interbank loans declined. Nevertheless, liquidity and capital buffers remained whole based on results from stress testing exercise.

The developments so far take us to the bigger role of uncertainties about the course of the pandemic on the economy (Quarles, 2020). The range of plausible economic scenarios poses implications for banks' business models, risk profiles as well as for supervision and micro prudential policy (Borio, 2020). There is a need to closely and frequently monitor risk dynamics in a holistic manner to capture the true health of financial institutions following the adoption of relief measures. BSP supervisors should continue to engage BSFIs in understanding how the COVID-19 situation has affected their business model, quality of assets, lending capacity, liquidity position, business operations and overall risk profile, how they are managing risks on their exposure and the role of the board and management in these activities. More high-frequency banking indicators are also needed to track the developments and impact of the pandemic. Given the intensity of the impact and the speed of the spread of the COVID-19 shock, keeping track of the fast-changing situation is crucially important.

The findings also entail implications on decisions related to the exit strategies of relief measures. While relief measures given to banks and their borrowers have been swift, the exit strategies should be carefully calibrated to avoid "cliff effects". Granular and forward-looking data on the impact of pandemic on credit worthiness of borrowers (corporations and households) based on surveys,



balance sheet and quantitative models will be extremely useful to supervisors. The BSP should work closely with BSFIs on the timing of a possible exit strategy and that precise and clear communication on the features of exit strategies and possible impact should be planned.

The insights outlined in this chapter have shown that in dealing with the aftershocks of the current pandemic, the BSP faces a crucial balancing act. On the one hand, the various measures are designed to encourage banks to support the real economy. On the other hand, these same measures have promoted the use of flexibility in some standards. Striking a balance between encouraging the use of flexibility in standards while preserving market confidence such that banks absorb rather than amplify risk will be key in fostering financial system stability.

In the short run, the BSP's supervisory priorities will include involvement of board and management on operational adjustments, including the BCP, keeping financial performance of banks at bay and supporting an effective action plan to resolve non-performing loans. The impact of the pandemic suggests some increase in non-performing loans after the temporary relief. While there is a pending legislative bill seeking to facilitate the sale of non-performing assets of public and private financial institutions in the House of Representatives, the BSP should also prepare to act swiftly to avoid a significant buildup of non-performing loans in the banking system. Over the long run, it should be recognized that prudential policy, while essential, cannot carry the burden of generating sustainable growth alongside financial system stability by itself.

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# Picturing the COVID-19 Pandemic from a Systemic Lens

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CHAPTER  
**SIX**



## 1. A crisis like no other

The Global Financial Crisis (GFC) just over a decade ago was supposed to have been the milestone with respect to the handling of crises and the oversight of financial markets. The GFC was compared to the 1929 Great Depression, with most market experts saying how closely the global economy resembled a waterfall. As a result, the post-GFC reform agenda focused heavily on the lessons learned, specifically how the so-called “Great Moderation” led to financial disruption at the height of the GFC. More importantly, the lessons also considered why the shift took most policymakers by surprise.

The lesson from the GFC centered on interlinked behaviors within a network as the cause of “systemic risks”.<sup>1</sup> Although some work had already been done on different agents within a community behaving in unsynchronized ways, the conventional thinking at that time (notably in light of the “Great Moderation”) was that the oversight of the financial market can be effectively managed through macroeconomic policies.<sup>2</sup> At the level of regulated entities such as banks, the thinking was that regulating the safety and soundness of the risk-taking activities of each bank was appropriate. Indeed, this was the basis of the Basel II Accord.<sup>3</sup> Both of these views proved to be inaccurate and insufficient, respectively.

Financial stability, then, in the post-GFC years has been distinctly about mitigating systemic risks as a collective outcome from a network of interlinked risk behaviors. Financial authorities, multilateral agencies as well as research- and policy-driven institutions vowed to avoid bringing the global system again to the edge of the waterfall. They vowed to do this by building system-wide resilience. The idea was to prevent financial system weaknesses from spilling over into the real economy<sup>4</sup> while greater focus was given to risks generated by the financial system itself (i.e., endogenous risks), without neglecting the usual risks to the system (i.e., exogenous risks).<sup>5</sup>

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1 The Financial Stability Board, International Monetary Fund and the Bank for International Settlements define systemic risk as a disruption to financial services - caused by an impairment of all or parts of the financial system - where such a disruption has the potential to have serious negative consequences for the real economy.

2 Ferguson (2002), for example, noted that: “The Federal Reserve has found it useful to focus on its financial stability objectives primarily through the lens of its macroeconomic goals – price stability and sustainable long-run growth.”

3 See Morris and Shin (2008), Brunnermeier et al., (2009), and Crocket (2000), among relevant references.

4 This highlights the definition of systemic risk espoused in the FSB-IMF-BIS report.

5 See <https://www.systemicrisk.ac.uk/systemic-risk>

While so much effort has been invested in this new line of policy, the COVID-19 pandemic created an altogether different dynamic. Starting as a local health issue in Wuhan city in the Hubei province of China, the World Health Organization (WHO) eventually declared it a pandemic on March 11. By definition then, COVID-19 had become a global phenomenon and the measures to contain its further spread required closing national borders and self-imposed lockdowns, cutting off cross-border supply chains, suspending economic activities and eroding incomes, parallel to the social effects of the virus itself.

This makes COVID-19 different. Unlike the 1929 Great Depression, the 1997 Asian Financial Crisis or the 2007 GFC, the fallout from COVID-19 does not have roots in the financial sector. It is, instead, a direct shock to the real economy and the policies instituted to contain the spread of the virus have caused a global recession.

Describing the pandemic as “a crisis like no other” is not simply a euphemism. The shock is global in extent and the virus remains unseen until it kills some individuals, even while it infects many other asymptotically (making them silent but effective carriers). Given its aggressive spread, the health infrastructure has been unable to cope. Early on, lockdowns were necessary to stave off further infections, but they were also constricting economic activity and threatening social disruption (via poverty and logistics). This is why that discussion led to a “lives *versus* livelihood” debate when clearly some balance between lives and livelihood is necessary.

For financial authorities, it is important to appreciate this economic environment. The shock is undoubtedly “systemic” as it is defined.<sup>6</sup> But unlike the GFC and the preparations that the financial authorities have made since then, this is not in the financial accelerator vein espoused by Bernanke-Gertler-Gilchrist (1996) where even relatively small financial market shocks cross over to become much bigger shocks in the real economy. Instead, this is the exact opposite: real economy difficulties may eventually affect the financial markets and create a potential second-round effect on the real sector.

The “unconventional” character of this systemic risk raises a number of challenges. There is no evident “policy playbook” because we have not seen such a shock in our lifetime. Many institutions, such as the International Monetary

6 Recall that the benchmark of systemic-ness is that the shock must have the ability to affect the rest of the economy and not just the financial market. In the case of COVID-19, the shock was already a direct hit on the economy.

Fund (IMF)<sup>7</sup>, have suggested that the ramifications will come close to that seen during the Great Depression. Yet, our understanding of that event does not really prepare us for dealing with a health-induced recession where a vaccine may be some time away.

## 2. Unconventionality in times of uncertainty

By the early weeks of March, it was clear that COVID-19 was beginning to take its toll on the economy. While the medical authorities eventually called for social distancing and the wearing of face masks, the President imposed the enhanced community quarantine (ECQ) in Metro Manila and the rest of Luzon by mid-March. The stay-at-home-and-suspend-business-activities directive was the immediate and necessary response to curtail the spread of the virus.

Financial authorities, however, understood that such remedial measures could eventually affect the financial market. This is where the challenges lie: the shock was not in the financial market (against which the financial authorities could act) and we did not have a ready playbook for a policy response (precisely because we have not seen a shock like COVID-19 in our lifetime).

What was clear was that this was a systemic shock. It was no longer a “risk” but rather an actual shock whose impact was still unfolding. What then should be our response?

From the perspective of systemic risk analysis, our immediate concern was that both the supply and demand side of the economy would be affected. In our Policy Note on COVID-19 (dated 19 March 2020), we noted how fast the number of confirmed cases was rising at the time that the brief was being written. The fact that the major economies driving growth — China<sup>8</sup>, the US, UK and key Schengen jurisdictions (Italy, Spain, Germany, France) — were affected by COVID-19 would only guarantee that the 2.9-percent growth projection for 2020 would not be met. What was not clear at that time was how close the world was to a no-growth situation, as estimates were still diverging.

<sup>7</sup> As early as March 24, the IMF noted that the world was already in a recession without waiting for the stereotypical two-quarters of negative growth. In subsequent briefings, the Fund noted that while its forecasts are prone to a high degree of uncertainty, the likely losses from COVID-19 could come close to those arising from the Great Depression.

<sup>8</sup> The fact that COVID-19 started from Wuhan, China is itself significant. China is the world’s manufacturing center with several multinational companies establishing manufacturing plants there. Wuhan, on the other hand, is a major rail and airline transportation hub, the latter connecting China to at least four other continents by direct flight.

The world oil market was also another source of uncertainty, in part from the demand shock, from supply chain cuts and from the tension between Saudi Arabia and Russia. This mattered for two reasons. For users of imported crude oil, this meant lower base costs. However, the bigger concern was that market prices were below the cost of drilling, putting the US shale industry as well as Saudi Arabia and Russia at risk. Media articles suggested that several US banks had already set up internal departments to manage the operations of their oil clients in anticipation of a major credit default.

Amidst the uncertainty, there was a “dash for cash” in global financial markets. We were already in a “lower-for-longer” period but risk premiums were also rising because of the uncertainties surrounding COVID-19. This was creating a divergence that, in a risk-averse world, tends to propagate the latter. Our view at that time was that the urgency was with curtailing de-risking and stabilizing the distribution of necessary goods as well as in addressing looming income pressures.

Taken together, our view of the systemic shocks is summarized in the following schematic (Figure 6.1) which is taken from the first semester 2020 Financial Stability Report. It is noteworthy that while there is a shock realized from the effects of COVID-19, the source of the systemic-ness is neither high inflation nor low levels of bank capitalization. At this point, COVID-19 is a once-in-a-lifetime event but the impairment of GDP, which is our ultimate metric for systemic concerns, is being caused by an income shock and elevated risk aversion. This is an important distinction.

On one hand, we also know that the effects of COVID-19 are disproportionately much more negative on lower income groups than those in the upper deciles. On the other hand, the reforms espoused under the Basel III agenda would not necessarily address the risk aversion that has dominated the financial market.

In a subsequent brief to management on 4 April 2020, we laid out our working premises:

- COVID-19 will impact the global economy at least in 2020 and hence all cross-border activities (i.e., external trade and remittances) will be affected for the remainder of the year.

- “Rebooting” the economy will depend more on local economic activities, knowing fully well that there are disruptions in both the demand side (incomes, consumption) and supply side (production, supply chains).

The banking industry is affected because both sides of the banks’ balance sheets are affected. The capital market is affected (and the clearing and settlement system as well) because market turnover is expected to fall and stay low. The contingent market may face unscheduled claims and face investment risks if market rates fall sharply. There will be increased pressure on the cash market to continue the flow and reflow of liquidity.

There would be a flight towards safe-haven currencies but given the global ramifications, it is not even clear which are safe-haven currencies.

We are facing systemic risks already and will encounter more systemic risks ahead as the macro-financial consequences of COVID-19 materialize. However, we also recognize that this is not the same systemic risk that was rooted in the financial market that eventually triggered the GFC.

In many ways then, our traditional thinking has to be modified. We normally oversee financial markets so that its disruptions — the risks by the system — do not spill over into the real economy (Figure 6.2). This was the very point of the definition of systemic risk as espoused by the Financial Stability Board (FSB), IMF and the Bank for International Settlements (BIS) that has become the *de facto* reference. However, COVID-19 is a shock instead to the financial system. Our concern now is for the ensuing weaknesses not to carry over into the financial market and trigger another round of disruptions that filter back to the real economy as illustrated in Figure 6.3.

Based on the above premises, the interventions that we specifically espoused focused on ensuring immediate liquidity in the market and addressing friction points.

With respect to the former, the unconventional policy of letting the central bank actively participate in the securities market was put forward. More than just the liquidity that this could generate, our view was that this added activity would reduce the risk premiums embedded in financial prices. This effectively manages yield curve volatility by separating the normal reward for liquidity and tenor risks from the uncertainty premium that was being priced-in. Repurchase agreements

(repos) between the BSP, the Bureau of the Treasury and the banks may further stimulate liquidity, in our view.

The fact that the shock was not emanating from the financial market also raised the opportunity to revisit longstanding issues in the capital market. To the extent that banks would not be willing to take on more credit and liquidity risks — given the nature of the inherent risks by leveraging on savings mobilization into intermediation — funding would likely be more available from the capital market.<sup>9</sup> But in a heightened risk-averse world, risk pricing and valuation are even more critical and, as such, specific interventions have been recommended.

To address the flight to safe-haven currencies, it was suggested that the US dollar-Philippine peso non-deliverable forward (NDF) market used during the 1997 crisis be reactivated. The added suggestion, however, was to expand the coverage to include a broader range of institutions. In addition, a US dollar-based repo market (last initiated as the GFC was unfolding) can likewise be reactivated. This would give the market the confidence that the Central Bank could be a counterparty if liquidity tightness ensued.

As the crisis was not in the financial market, we likewise saw an opportunity to flag and address some of the friction points. In another policy note, this time on the capital market, we raised the need to enhance funding liquidity across benchmark tenors, consider the streamlining of benchmark tenors and the strengthening of price discovery to make full advantage of “done” transactions. The possible enhancement of funding liquidity could address the brewing investment risks faced by insurance companies whose future yields may now be much lower than their previous estimates. This could also address liquidity needs from unscheduled insurance claims.

As we had been monitoring interest coverage ratios, we could envision how the suspension of economic activity would likely affect debt servicing, specifically the timing of maturing obligations versus the announced earnings before interest and taxes (EBIT). At the aggregate level, we were already monitoring leverage conditions from the standpoint of the credit-to-GDP-gap model as laid out by the BIS. At the firm level, data available to us allowed us to formulate networks between and among firms and economic activities. This monitoring initiative was expedited by COVID-19 and remains today an important element in our systemic risk analysis.

<sup>9</sup> The disproportionate effect on the less fortunate families suggests that aggregate saving would probably not be affected much since more than 70 percent of household saving is from the top 30 percent of families.

The Office of Systemic Risk Management's (OSRM) network analysis (a sampling is presented in Figure 6.4), in particular, uses firm-level data to map out connections with other firms as well as interlinkages with economic activities. Where data permits, this map extends to activities with counterparties in other jurisdictions. In this form, contagion and complementarities are easily seen and shocks from various sources can be simulated to give us an idea of how the overall effects pan out. In the situation as we find our markets today, this is certainly a useful monitoring construct.

Looking ahead, the country's experience with the public health issue likewise highlighted the need for vigilance in the financial market. As approved by both the Financial Stability Policy Committee (FSPC)<sup>10</sup> of the BSP and by the Financial Stability Coordination Council (FSCC),<sup>11</sup> work towards a systemic risk crisis management (SRCM) framework is now underway under the auspices of the FSCC. The SRCM (Figure 6.5) is a tactical plan that lays out the key actions to be undertaken once a systemic risk crisis is called by the chairman of the FSCC and identifies the financial authorities who shall be in charge of the different aspects of the framework. Such a framework covers several key elements such as logistics, monitoring, policy and communication.

When all of the above interventions are considered, the common denominator is the deliberate intent to take a holistic view of risk behaviors and then to "connect the dots." The very point of systemic risk intervention is to be preemptive rather than reactive, and in the cases outlined above, the objective was always to instill agility. This requires flexibility in the content of the policy intervention and speed to implement them once these are approved by senior management.

<sup>10</sup> The BSP Monetary Board approved the creation of the FSPC in January 2020 to oversee and decide on the financial stability initiatives of the BSP. The FSPC was officially convened on 26 February 2020 by the BSP Governor as its Chairman, counting on the other Monetary Board Members, including the Secretary of Finance, as FSPC members. This gives financial stability the most senior possible representation with a Board-level committee in the BSP.

<sup>11</sup> The FSCC was first convened in October 2011 as an initiative of the BSP. It provides the financial authorities a distinct venue to discuss the state of stability and discuss possible macroprudential policies, where warranted. Apart from the convening institution, the FSCC counts as member agencies the Department of Finance, the Securities and Exchange Commission, the Insurance Commission and the Philippine Deposit Insurance Corporation.

### 3. What COVID-19 means for systemic risk analysis

Rahm Emmanuel, former Chief-of-Staff for US President Barack Obama, once quoted Winston Churchill's adage to "never allow a good crisis to go to waste" (Mutter, 2016). These challenging times now gives us the opportunity not to waste the opportunities and lessons brought about by a crisis.

The current pandemic presents a "test case" for systemic risk analysis, especially with its idiosyncratic origins and outright shock to the real economy. While the GFC lessons placed systemic risk as an utmost priority, the current crisis posed unconventional systemic shocks that were beyond comparison, moving past the stereotypical systemic risks envisioned by the post-GFC reform agenda.

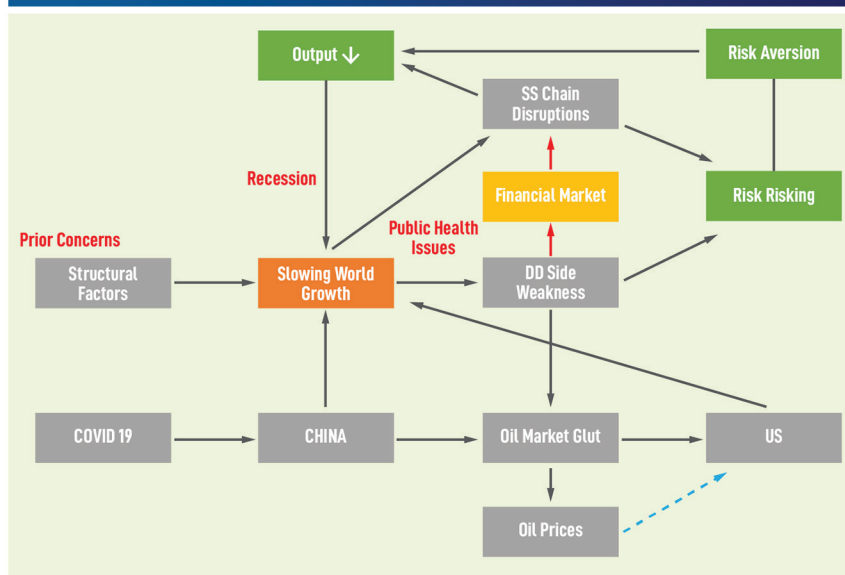
Does COVID-19 then invalidate a key lesson of the GFC on the need to focus on systemic risks? The crisis actually substantiates the need to strengthen systemic risk oversight and policy. Significantly, risk aversion remains a critical GFC lesson relevant today. For financial authorities, the policy issue will always revolve around the risk behavior of a community of stakeholders. It is from this risk behavior (and the linkages among them) that we can draw the following:

- Societal (i.e., system-wide) risk outcomes arise from the interlinked risk behaviors of individual entities;
- These societal outcomes cannot readily be mapped by simply looking at the state of each individual entity; that the most rational action of private entities can be the most damaging for the whole community;
- Entities adapt their behaviors based on experience and adjust accordingly; and
- Different agents under the same conditions are more likely to behave differently, moving policymakers away from the "representative agent" that has dominated traditional economic models.

Financial authorities must thus consider these takeaways in crafting post-crisis policies, bearing in mind that the financial system (and the entire economy) is a network with sequence-sensitive transactions. Hence, policies must have a systemic perspective and must account for the interconnectedness of entities in the system, with the realization of non-linearity and rationality of risk behaviors.

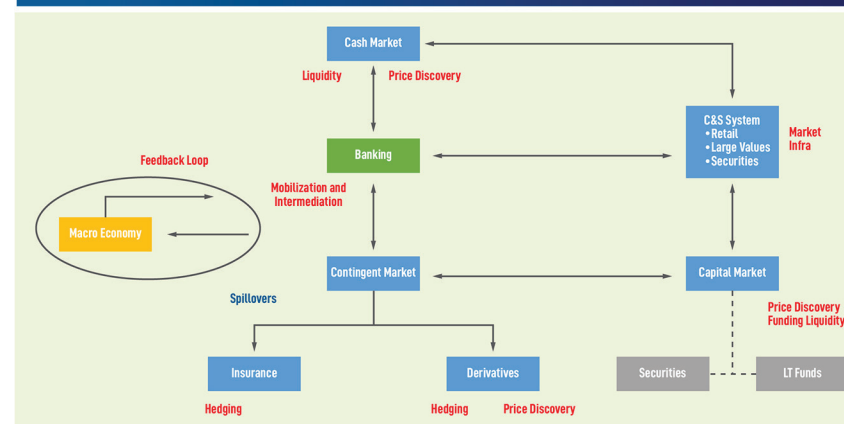
Right now, it is clear that the pandemic has (i) impaired incomes and (ii) heightened risk aversion born out of uncertainties. Evidently, none of these have stemmed from high inflation or low-level capital, which were the typical red flags of the post-GFC reforms. Accordingly, the two points from the current crisis require us then to be highly conscious of how systemic disruptions can happen within and outside the system and how we can think beyond the conventional policy lens in order to add to the ever-changing pages of our crisis playbook.

Figure 6.1. COVID-19 and Potential Spillovers into the Financial System



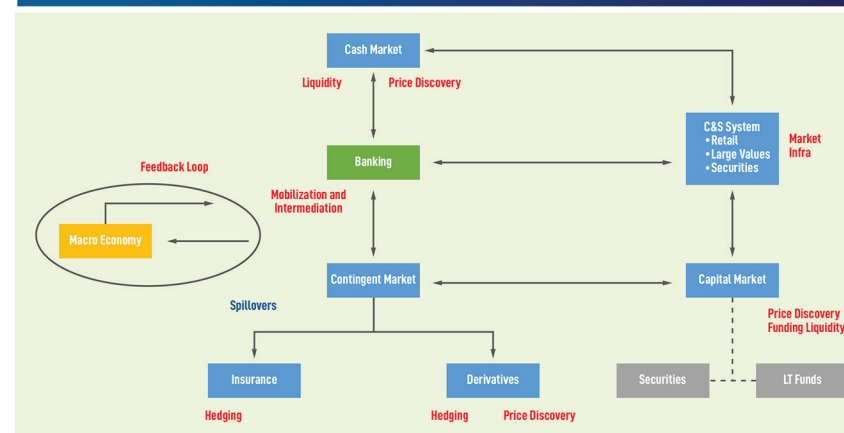
Source: OSRM

Figure 6.2. The 4Cs Structure of the Financial System



Source: OSRM

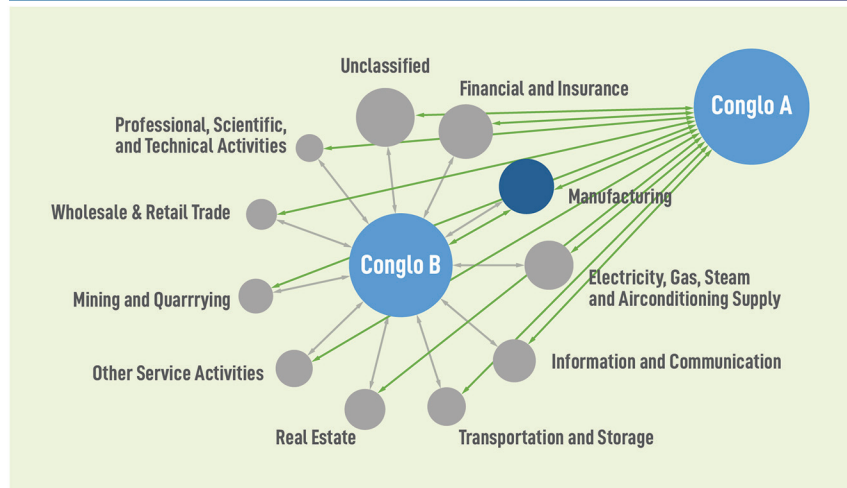
Figure 6.3. COVID-19 and Potential Spillovers into the Financial System



Source: OSRM

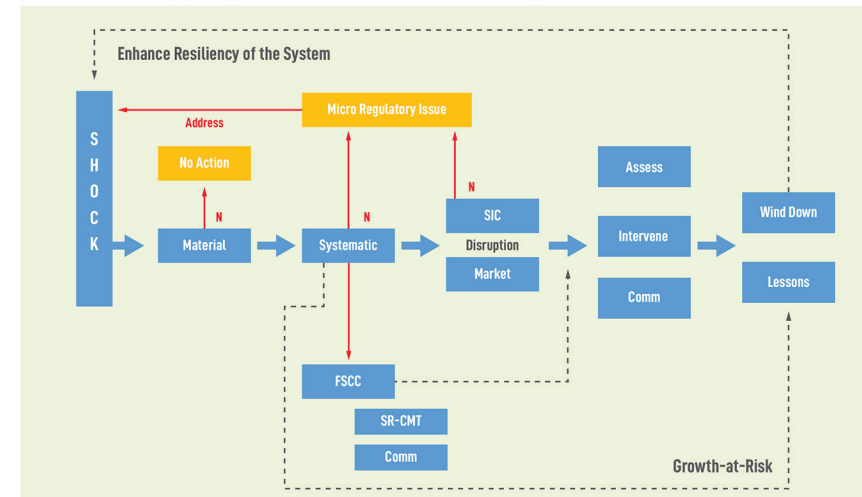


Figure 6.4. Economic Activities and Firm-Level Networks



Source: OSRM calculations using S&amp;P Capital IQ

Figure 6.5. Systemic Risk Crisis Management Framework



Source: OSRM

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# Legislative Initiatives, Milestones and Legal Basis of Policy Tools Deployed During the Pandemic

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CHAPTER  
**SEVEN**



To manage and contain the coronavirus 2019 (COVID-19) pandemic in the Philippines, the National Government (NG) was constrained to impose large-scale community quarantines that shut down economic activities, restricted business operations and caused an economic recession.<sup>1</sup> The number of operating businesses during the quarantine period varied depending on the stringency of the community quarantine, ranging from enhanced community quarantine (ECQ), modified ECQ (MECQ), general community quarantine (GCQ) to modified GCQ (MGCQ).<sup>2</sup>

The unpredictability of the health crisis and its consequences on economic activities hurt the financial sector and a large number of companies, and ultimately, the public. These companies provide employment to the Filipino people, create goods and services, pay taxes and support the Philippine economy. In this regard, the State needed to marshal its scarce resources to provide relief to the most affected and vulnerable sectors and to strengthen these sectors toward faster and more sustainable economic recovery.

In an unprecedented move, the Philippine legislature used digital platforms (e.g., Zoom and WebEx) to conduct legislative hearings to comply with anti-COVID-19 protocols. As such, the Congress was able to enact landmark laws aimed at managing the adverse financial consequences of the pandemic and stimulating the economy. This chapter highlights some of these legislative milestones and their salient features. The Bangko Sentral ng Pilipinas (BSP) played an active role in crafting these legislative measures, together with the NG's economic managers, by spearheading several technical working group discussions and participating in various legislative committee hearings.

Cognizant of its role as the country's monetary authority, the BSP stood at the forefront of maintaining price and financial stability by complementing the NG's fiscal policies in dealing with economic fall-out from the health crisis. Using its legal authority under the New Central Bank Act<sup>3</sup> (BSP Charter), which was just recently amended in 2019 by Republic Act (RA) No. 11211, the BSP immediately

deployed its various monetary, macroprudential and supervisory tools at the start of the pandemic. The recent amendment of the BSP Charter is providential, as this further strengthened the BSP and placed it in a better position to face the emerging risks to the financial stability and the economy as a result of the pandemic. Likewise, pursuant to its Charter, the BSP injected money to the financial system to help the NG fund its war chest through the following: (i) reverse repurchase agreement (RRP) with the Bureau of Treasury (BTr) amounting to ₱300 billion; (ii) purchase of government securities (GS) amounting to ₱500 billion; (iii) remittance of dividends to the NG amounting to ₱23 billion; and (iv) direct provisional advances to the NG amounting to ₱540 billion. The last part of this chapter discusses the legal basis of the tools deployed during the pandemic.

## 1. Key legislative initiatives

Within a stable financial system, economic recovery is a two-pronged approach—monetary and fiscal. The monetary aspect falls within the existing BSP powers and authority under the BSP Charter, which was further strengthened by the amendments under RA No. 11211 that granted BSP additional powers to ensure financial stability, promote employment and issue securities, among others. Conversely, to the extent that some measures needed for economic recovery are not covered by existing laws, the State must enact fiscal stimulus and measures to enhance financial stability to mitigate the adverse effects of the COVID-19 pandemic.

### 1.1 *Bayanihan to Heal As One Act*<sup>4</sup> (*Bayanihan I*)

Bayanihan I was signed into law on 24 March 2020 and took effect upon its publication on 25 March 2020. Through Bayanihan I, the entire Philippines was placed in a state of national emergency and the President of the Philippines was vested with temporary emergency powers for a period of three months. One of these is the President's authority to implement a mandatory grace period for all loans falling due within the ECQ and MECQ periods under Section 4(aa) of Bayanihan I.<sup>5</sup> This aims to address borrowers' inability to meet their loans falling due during said periods because of the widespread cessation of business operations. It will also allow borrowers to pay their maturing obligations at a later

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1 See Mapa, D. (2020, August 6). GDP growth rate drops by 16.5 percent in the second quarter of 2020; the lowest starting 1981 series. Philippine Statistics Authority. Retrieved from <https://psa.gov.ph/press-releases/id/162842>

2 See Inter-Agency Task Force for the Management of Emerging Infectious Diseases. (2020). Omnibus Guidelines on the Implementation of Community Quarantine in the Philippines with Amendments as of July 16, 2020. Official Gazette. Retrieved from <https://www.officialgazette.gov.ph/downloads/2020/07jul/20200716-omnibus-guidelines-on-the-implementation-of-community-quarantine-in-the-philippines.pdf>

3 Rep. Act No. 7653 (1993), amended by Rep. Act No. 11211 (2019).

4 Rep. Act No. 11469 (2020).

5 While Bayanihan I, Section 4(aa) provides that the mandatory grace period shall apply during ECQ period, MECQ was interpreted to have the same effect as the ECQ with respect to the application of the mandatory grace period [BSP Mem. No. M-2020-042 (18 May 2020)].

date, without having to pay for additional interest on interest,<sup>6</sup> fees and charges. The Department of Finance (DOF) issued the implementing rules and regulations (IRR) of Section 4(aa) of Bayanihan I on 1 April 2020. Subsequently, BSP issued several memoranda responding to the frequently asked questions about Section 4(aa) of Bayanihan I. Summarized below are the salient provisions of Section 4(aa) of Bayanihan I:

*Covered institutions.* The mandatory grace period covers all lenders, including banks, quasi-banks, non-stock savings and loan associations, credit card issuers, pawnshops and other credit-granting financial institutions (FIs) under the supervision of BSP, Securities and Exchange Commission (SEC) and Cooperative Development Authority, whether public or private, including the Government Service Insurance System (GSIS), Social Security System (SSS) and Home Development Mutual Fund (Pag-IBIG Fund).

*Mandatory grace period.* Covered institutions shall implement a 30-day grace period for all loans with principal or interest falling due within the initial ECQ period without incurring interest on interest, penalties, fees and other charges. This 30-day grace period shall automatically be extended if the President extends the ECQ period, including the MECQ period. Effectively, due to Section 4(aa) of Bayanihan I, all principal and interest falling due between 17 March 2020 and 31 May 2020 enjoyed the mandatory grace period.

*Covered loans.* Loans refer to those extended by covered institutions to individuals, households, micro, small and medium enterprises (MSMEs), corporate borrowers and other counterparties. Since Bayanihan I and the IRR of its Section 4(aa) cover all lenders without distinction, then the mandatory grace period shall apply to all loans extended by all covered FIs irrespective of their place of operation. For example, FIs outside Luzon are covered even if a majority of the areas are not under ECQ or MECQ.

*Other benefits.* Covered institutions shall not apply interest on interest, fees and charges on future payments or amortizations of individual, household, MSMEs and corporate borrowers relating to the principal and interest falling due between 17 March 2020 and 31 May 2020. Covered institutions are also prohibited from requiring their clients to waive the application of the provisions of Bayanihan I, including the mandatory grace period. Any waiver previously executed by borrowers covering loan payments falling due during the ECQ period

shall be considered void. Nonetheless, borrowers may still choose to pay their obligations as they fall due during the ECQ and MECQ periods.

The mandatory grace period shall apply to each of the multiple loans of individuals and entities. No additional documentary stamp tax (DST) shall be imposed on the loans because of the mandatory grace period granted as well as the resulting credit extensions and credit restructuring. The borrower may pay the accrued interest during the mandatory grace on a staggered basis over the remaining life of the loan. Nonetheless, borrowers may pay the accrued interest in full on the new date following the application of the mandatory grace period. Likewise, covered FIs may offer less onerous payment schemes with the consent of the borrower.

## 1.2 Bayanihan to Recover As One Act<sup>7</sup> (Bayanihan II)

With the expiration of Bayanihan I, Congress initiated the enactment of Bayanihan II authorizing the President to exercise powers necessary to respond to the COVID-19 pandemic and foster early recovery. On 11 September 2020, the President signed into law RA No. 11494 or the Bayanihan II. It took effect upon its publication on 15 September 2020.

Similar to its earlier version, Bayanihan II is an emergency measure passed by Congress that will expire on 19 December 2020, or when Congress adjourns, except for some provisions that will survive. This law aims to (i) reduce the adverse impact of the COVID-19 pandemic on the socioeconomic well-being of all Filipinos by providing assistance, subsidies and other forms of socioeconomic relief; (ii) mitigate the economic cost and losses stemming from the pandemic; (iii) restore public trust and confidence in social and economic institutions; and (iv) accelerate the recovery and bolster the resilience of the Philippine economy through measures grounded on economic inclusivity and collective growth through fiscal sustainability. With these objectives, Bayanihan II grants the President temporary powers to address the health crisis and its economic implications. These powers include the following:

### i. Government Financial Institutions (GFIs) financial assistance programs

*Small Business Corporation (SBCorp).* Section 4(z) of Bayanihan II authorizes the President to direct SBCorp to expand its existing loan programs for MSMEs, cooperatives, hospitals, tourism and OFWs affected by the COVID-19 pandemic and by other socioeconomic reversals. The expansion can be done through a combination of the following: increasing available loanable funds, reducing

<sup>6</sup> The language of Bayanihan I provides “without incurring interests.” The DOF interpreted this phrase to mean “interest on interest” in the IRR of Bayanihan I, § 4(aa).

<sup>7</sup> Rep. Act No. 11494 (2020).

documentary requirements, increasing maximum loan amounts per borrower, reducing interest rates, extending loan terms and using financial technologies to expand reach, increase access and set fast turn-around loan processing time. The President may also direct SBCorp to allow the use of loan proceeds for business debt obligations including those incurred before the covered period or acquisition of new technologies and systems to adjust business processes for resiliency.

*Land Bank of the Philippines (LBP) and Development Bank of the Philippines (DBP).* Section 4(aa) of Bayanihan II authorizes the President to direct LBP and DBP to introduce a low-interest and “flexible term” loan program for operating expenses available to businesses affected by the COVID-19 pandemic. This will assist and encourage businesses and their creditors to continue investing in, lending to and operating their businesses. In addition, Bayanihan II requires that priority shall be given to agri-fishery and non-essential businesses that are MSMEs, including start-ups and cooperatives.

*Philippine Guarantee Corporation (PhilGuarantee).* Section 4(bb) of Bayanihan II authorizes the President to direct PhilGuarantee to: (i) issue an expanded government guarantee program for non-essential businesses; (ii) ease current rules and regulations and give preference to critically impacted businesses, MSMEs, cooperatives and activities that support Department of Health initiatives towards ensuring an adequate and responsive supply of health care services; and (iii) guarantee the loan portfolio of partner FIs of eligible MSMEs and cooperative loans.

## ii. Loan moratorium and regulatory reliefs

*Loan Moratorium.* Section 4(uu) of Bayanihan II authorizes the President to direct covered institutions to implement a one-time 60-day grace period for the payment of all loans falling due on or before 31 December 2020, thereby effectively extending the maturity of said loans. Nonetheless, parties may mutually agree for a grace period longer than 60 days. Covered institutions include banks, quasi-banks, financing companies, lending companies, real estate developers, insurance companies providing life insurance policies, pre-need companies, entities providing in-house financing for goods and properties purchased, asset and liabilities management companies, and other FIs, public and private, including GSIS, SSS and Pag-IBIG Fund.

Covered lending institutions shall not impose “interest on interest, penalties, fees, and other charges” during the implementation of the mandatory grace period. All loans may be settled on a staggered basis until 31 December 2020 or as may be agreed upon by the parties. The moratorium covers all loans, including salary, personal, housing, commercial and motor vehicle loans, as well as amortizations, financial lease payments, premium payments and credit card payments. However, it shall not apply to interbank loan and bank borrowings.

*Regulatory Reliefs.* FIs that agree to further loan term extensions or restructuring pursuant to Section 4(uu) of Bayanihan II shall be entitled to regulatory reliefs, as may be determined by BSP, which may include the following: (i) staggered booking of allowances for credit losses; (ii) exemption from loan-loss provisioning; (iii) exemption from the limits on real estate loans, when applicable; (iv) exemption from related party transaction restrictions; and (v) non-inclusion in the FI’s reporting on non-performing loans (NPLs). Loan term extensions or restructuring pursuant to Section 4(uu) of Bayanihan II shall be exempt from DST.

## iii. Lowering of interest rates, reserves and reliefs

Bayanihan II has significant provisions on credit and lending primarily affecting the banks and FIs. It is noteworthy that Congress merely encourages, but does not mandate, BSP to perform the following actions, in recognition of BSP’s independence as the central monetary authority and supervisor of banks:

- a. Section 4(x) provides for the availability of credit to the productive sectors of the economy, especially in the countryside, through measures including lowering the effective lending interest rates and reserve requirements of lending institutions. Credit accommodation to MSMEs, cooperatives and those who are self-employed shall be charged a low interest, payable within three years, and shall not require any collateral if the loan does not exceed ₱3,000,000.
- b. Section 4(ccc) encourages BSP to allow private banks and FIs to (i) reallocate any unutilized loanable funds to housing loans; and (ii) grant subsidy to the home loan borrowers at the rate equivalent to the gross receipt tax imposed on banks and FIs on their interest income.



- c. Section 4(ddd) encourages BSP and SEC to adopt measures to encourage the banking industry and other FIs to extend loans and other forms of financial accommodation to help businesses recover from the economic effects of COVID-19 crisis, and to enable the banking industry to manage appropriately its risks and potential losses. The BSP and SEC are also authorized to grant reporting relief to their supervised entities.

#### iv. Additional provisional advances to the NG

Under Section 89 of the BSP Charter, the BSP may make direct provisional advances, with or without interest, to the NG to finance expenditures authorized in the annual appropriation, subject to the following conditions: (i) the advances shall be repaid before the end of three months extendible by another three months as the Monetary Board (MB) may allow following the date the NG received such provisional advances; and (ii) the advances shall not, in their aggregate, exceed 20 percent of the average annual income of the NG for the last three preceding fiscal years.

Notwithstanding Section 89 of the BSP Charter, Section 4(bbb) of Bayanihan II authorizes BSP to make additional direct provisional advances, with or without interest, to the NG to finance expenditures authorized by law that will address and respond to the COVID-19 situation. However, to protect BSP's independence, Section 4(bbb) of Bayanihan II imposes the following conditions: (i) the advances shall not, in their aggregate, exceed 10 percent of the average income of the NG for fiscal years 2017 to 2019; (ii) the advances shall be availed of within two years from the effectivity of Bayanihan II; and (iii) the advances shall be repaid before the end of one year following the date that the NG received such additional direct provisional advances pursuant to Bayanihan II, extendible for another year as the MB may allow. This authority effectively allows BSP to extend provisional advances to the NG at an amount not exceeding 30 percent of the NG's average income for fiscal years 2017 to 2019. Of the new 30-percent ceiling, 20 percent is in line with the BSP Charter while the additional 10 percent is by virtue of Bayanihan II.

### 1.3 Pending Legislation

#### i. Bill on GFIs Unified Initiatives to Distressed Enterprises for Economic Recovery Act<sup>8</sup> (GUIDE Bill)

GUIDE Bill's principal objective is to provide financial assistance to distressed enterprises severely affected by the COVID-19 pandemic and to encourage these enterprises to continue operations and keep their workers. Particularly, GUIDE Bill intends to expand the loan programs of (i) DBP to eligible MSMEs engaged in infrastructure, service industry or manufacturing business; and (ii) LBP to eligible MSMEs engaged in activities in the agribusiness value chain. DBP and LBP may also rediscount loans granted by BSP-supervised FIs, SBCorp and Department of Agriculture – Agricultural Credit Policy Council to eligible MSMEs affected by COVID-19.

GUIDE Bill authorizes LBP and DBP to participate in the financial and capital markets by allowing investments in distressed enterprises through a special holding company (SHC). The SHC shall rehabilitate strategically important companies experiencing temporary solvency issues due to the pandemic, including those from the agriculture, infrastructure, service industry, manufacturing and other industries to be identified in the IRR. The establishment, administration and operation of the SHC shall be subject to the principles, guidelines, conditions and limitations laid down in GUIDE Bill. These provisions will cover matters such as equity participation in the SHC, exit mechanism for the NG's investment, investment guidelines and qualification and restrictions for the SHC's chosen investee companies.

All transactions of DBP, LBP and SHC pursuant to their mandate and functions under GUIDE Bill shall enjoy the following time-bound privileges: (i) exemption from applicable taxes and entitlement to reduced registration and transfer fees; and (ii) adoption of Negotiated Procurement under Emergency Cases under Government Procurement Reform Act<sup>9</sup> for their procurements; and (iii) exemption from Philippine Competition Act,<sup>10</sup> ratios, ceilings and limitations under The

<sup>8</sup> GUIDE Bill is embodied in House Bill (HB) No. 7749 authored by Reps. Junie E. Cua, et al., and was approved by the House of Representatives (HOR) Defeat COVID-19 Ad Hoc Committee on 28 July 2020. Pursuant to Defeat COVID-19 Ad Hoc Committee Report No. 524, HB No. 7749 substituted HB No. 6795 filed by Rep. Junie E. Cua. (Status of the bills as of 30 September 2020; discussion is based on the HB No. 7749.)

<sup>9</sup> Rep. Act No. 9184 (2003).

<sup>10</sup> Rep. Act No. 10667 (2015).

General Banking Law of 2000<sup>11</sup> subject to the conditions as may be determined by the MB, and the GOCC Governance Act of 2011, as may be appropriate.

## ii. Bill on Financial Institutions Strategic Transfer Act<sup>12</sup> (FIST Bill)

Due to the disruption of economic activities caused by the COVID-19 pandemic, most FIs are facing a period of delayed loan collections and are at risk of recording higher non-performing assets (NPAs) across all borrower segments. In order to respond to the looming increase in NPAs, FIST Bill encourages FIs to sell NPAs to asset management companies, created as Financial Institutions Strategic Transfer Corporations (FISTCs), by giving tax exemptions and other fiscal incentives on certain transfers of these NPAs. This will enable FIs to free up much-needed liquidity for lending to the productive sectors of the economy crucial to economic recovery. Likewise, the FIST Bill encourages the private sector to incorporate and invest in FISTCs and help in disposing NPAs with the end view of contributing to economic growth. BSP recognizes the objectives of FIST Bill in cushioning the adverse impact of the pandemic and generally supports FIST Bill and its laudable objectives.

FIST Bill uses as a model the Special Purpose Vehicle Act of 2002<sup>13</sup> (SPV Law), which was enacted in response to the 1997 Asian Financial Crisis. FIST Bill introduces several innovations considering the issues encountered during the implementation of SPV Law and the FIs' present needs due to the pandemic. These include the following salient provisions common to HB No. 6816 and SB No. 1849: (i) *expanded coverage of FIs* to include lending companies,<sup>14</sup> and other institutions licensed by BSP to perform quasi-banking functions and credit-granting activities; (ii) transfers of FIs' NPAs to FISTCs shall be in the *nature of a true sale*, without prejudice to the FI and the FISTC agreeing to a sharing of profits, and the transferor-FI must not have legal or beneficial ownership of more than 10 percent or have a direct or indirect control of the transferee-FISTC; (iii) *safeguard against collusion and fraud*; (iv) *prohibition against injunctive relief clause*; and (v) *financial consumer protection mechanism*.

<sup>11</sup> Rep. Act No. 8791 (2000).

<sup>12</sup> In the HOR, FIST Bill, embodied in HB No. 6816 filed by Rep. Junie E. Cua, et al., was approved on third and final reading on 2 June 2020 and was transmitted to, and received by, the Senate on 3 June 2020. In the Senate, the following counterpart bills on FIST were filed: (i) SB No. 1594 filed by Sen. Imee R. Marcos on 11 June 2020, (ii) SB No. 1596 filed by Sen. Manuel "Lito" M. Lapid on 15 June 2020, and (iii) SB No. 1652 filed by Sen. Ralph Recto on 6 July 2020. On 24 September 2020, the Committees on Banks, Financial Institutions and Currencies and Committee on Ways and Means jointly filed SB No. 1849, under Committee Report No. 116, in substitution of SB Nos. 1594, 1596 and 1652. On 10 November 2020, the Senate approved on third and final reading SB No. 1849. (Status of the bills as of 16 November 2020; discussion is based on HB No. 6816 and SB No. 1849.)

<sup>13</sup> Rep. Act No. 9182, amended by Rep. Act No. 9343.

<sup>14</sup> As defined under Rep. Act No. 9474, or the "Lending Company Regulation Act of 2007."

Table 7.1 summarizes the types of transfers which are entitled to fiscal incentives within the entitlement period.

Nature of Transfer	Fiscal Incentives	Entitlement period
Transfers of NPAs from an FI to a FISTC or dation in payment (dacion en pago) by the borrower or by a third party in favor of an FI	Exemption from DST, capital gains tax, creditable withholding tax, and value-added tax or gross receipts tax, whichever is applicable; and	HB 6816: Within two years from the date of effectivity of the IRR or of the applicable revenue regulations, whichever comes later. SB 1849: Within two years from approval of the FISTC Plan.
Transfers from a FISTC to a third party of NPAs acquired by the FISTC within such two-year period, or dation in payment (dacion en pago) by the borrower or by a third party in favor of a FISTC	50-percent reduction in the registration and transfer fees imposed by the Land Registration Authority, and filing fees for any foreclosure initiated by the FISTC in relation to any NPA acquired from an FI	Within five years from the date of acquisition by the FISTC
New loans in excess of existing loans extended to borrowers with NPLs that have been acquired by the FISTC	Exemption from income tax on net interest income, DST and mortgage registration fees	Within five years from the date of acquisition of NPLs by the FISTC
Capital infusion by FISTCs to the borrowers with NPLs	Exemption from DST	

Source: FIST Bill

## 2. Legal basis of policy tools deployed during the pandemic

The imposition of various types of community quarantines in the country compelled the NG to secure additional funds to promptly address the vast deleterious effects of COVID-19. In line with its mandate to maintain price stability, promote financial stability and work closely with the NG, the BSP deployed its available tools to help raise funds for the NG. Thus, the BSP displayed its commitment and readiness to support the NG's effort to mitigate the adverse impact of the COVID-19 pandemic. Some of the extraordinary tools deployed are the following:

### 2.1 Direct purchase of GS from the NG

Section 89 of the BSP Charter authorizes the BSP to make direct provisional advances, with or without interest, to the NG to finance expenditures authorized in its annual appropriation, subject to certain limitations. Pursuant to this authority, BSP extended provisional advances to the NG, through the BTr, by executing an RRP involving GS amounting to ₱300 billion. Based on the agreement, BTr will buy back the GS from BSP for the same amount, at zero interest, after three months, extendible by another three months as the MB may allow.

The transaction was consummated on 27 March 2020 and was set to expire on 29 June 2020. Upon BTr's request, the MB approved on 4 June 2020 the extension of the RRP for another three months under the same terms, set of GS and set of documentation. Hence, the new maturity date of the agreement is on 27 September 2020. The NG bought back the GS and paid the BSP ₱300 billion on 29 September 2020.

### **2.2 Purchase of GS in the open market**

To achieve the objectives of national monetary policy, the BSP is authorized under Section 91 of the BSP Charter to buy and sell GS in the open market for its own account. In line with BSP's mandate and powers under Sections 3, 5 and 91 of the BSP Charter, as well as Section 4 of Bayanihan I,<sup>15</sup> the MB approved on 7 April 2020 BSP's purchase of GS to be undertaken from April to June 2020 based on BTr's auction schedule. These purchases amounted to about ₱500 billion.

### **2.3 Remittance of dividends to the NG**

The amendments introduced in BSP's Charter include additional BSP capitalization of ₱150 billion. Under Section 2 of the BSP Charter, the increase in capitalization shall be funded solely from the declared dividends of BSP in favor of the NG. Thus, any and all declared dividends shall be applied as payment for BSP's increase in capitalization. However, considering the extraordinary circumstances the Philippines is facing, the MB decided to defer the application of BSP's dividends for 2019 to its capital and to remit instead to the NG ₱23 billion dividends to support the latter's programs during the pandemic. The BSP remitted the said dividends in two tranches amounting to ₱20 billion and ₱3 billion on 26 March 2020 and 28 September 2020, respectively, through a direct credit to the Treasurer of the Philippines.

### **2.4 Provisional advances to the NG**

On 24 September 2020, pursuant to its authority under Section 89 of the BSP Charter, the MB approved the request of the NG for a new tranche of provisional advances from the BSP amounting to ₱540 billion. The interest-free loan shall be evidenced by a promissory note to be issued by the NG in favor of the BSP with a maturity date of 29 December 2020.

## **3. Moving forward**

The BSP is cognizant of the need to maintain the safety and stability of the financial system amid the COVID-19 crisis. Apart from adopting monetary policies, the BSP has been closely working with the NG in crafting legislative measures to stimulate economic recovery, including providing liquidity support to assist FIs in their lending operations and in performing their role of efficiently mobilizing savings and investments.

With the benefit of Filipino people in mind, the BSP is prepared to use the full range of monetary policy and regulatory measures to fulfill its price and financial stability objectives under the law. For the first time in Philippine history, the BSP invoked Section 89 of the BSP Charter to extend advances to the NG by executing an RRP and loan agreement. The MB also approved the setting of an annual interest rate ceiling of 24 percent on all credit card transactions effective 3 November 2020, pursuant to the Philippine Credit Card Industry Regulation Law.<sup>16</sup> This is the first time that the MB exercised its authority to place a limit on interest rates since these ceilings were lifted by Circular No. 905 in 1983. These are extraordinary measures the BSP adopted to help the Filipino people cope with this pandemic.

Quoting BSP Governor Benjamin E. Diokno, "We are one government. We are one Filipino nation. And we, at BSP, shall support all efforts to fight this once-in-a-lifetime pandemic and keep the economy afloat. BSP has been and is ready to employ the necessary tools in its arsenal to address the impact of COVID-19 while staying true to its mandate."

Moving forward, BSP will continue to closely work with the NG in crafting policies and measures with a whole-of-government approach for the country's economic recovery, sustained growth and development.

<sup>16</sup> Rep. Act No. 10870 (2016).

<sup>15</sup> BSP Charter, § 3 provides for BSP's responsibility and primary objective while § 5 of the same law provides for BSP's corporate powers. Also, Bayanihan I, § 4 provides for the President's authority to ensure availability of credit to the production sectors of the economy and to allocate cash, fund, investments, including unutilized or unreleased subsidies and transfers, held by any GOCC, among other temporary emergency powers.

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# **Payments and Settlement Systems: Anchors of Financial System Resilience and Stability in the Time of COVID-19**

Jay M. Dizon, Anna Marie B. Lagman, Remedios C. Macapinlac and Marie Joyce C. Elevado\*

CHAPTER  
**EIGHT**

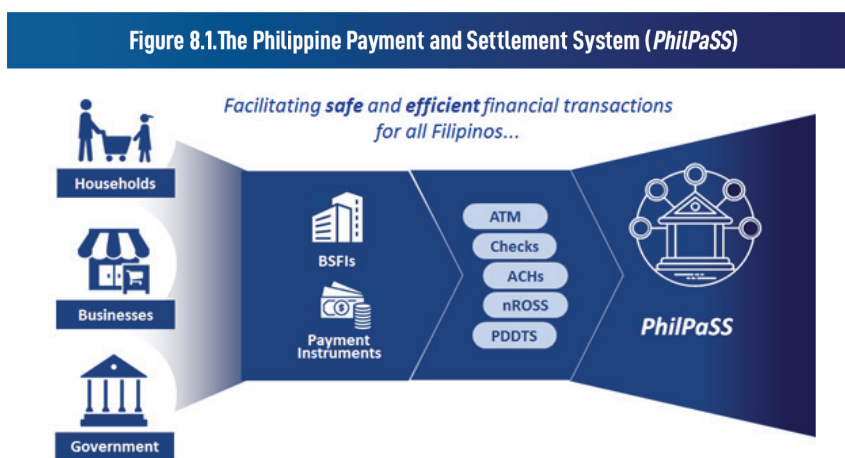




## 1. The role of the Philippine Payment and Settlement System (*PhilPaSS*) during the COVID-19 pandemic

The *PhilPaSS*<sup>1</sup> is a fully automated facility that enables the payment of high value and retail transactions and settlement in Philippine pesos through the demand deposit accounts (DDAs) of the system participants. It is a real-time gross settlement (RTGS) system designed to address related risks and achieve safe, uninterrupted, final and irrevocable settlement of financial transactions. In addition to electronically transferring funds among participating financial institutions, participants are able to manage their DDAs online through the system.

By minimizing payment and settlement risks through *PhilPaSS*, the BSP is able to provide safe and efficient payment and settlement systems for Filipinos (3<sup>rd</sup> pillar of the BSP), and enhance the availability, convenience, efficiency and integrity of financial transactions (2<sup>nd</sup> pillar of financial stability) as well as of financial markets (1<sup>st</sup> pillar of monetary stability).



Source: BSP

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1 The *PhilPaSS* is operated by the BSP through its Payments and Settlements Office (PSO).

Financial transactions that settle in *PhilPaSS* include:

- Payment instructions initiated directly by participants for customer payments, government collections and other interbank transactions.
- Transactions with the BSP such as deposits, withdrawals, payment of supervisory fees, deposits of maturing loan obligations, settlement of investments in BSP's short-term liability products and fees collected for online application of foreign currency denominated loans.
- Transactions through other financial infrastructures that provide essential services to the banking public such as those made through automated teller machines (ATMs), automated clearing houses (ACHs) and checks as well as settlement of government securities trade transactions (allowing for compliance with international standards on delivery versus payment) and of the Philippine peso leg of US dollar trades (international standards on payment versus payment).

### 1.1 Adjustments on the operations of *PhilPaSS* and of its participants

During the community quarantine period, the Payments and Settlements Office (PSO) ensured continuing operations of *PhilPaSS* while complying with directives to reduce exposure of personnel (both from the BSP and from the participating financial institutions or FIs) to health risks. These included:

1. Initially, a skeleton force operating in two separate sites, and eventual successful installation of efficient and secured work-from-home arrangements for PSO personnel while servicing the Filipinos albeit within reduced business hours; and
2. Procedures to electronically submit requests to continually process documents and communicate with PSO's Help Desk were established.

The public was constantly kept abreast with the availability of the *PhilPaSS* and the above arrangements through various advisories and BSP memoranda.

### 1.2 Relief measure extended to *PhilPaSS* participants

As the Philippine economy strives to recover from the severe effects of the coronavirus pandemic, it was critical that FIs continue to be able to effectively provide financial services and promote the digitalization of payment services. With this, the BSP extended a temporary waiver of fees for fund transfer



transactions made through *PhilPaSS* beginning 1 April 2020 until the end of the year.<sup>2</sup> The measure is intended to provide further support for the efficient operations of FIs and foster a supportive environment within which BSP-supervised entities can extend improved financial intermediation services to the public. In its memorandum to banks, the BSP encouraged the participants of the system to actively disseminate to the public the available ACHs and *PhilPaSS* as facilities to electronically transfer funds to target recipient-accounts maintained with other banks participating in the network, thereby providing Filipinos a wide range of digital payment channels.

### 1.3 Volume and value of transactions in *PhilPaSS* pre- and post-COVID

In the first semester of 2020, there was an increase of almost 80 percent in the value of the total transactions that settled in *PhilPaSS* compared with the same period in 2019. While the volume increased only by 2 percent during the period, the value of these transactions increased to ₱244 trillion, an average of ₱2 trillion per day versus the average of only ₱1.2 trillion per day in the first semester of 2019. (Table 8.1)

Table 8.1. Transactions in *PhilPaSS*

Transactions in <i>PhilPaSS</i>	Volume, In Thousands			Value, In Billion Pesos		
	St:19	St:20	YoY Growth	St:19	St:20	YoY Growth
<b>DIRECT PARTICIPANTS</b>	375	405	8%	109,833	218,079	99%
Interbank Transactions	328	354	8%	24,023	19,651	-18%
Transactions by BSP Units	2	1	-49%	2	2	-5%
Transactions with BSP Units	44	50	12%	85,808	198,425	131%
Monetary Operations	24	36	52%	75,705	194,587	157%
Others	21	14	-33%	10,103	3,383	-62%
<b>THROUGH THIRD PARTY PAYMENT SERVICE PROVIDERS</b>	186	180	-3%	26,189	25,097	-4%
Automated Telling Machines	18	17	-3%	545	732	34%
Automated Clearing Houses	17	21	21%	425	778	83%
PESONet	5	7	21%	328	551	68%
InstaPay	11	15	29%	97	227	135%
Checks	9	10	13%	3,034	2,366	-22%
Peso/US Dollar Trades	96	89	-7%	18,472	15,995	-13%
Government Securities	47	43	-9%	3,714	5,226	41%
<b>THROUGH THE CENTRAL FINANCIAL ACCOUNTING SYSTEM</b>	46	34	-26%	970	590	-39%
<b>TOTAL TRANSACTIONS SETTLED IN <i>PhilPaSS</i></b>	<b>606</b>	<b>619</b>	<b>2%</b>	<b>36,992</b>	<b>243,765</b>	<b>78%</b>
<i>Average per day</i>						
No. of Working Days	119	123		119	123	
Average transactions per day	5.09	5.03	-1%	1,151	1,982	72%

Source: Payments and Settlements Office

<sup>2</sup> Under the following BSP memoranda:

M-2020-027 dated 21 April 2020 – waiver of fees until the end of the enhanced community quarantine (ECQ) on 30 April 2020

M-2020-035 dated 28 April 2020 – extension of waiver until 15 May 2020 in line with the extension of the ECQ

M-2020-041 dated 15 May 2020 – extension of waiver until 29 May 2020 in line with the modified ECQ

M-2020-044 dated 29 May 2020 – extension of waiver until 11 June 2020 in line with BSP's guidelines under the General Community Quarantine

M-2020-048 dated 05 June 2020 – extension of waiver until the last business day of year 2020

The large increase in the value of transactions that settled in *PhilPaSS* during the first half of 2020 versus the same period in 2019 was mainly due to the surge in the value of monetary operations of almost 160 percent. These transactions accounted for about 70 percent of the value of the total transactions. Although the Philippine peso-US dollar trades declined during the period by 13 percent and other fund transfers directly initiated by financial institutions fell by almost 40 percent, these accounted for only 10 percent and 6 percent of the total value of transactions, respectively.

In terms of volume, monetary operations account for only about 5 percent of the total number of transactions that settled in *PhilPaSS*. The total volume of transactions in *PhilPaSS* increased during the period mainly due to the increase in interbank transfers of customer payments initiated directly by FIs. However, the increase in customer payments was negated by the decline in the number of peso-dollar trades (which dropped by 7 percent and accounted for 15 percent of total transactions), government securities (which fell by almost 10 percent and make up 7 percent of total transactions), and transactions made through the BSP's central financial accounting system (which declined by almost 30 percent and accounted for 7 percent of the total number of transactions).

#### 1.4 Updates on the next-generation *PhilPaSS*

The BSP shall implement by year 2021 a next generation RTGS system to be named as the *PhilPaSS<sup>plus</sup>*. Replacing the 17-year old *PhilPaSS*, the *PhilPaSS<sup>plus</sup>* shall provide more comprehensive functionalities to better service larger numbers and varying types and complexities of financial transactions and reduce data redundancy. In addition, the *PhilPaSS<sup>plus</sup>* shall use the latest technology to improve risk reduction, increase security levels, provide more complete data or information, provide for flexible liquidity management, increase provisions for business continuity and standardize the communication message format using the ISO 20022 international standard. The push for interoperability will significantly improve the end-to-end payer-to-payee processes among FIs and prepare as well for the goals for the efficiency of cross-border payments which is now a priority for the G20.

The BSP began designing the new system last December 2019. Notwithstanding the pandemic, the PSO continued to pursue the design based on the set timelines with ongoing intensive, albeit virtual, coordination with the service provider, BSP units involved, and all financial institutions and third-party payment service providers (TPPSPs) that participate in *PhilPaSS*, on schedule for the Go-Live date of the *PhilPaSS<sup>plus</sup>* in June 2021.

Also in 2019, BSP's Monetary Board required all FIs and TPPSPs that transmit to the RTGS system, electronic instructions in their systems and/ or infrastructures used to transmit such payment instructions, to implement the ISO 20022 standard. Even amidst the COVID situation, the BSP, still in coordination with its external stakeholders, successfully established the ISO 20022 Rulebook for the Philippine financial industry and ensured to on-board stakeholders through several virtual user briefings and active dissemination of advisories and guidelines. Through the Task Force on the implementation of the ISO 20022 standard, the BSP shall continue to ensure compliance with BSP's roadmap, parallel to the timelines of the launch of the *PhilPaSS<sup>plus</sup>*.

## 2. The National Retail Payment System: A conduit for the adoption of a safe, efficient and reliable retail payment system

The result of the diagnostic study conducted by the Better Than Cash Alliance (BTCA) in 2015 using 2013 payments data called for revolutionary changes in the way retail payment systems in the country were structured and governed.<sup>3</sup> The share of digital payments in the Philippines then was only about 1 percent of the total volume of payment transactions. This extremely low adoption of electronic payment services motivated the BSP to push the National Retail Payment System (NRPS) regulatory framework forward, targeting the share of digital payments to reach 20 percent by 2020 (BTCA, 2019) and 50 percent by 2023. The BSP envisioned the NRPS to pave the way for a safe, efficient, reliable and inclusive electronic retail payment system in the country.

<sup>3</sup> The Better Than Cash Alliance (BTCA) is a partnership of governments, companies and international organizations that accelerates the transition from cash to digital payments to advance the sustainable development goals (SDGs). The goals are a universal call to action to end poverty, protect the planet and improve the lives and prospects of everyone, everywhere. These were adopted by all United Nations member states, including the Philippines, in 2015.

Seen from a broad perspective, the adoption of the NRPS was in response to a pressing need for channels that can provide the efficiency required by an emerging Philippine economy and at the same time allow Filipinos to benefit from the safety, reliability and fitness of digital infrastructure in delivering financial services even to far-flung communities beyond the reach of traditional brick-and-mortar facilities. At the core of the NRPS framework are governance principles and standards that set a level playing field for the banks and non-bank e-money issuers and require them to pursue interoperable payment services. The BSP recognizes that interoperability is instrumental in accelerating economic growth as interlinked payment services enable the smooth and efficient flow of funds in support of productive activities that fuel economic advancement.

Indeed, the NRPS led to the following transformative changes in retail payments:

- i. Improvement in system governance with the creation of the Philippine Payments Management, Inc. (PPMI) as the governing body under the NRPS.<sup>4</sup>
- ii. Establishment of the Philippine Electronic Fund Transfer System and Operations Network (PESONet), which allows crediting of funds to the account of the payee on the same banking day the sender made the transfer.

PESONet is the rail used for the EGov Pay, which is an electronic payment facility that allows individuals and businesses to digitally pay taxes, licenses, permits and other obligations to the government. The EGov Pay uses the Land Bank of the Philippines (LBP) LinkBiz Portal through which the payers can access this payment facility.

- iii. Creation of InstaPay, which is a real-time electronic fund transfer system.

Fund transfers via InstaPay can be done with the use of QR codes which have been made interoperable following the BSP's policy requiring the adoption of a National QR Code Standard dubbed "QR Ph" by the industry. The Person-to-Person (P2P) QR Ph was launched in November 2019.

<sup>4</sup> A payment system management body (PSMB) is a private industry-led governing body that is duly recognized by the BSP to develop and enforce rules and agreements pertaining to members' clearing and settlement activities in accordance with the NRPS Framework and BSP regulations.

As of end-August 2020, PESONet has 62 participating institutions while InstaPay has 47 participants. The increasing participation of thrift banks, rural banks and electronic money issuers (EMIs) is a sign that the country's retail payment ecosystem is becoming more inclusive. These smaller institutions cater to the needs of the unserved and underserved communities.

The abovementioned initiatives have yielded remarkable results. The follow-through diagnostic study carried out by the BTCA in 2019 reveals that the share of digital payments in the Philippines as of end-2018 has increased to around 10 percent in volume and 20 percent by value (BTCA, 2019).

Interestingly, these advances in the country's retail payment system were achieved before the COVID-19 pandemic, which underscored even more the need for digital payment services around the world. The digital fund transfer rails that came after the adoption of the NRPS have been certainly helpful in ensuring that money circulation continues and remains efficient amid the pandemic. Realizing that digital payment services are critical in these times when making transactions face to face entails deadly health hazards, the BSP has adopted further measures to encourage use of these contactless services.

### **3. The BSP's regulatory response against the pandemic<sup>5</sup>**

Even as the NRPS prepared the country against this rare but disruptive pandemic with deep adverse economic impact, the BSP took additional steps to ensure that digital payment services helped in controlling COVID-19 transmissions while alleviating the plight of the most vulnerable sectors.

#### **3.1 Suspension of fees and charges imposed on electronic transactions**

The BSFIs were urged to suspend the charging of all fees imposed on the use of online banking platforms or electronic money, including those for InstaPay and PESONet services.<sup>6</sup> This call was aligned with the BSP's relief measure that also waives the transaction fees on interbank fund transfers done through the *PhilPaSS*. With this relief measure, the BSP-supervised Financial Institutions (BSFIs) were strongly encouraged to extend such a relief to the users of digital

<sup>5</sup> The enhanced community quarantine (ECQ) and stringent social distancing measures over the entire Luzon, including the National Capital Region (NCR), were imposed by the national government on 17 March 2020.

<sup>6</sup> See BSP Memorandum No. M-2020-008 dated 14 March 2020.

funds transfer services and ATMs.<sup>7</sup> Apart from easing the financial burden on Filipino households, the waiver of electronic funds transfer fees aimed to promote the use of digital payment and financial services since these minimize physical contact associated with the spread of COVID-19.

There were 30 BSFIs that agreed to waive the fees for PESONet and InstaPay transactions. Twenty-eight (28) of them were banks and two (2) were non-bank EMIs. These BSFIs have extended the waivers until either 30 September 2020 or 31 December 2020, with some maintaining the extension until further notice.

### **3.2 Relief measure waiving the filing, processing and licensing fees for electronic payment and financial services (EPFS)<sup>8</sup>**

Cognizant of the critical role of electronic banking and digital payment services in preventing the spread of COVID-19, the BSP has suspended the charging of filing, processing and licensing fees related to the grant of EPFS licenses.

The waiver of such fees aims to encourage BSFIs to offer safe, efficient and reliable digital channels that support critical payment use cases such as social benefit transfers, remittances and payments to billers including merchants, suppliers and the government.

### **3.3 Payment system oversight amid the COVID-19 outbreak**

The BSP implemented essential oversight interventions to sustain the smooth flow of funds in the economy despite some efficiency deterrents caused by the pandemic.

- *Requirement to adopt response plans.* The BSP required the critical operators of payment systems (OPS) and the payment service providers (PSPs) to adopt appropriate response mechanisms to ensure the health and safety of their employees and customers, while continuing the delivery of essential financial services to the general public.<sup>9</sup> Such intervention was essential in ensuring that clearing and settlement services remain robust and capable of addressing potential disruptions owing to the pandemic.

<sup>7</sup> See BSP Memorandum No. M-2020-031 dated 25 April 2020.

<sup>8</sup> See BSP Memorandum No. M-2020-033 dated 27 April 2020.

<sup>9</sup> See BSP Memorandum No. M-2020-006 dated 11 March 2020.

- *Surveillance of retail payment transactions.* In order to ensure that retail payment systems are responsive to the needs of the public despite the imposition of community quarantines, the BSP monitored the volume and value of payment transactions that are done through ATMs and checks, and those coursed through PESONet and InstaPay.

### **3.4 Continued collaboration with key stakeholders**

Strategic partnerships with key payment system stakeholders are continuously being pursued to sustain the country's momentum in digitizing payments.

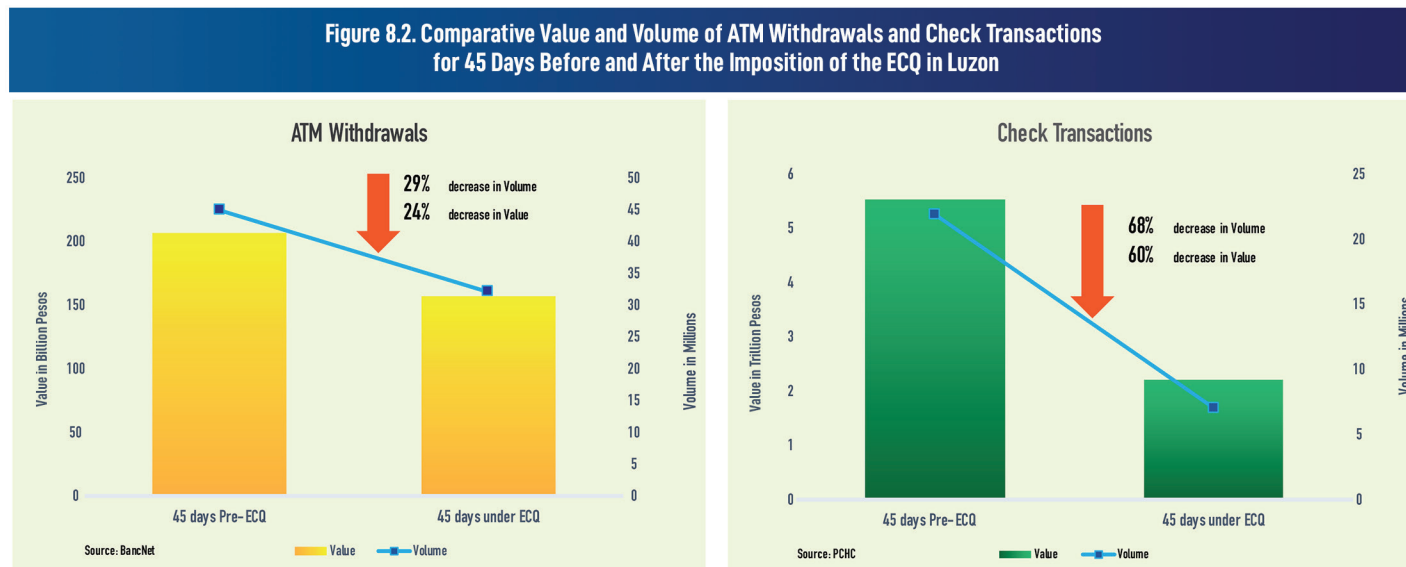
- *QR Ph for P2M payments.* The QR Ph adoption is expected to deepen with the availability of the Person-to-Merchant (P2M) QR Ph in the near term. This facet of the QR Ph implementation is expected to advance the BSP's financial inclusion agenda since it will attract the small unbanked vendors and their customers to own a transaction account in order to experience the convenience of using P2M QR Ph in settling their transactions.
- *Bills payment.* The bills payment initiative aims to eliminate the inefficiencies associated with the current fragmented bills payment mechanisms that require a biller to enter into a bilateral arrangement with a PSP in order to collect from the clients of the PSP through electronic means. Upon its implementation, the billers will be capable of collecting from their customers even if the PSPs of the billers are different from those of the customers.
- *Direct debit.* A direct debit arrangement allows a customer to authorize payees to pull funds directly from his account. Having such an arrangement shall enhance customers' management of recurring payments and shall aid payees streamline collection efforts and receive expected cash inflows on time.
- *Affordable fees on micro transactions.* Together with PPMTI, the BSP is working to reduce the cost of doing digital payments in order to encourage the consumers to shift from cash-based to digital transactions.

### 3.5 Participation in webinars promoting digital payments

The BSP has actively supported information campaigns that promote wider adoption of digital payments. With the goal of deepening digital financial literacy, key officers of the BSP participated as speakers in various fora and webinars such as those hosted by the Department of Trade and Industry (DTI), Department of Tourism (DOT), Department of Education (DepEd) and the Union Bank of the Philippines (UBP).

### 4. COVID-19's impact on retail payments based on empirical support

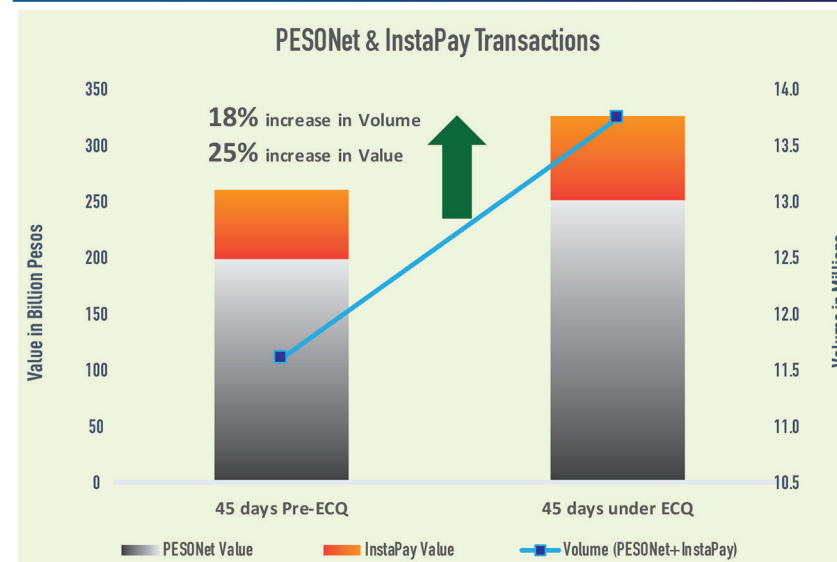
The BSP noted that the volume and value of ATM withdrawals plunged by almost 30 percent and 25 percent, respectively, in the first 45 days of the enhanced community quarantine (ECQ) compared with same period prior to the ECQ. A similar trend was seen in check payments, with the volume declining by 70 percent and value shrinking by 60 percent. The lowest volume and value of ATM withdrawals and check payments, year to date, were observed in April 2020 when the ECQ was in effect for a full month (Figure 8.2).



In contrast, there was a sustained rise in the volume and value of electronic fund transfers via PESONet and InstaPay during the same period. A total of 13.7 million transfers worth ₱325 billion of combined PESONet and InstaPay transactions were recorded for the first 45 days under ECQ. These numbers represent a substantial upswing of 20 percent in volume and 25 percent in value compared with the same time span before the ECQ (Figure 8.3).

The greater use of PESONet and InstaPay for retail payments reflects the natural tendency and the increasing preference of the public for digital payment services, being the most practical, convenient and secure means for transferring funds. At the same time, the BSP's regulatory actions helped move things along faster. For example, the quarterly volume and value of both InstaPay and PESONet transactions grew more notably when the payment service providers heeded the BSP's call to waive the fees on these electronic funds transfer services (Figure 8.4).

Figure 8.3. Comparative Value and Volume of PESONet and InstaPay Settlements for 45 Days Before and After the Imposition of ECQ



Source: Bancnet and Philippine Clearing House Corporation (PCHC)

Figure 8.4. Comparative Value and Volume of PESONet and InstaPay Settlements for Q1 and Q2 2020



Source: Bancnet and Philippine Clearing House Corporation (PCHC)



Meanwhile, the upward trajectory in digital retail payments data remained even after the community quarantine was relaxed from ECQ to general community quarantine (GCQ) starting June 2020. The PESONet and InstaPay payments leaped in volume to 51.2 million amounting to

₱862.3 billion as of the quarter ending 30 June 2020. This represents a 122 percent growth in volume and 59 percent increase in value from the preceding quarter.

It is notable that PESONet has helped ensure that the vulnerable sectors efficiently and safely received the government's financial assistance during the community quarantines. In particular, PESONet was used by the Development Bank of the Philippines to distribute the Social Security System's (SSS) small business wage subsidy (SBWS) under the national government's social amelioration program (SAP) to 3.4 million employees who were affected by the ECQ. It was also used in the deployment of amelioration to some beneficiaries of the Pantawid Pamilyang Pilipino Program (4Ps). PESONet will further play an important role in the deployment of social benefits. Starting October 2020, the SSS will release its members' benefits and loans through PESONet participating institutions. There are around 2.77 million pensioners who will depend on PESONet to safely and efficiently receive their SSS benefits.

The consistent progressive development in InstaPay and PESONet usage shows the sustainable impact of the BSP's regulatory actions.

## **5. COVID-19's impact on remittances and remittance service providers**

Remittances have been a growth driver of the Philippine economy, fueling both household income and consumption. The remittance market in the Philippines is sustained mainly by the influx of workers in urban centers across the country and by remittances from overseas Filipinos (OFs). In 2019, the Philippines was

the fourth largest destination for international remittances, posting transactions worth US\$33.5 billion which accounted for 9.3 percent of the country's gross domestic product (GDP) and 7.8 percent of its gross national income (GNI).

A substantial portion of the OF remittances is in the form of cash coursed through banks. Remittances worth US\$30.1 billion flowed into the country from both land-based workers (US\$23.6 billion) and sea-based workers (US\$6.5 billion) in 2019. About 78.4 percent of these inflows came from the United States (US), Saudi Arabia, Singapore, Japan, United Arab Emirates (UAE), United Kingdom (UK), Canada, Hong Kong, Germany and Kuwait.

In the Philippines, remittance inflows are facilitated through remittance channels (RCs) which are under the supervision of the BSP. RCs offer an efficient means of payment and money transfer even to distant communities, hence the RCs' special role in advancing financial inclusion.

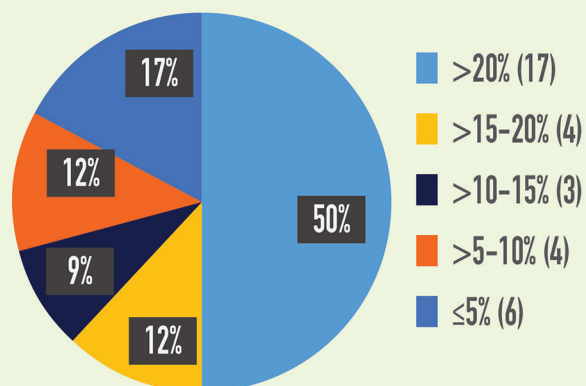
The outbreak of the COVID-19 and the corresponding measures undertaken to combat its spread pose challenges to the remittance market. In the past, remittances have been counter-cyclical as migrant workers send more money home during crises. However, the COVID-19 pandemic is an unprecedented global crisis that resulted in economic recessions across the world, affecting the employment of migrant Filipino workers.

During the implementation of community quarantines, the money remittance businesses were among the essential services allowed to operate. Based on a survey conducted by the BSP in May 2020, the RCs in the country remained mostly operational, albeit at varying operating capacity (BSP, 2020). Despite their continuous operation, however, the RCs experienced notable business slowdown. Majority of them reported a volume decline in April compared with the previous month as well as with the same month the year before. The declines covered both on- and off-shore sources. At least half of the respondents suffered a decline by more than 20 percent<sup>10</sup> (Figures 8.5 and 8.6).

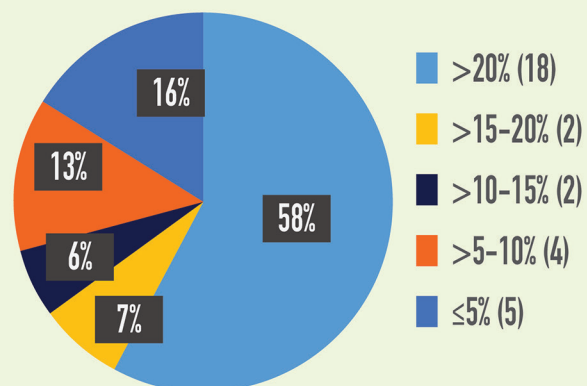
<sup>10</sup> The National Capital Region was put under the community quarantine on 15 March 2020 followed by a declaration of ECQ for the entirety of Luzon on 17 March 2020.

Figure 8.5. Reported Declines in the Volume of Domestic Remittances

Range of Declines in Volume of Domestic Remittances (April 2020 vs March 2020)



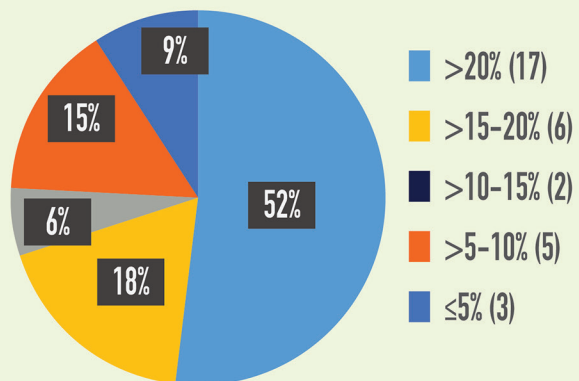
Range of Declines in Volume of Domestic Remittances (April 2020 vs April 2019)



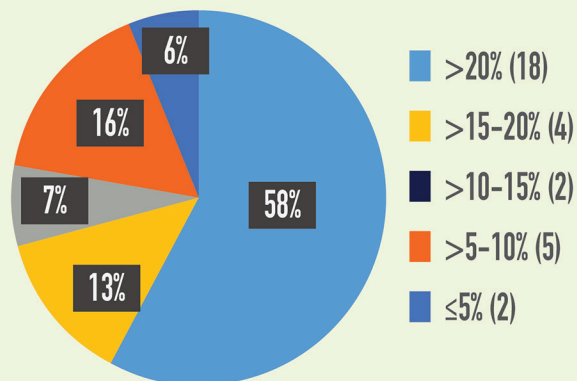
Source: BSP (2020)

Figure 8.6. Reported Declines in the Volume of International Remittances

Range of Declines in Volume of International Remittances (April 2020 vs March 2020)



Range of Declines in Volume of International Remittances (April 2020 vs April 2019)



Source: BSP (2020)

The volume and value of international remittance transactions have likewise declined on the back of closures of international corridors and quarantine measures imposed by different countries particularly the US, Saudi Arabia, Singapore, Japan, UAE, UK, Canada, Hong Kong and Kuwait where most OFs are located. As of end-May 2020, the number of displaced OFWs was 323,537 and this figure is projected to increase as the crisis lingers (Nakpil, 2020).

The COVID-19 pandemic highlighted the importance of business continuity plans and the need for innovative strategies enabling digital business operations. Digitalization is key to sustaining business operations even in times of major business disruptions. This observation is drawn from the survey responses of a few RCs that reported a rise instead of a downturn in business. Majority of these RCs are banks and virtual currency exchanges (VCEs) that employ online remittance platforms that allow customers to remotely make a remittance.<sup>11</sup> It is worth noting that the adoption of digital remittance platforms among the RCs in the country has yet to grow. The survey reveals that about 48 percent of the RCs do not use a digital platform; for those who do, only 30 percent or less of the total remittances they have processed using digital channels.

The foregoing data and survey results suggest that the Philippine remittance industry still lags in adopting digital platforms, constraining the RCs' services during the pandemic. This concern can be addressed through proper collaboration between the BSP and the remittance industry to ensure that the needs of the sector are taken into account in the BSP's broader initiatives to enhance the adoption of digital payments in the country.

## 6. Strengthening payment system oversight

The BSP's thrust of encouraging innovative digital payment services comes along with its mandate of safeguarding the efficiency and safety of the national payment system. In this regard, the BSP has issued a payment system oversight framework (PSOF) that sets out the BSP's approach to governing payment systems in accordance with the National Payment Systems Act. Currently, the BSP is developing an action plan which will ensure smooth implementation of the PSOF<sup>12</sup> with the following key provisions:

- Cooperative oversight. The responsibilities of the BSP interrelate with those of other regulators. For instance, there are financial activities that involve two linked settlements, such as the delivery of a security against payment of cash, where the security settlement is under the regulatory ambit of the Securities and Exchange Commission (SEC) while the money settlement is subject to oversight by the BSP. In this context, the PSOF allows the BSP to engage in cooperative oversight to address the need for comprehensive regulation over interrelated financial market infrastructures (FMIs).
- Designation of payment systems. Through the adoption of a risk-based oversight approach, the framework focuses supervision over designated payment systems. Designation of payment systems shall be conducted by the BSP, taking into account relevant information gathered from its monitoring activities. The critical information that shall form the bases of designation include: industry market share of a payment system; nature and complexity of transactions being processed by the system; and interdependence with other payment systems or FMIs. A designated payment system shall be classified as either:
  - Systemically important payment system (SIPS) – a payment system that poses or has the potential to pose systemic risk that could threaten the stability of the national payment system; or
  - Prominently important payment system (PIPS) – a payment system that may not trigger or transmit systemic risk but could have a major economic impact or undermine the confidence of the public in the national payment system or in the circulation of money.

The operator of a designated payment system and its participants, which include banks, non-bank e-money issuers and critical service providers, are subject to closer oversight in view of the importance of the designated system in the broader national payment system. The BSP can revoke the designation of a payment system under justifiable circumstances.

- Measures to avert disruption in payment systems. When a threat to the safety, efficiency and reliability of a designated payment system exists due to weaknesses in governance by the operator of a designated payment system, the BSP shall appoint, without need for prior court hearing, a manager of recognized competence in the payments field to administer the operation of a designated payment system.

<sup>11</sup> A virtual currency exchange (VCE) service refers to the conversion or exchange of fiat currency or other value into a virtual currency (VC), or the conversion or exchange of VC into fiat currency or other value. A VC refers to any type of digital unit that is used as a medium of exchange or a form of digitally-stored value created by agreement within the community of VC users.

<sup>12</sup> See BSP Circular No. 1089 dated 7 July 2020.

## 7. Conclusion

The BSP's efforts in overseeing and developing payment systems through continuous collaborative engagement with the payment services industry and other stakeholders have proven to be worthwhile endeavors in building the national payment system's resilience against extraordinary adverse scenarios such as the COVID-19 pandemic.

The enhancement of the country's RTGS system is one of the major initiatives of the BSP to provide a more robust infrastructure to cater to the fast increasing requirements of the financial industry and further support the goal of making the country's payment and settlement system more safe, efficient and inclusive while facilitating integration across domestic and global payment systems.

Moreover, the reforms championed by the BSP under the NRPS prior to the pandemic (i.e., 2015-2019) enabled the country's payment system in general to withstand market stresses. Nevertheless, most remittance companies, which

represent an important segment of the payment system, have to integrate digital transformation in their business strategies in order to enhance their resilience against extreme business disruptions such as the COVID-19 pandemic.

Despite improvements in payment system safety and efficiency following the establishment of the NRPS, the BSP had to carry out supplemental regulatory actions to boost the system's strength against extraordinary sources of stress. The BSP's actions in response to the pandemic have contributed to the greater use of contactless means of payment, particularly the PESONet and InstaPay services, which have been critical in controlling COVID-19 transmission.

As the country's payment system continues to evolve against the backdrop of the COVID-19 pandemic, the BSP shall continue to be dynamic and responsive in pursuing its goal of promoting wider adoption of digital payment services. The digital shift has proven to be more than helpful in overcoming the health crisis and in mitigating its pervasive impact on the economy.

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# Continuity of Core Financial Services and Cybersecurity Implications

Maricris A. Salud, Jovelyn M. Hao and Cris Benson S. Leuterio\*

CHAPTER  
**NINE**



## 1. Background

Whether one calls it a black swan or a gray rhino, the COVID-19 pandemic has undoubtedly brought transformational changes in financial services. In late February to early March 2020, some governments started to impose community lockdowns and implement social distancing to slow down the spread of the virus. Soon after, more national governments followed suit as countries began to face the realities of a pandemic. These measures restrained travel, economic and social activities, creating a major dent to the global economy.

Amid strict social distancing measures and mobility restrictions, BSP-supervised financial institutions (BSFIs) must rethink their business models and strategies to sustain the delivery of core financial services while coping with the ensuing challenges. These include capacity constraints, technology and network issues as well as the onslaught of COVID-19-related cyberthreats and attacks. The Technology Risk and Innovation Supervision Department (TRISD) of the BSP is at the forefront of proactively monitoring the digital and cyber environment surrounding BSFIs. This is in line with TRISD's mandate of fostering responsible digital innovation, sound technology and cyber risk management of BSFIs. The department's mandate has become even more crucial amid the global pandemic situation.

This chapter provides insights on the impact of the COVID-19 pandemic to the technology risks, cybersecurity posture and digital transformation initiatives of the BSFIs, including non-bank e-money issuers (EMIs)<sup>1</sup> and virtual currency exchanges (VCEs)<sup>2</sup>. It also discusses the BSP's initial and ongoing policy and supervisory responses to manage risks while harnessing unforeseen opportunities. It covers the range of supervisory tools deployed, the results of the baseline survey on the impact of COVID-19, constraints faced by the BSP and the BSFIs, realizations and lessons learned, and action plans to keep the BSFIs resilient in these turbulent times. As the BSP and the BSFIs work together and pursue innovative strategies to safely transition towards the new economy,

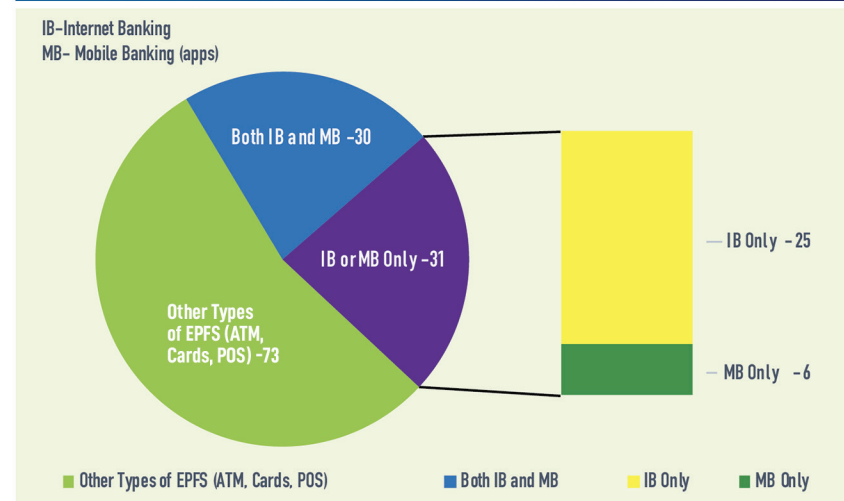
\* Maricris A. Salud (Deputy Director), Jovelyn M. Hao (Manager) and Cris Benson S. Leuterio (Bank Officer V) are from the Technology Risk and Innovation Supervision Department (TRISD).

1 E-money issuers are non-bank institutions registered with the BSP as a money transfer agent under Sec. 4511N of the MORNBI. (Please spell out acronym)

2 VC exchange refers to an entity that provides facility or services for the conversion or exchange of fiat currency to VC or vice versa.

this chapter also tackles the policy directions aimed at helping the industry face headwinds and uncertainties.

Figure 9.1. Summary of Banks with Authority to Provide EPFS



Source: TRISD Staff, Summary of Banks with Authority to Provide EPFS, August 2020

## 2. Pre-COVID-19 digital financial services landscape

Over the years, the BSP pursued responsible digital transformation of the financial services industry as an innovative tool to expand the reach of financial inclusion in the country. It offered beneficial opportunities and services to the unbanked and underbanked segments of our society. In addition, technology adoption enabled financial institutions to ramp up operational agility, tap a wider customer base and provide modern financial services in line with market demands.

It is not surprising, therefore, that the establishment of financial touchpoints through electronic payment and financial services (EPFS) continues to accelerate since electronic banking started way back in the early 2000s. These include onsite and offsite automated teller machines (ATMs), mobile point-of-sale devices and online channels such as internet and mobile banking platforms/applications. However, EPFS adoption remains at the emerging phase as only 134 out of 547 banks, or roughly 24.5 percent, have embarked on EPFS as of December 30, 2019



(Figure 9.1). Of the 134 banks, 61 banks, or 45.5 percent, offer internet or mobile banking while only five banks offer fully digital end-to-end products.

### 3. COVID-19 pandemic: The unexpected catalyst for digital financial services

For the financial services industry, the COVID-19 pandemic has become the unexpected catalyst for the increased adoption of digital financial services. Since the start of the enhanced community quarantine (ECQ) period in March 2020, mobility restrictions have driven consumers to utilize online banking/ financial services instead of the usual over-the-counter (OTC) and ATM services. Meanwhile, the national government through the Department of Social Welfare and Development (DSWD) also relied on tech-enabled financial services for the “contactless release” of financial assistance under the social amelioration program (SAP).

**Figure 9.2. Purely Digital Accounts Opened During ECQ Period**

**Total Accounts Opened**  
**4.151 Million**  
**Mar 17 - Apr 30**

**Accounts Opened per Day**  
**81,727**   **113,300**  
**Mar 17 - Apr 15**   **Apr 16 - 30**

**39%**  
**increase**

Source: TRISD Staff, BSFI Survey on Digital Account Opening

Our data shows that from 17 March to 30 April 2020, around 4.151 million digital accounts were opened among banks and non-bank electronic money issuers (Figure 9.2). Accounts opened per day averaged to 113,300 from April 16 to 30 corresponding to a 39 percent increase from the previous month's figures. InstaPay and PESONet transactions likewise posted record increases in the same

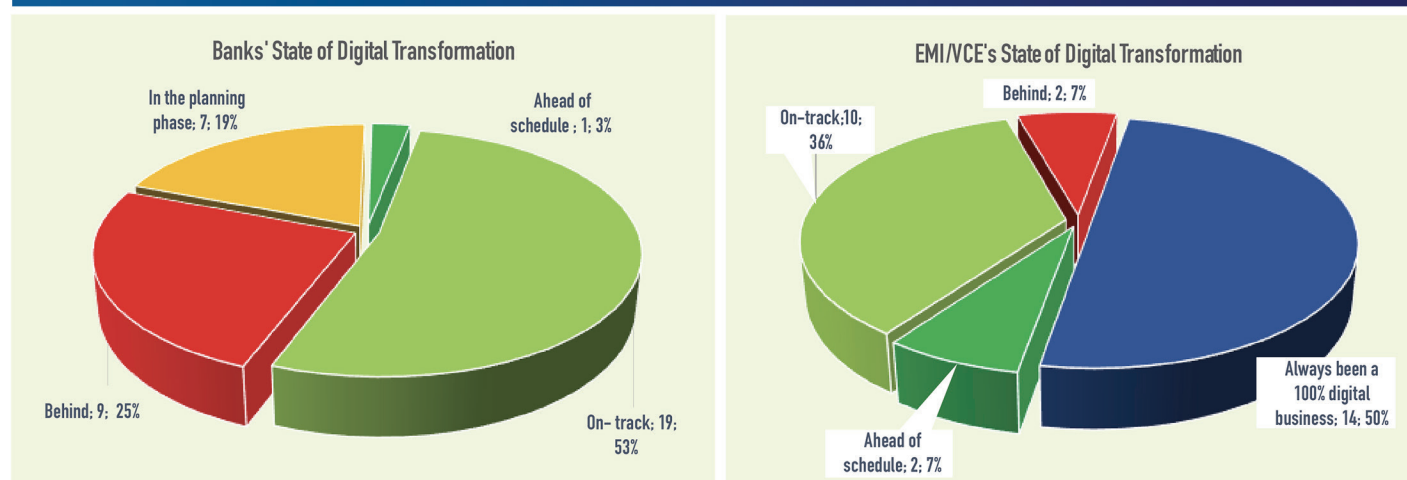
period. Indeed, Filipinos have taken advantage of digital-centric supervised institutions capable of delivering fully digital customer onboarding processes, online payments and remittance and other tech-enabled financial services.

Such numbers reveal that this is an excellent opportunity to bolster the digital foothold as more people are exploring and getting more comfortable with the online methods of payment. In a study (Laforga, B., 2020) conducted by Visa, around 70 percent of Filipinos who used digital payment channels during the lockdown will likely continue to do so. In a related study (Agcaoili, 2020) done by YouGov in July 2020, 75 percent of Filipinos believe it is important for small businesses to have an online presence. These positive developments can add about 1 percentage point to the annual gross domestic product (GDP) of mature economies and more than 3 percentage points to those of emerging economies like the Philippines (Boston Consulting Group, 2019).

Globally, the pandemic is yielding promising benefits for digital transformation. In the World Retail Banking Report 2020 (Capgemini and Efma, 2020), more than half (57 percent) of Capgemini surveyed customers now prefer internet banking, up from 49 percent before COVID-19. Customers are also favoring mobile banking apps in these times of social distancing, with the figure rising to 55 percent, compared with 47 percent previously.

To gauge the preparedness of BSFIs to deal with this pandemic, the BSP-Financial Supervision Sector gathered insights from the top 20 banks, including their subsidiaries, and 28 EMIs/VCEs. The survey showed that almost 85 percent of the respondents have already integrated their digital initiatives in their business roadmap while the rest are still updating their strategy or use cases. Nonetheless, only 14 respondents or 21.9 percent, all of which are EMIs/VCEs, believe that they have always been operating a digital business while 34 respondents, or 53.1 percent, mostly EMIs/VCEs, mentioned that above 75 percent of all their critical client-oriented activities can be done digitally. Figure 9.3 shows that most banks still lean largely towards traditional modes of financial services delivery while EMIs/VCEs have more digitally-focused business models.

Figure 9.3. State of Digital Transformation of Banks vs. EMIs/VCEs



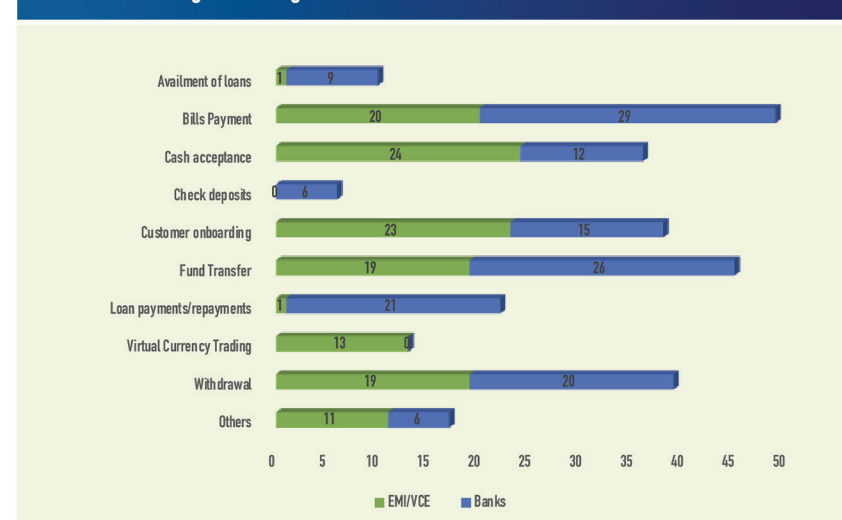
Source: TRISD Staff, Results of the Baseline Assessment on the Impact of COVID-19 Pandemic to the Regulated FinTech Industry and Critical Operators of Payment Systems, September 2020; SPRD Staff, Top 20 UKBs-Baseline Survey-Working File, July 2020

Most EMIs<sup>3</sup>/VCEs positioned themselves as digital entities in the hope of increasing market share, agility and customer satisfaction by more than 60 percent. In terms of readiness, Figure 9.4 shows the number of financial services offered by the respondents' digital channels that can be completed without requiring customers to visit the service providers' branches or offices.

Similar to the results of the consumer survey conducted by Capgemini, the baseline survey shows an increasing number of Filipino customers who prefer to do financial transactions from the comfort of their homes, leading to the rise in digital sign-ups and transactions. This trend prompted financial institutions to accelerate their digital onboarding projects and fast-track the development of key functionalities in digital channels such as acceptance of remote check deposits, placements of investments and other financial transactions.

<sup>3</sup> Availment of loans offered in e-money platforms of EMIs is made possible through partnership with credit granting institutions who fully bear the credit risks.

Figure 9.4. Digital Financial Services of Banks vs. EMIs/VCEs



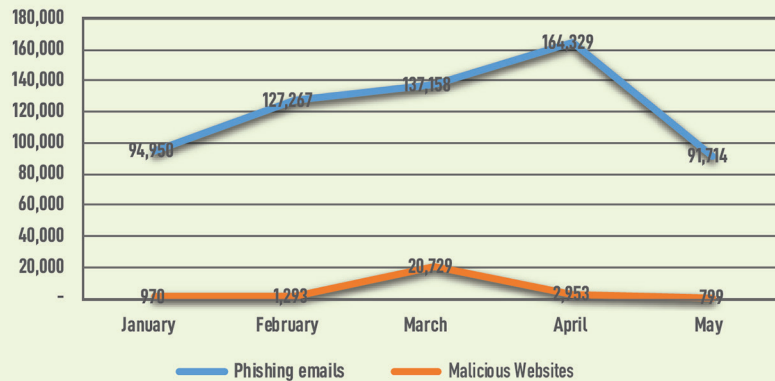
Source: TRISD Staff, Results of the Baseline Assessment on the Impact of COVID-19 Pandemic to the Regulated FinTech Industry and Critical Operators of Payment Systems, September 2020; SPRD Staff, Top 20 UKBs-Baseline Survey-Working File, July 2020

#### 4. Anticipating a more dynamic cyberthreat landscape

With the massive shift to digital financial services along with the public's overall sensitivities brought about by the COVID-19 pandemic, cyberthreat actors remain unrelenting in carrying out their cybercriminal activities. These range from phishing attempts and fake websites that lure clients to defraud or give out sensitive information to cyber-espionage or man-in-the-middle attacks in remote work environments. Undoubtedly, the COVID-19 pandemic set into motion the dynamic uncertainties in the cyberthreat landscape.

As depicted in Figure 9.5, phishing emails and malicious websites exhibited increasing trend since January 2020 as confirmed by the BSP's surveillance reports<sup>4</sup> on the heightened cyberthreat level. Amidst the global COVID-19 pandemic, the threat posed by malicious websites was the first to gain momentum, reaching its peak at the onset of the ECQ period. When malicious websites started to dwindle, cyberthreat actors turned to phishing emails where it peaked in April within the ECQ period. On a positive note, phishing emails

**Figure 9.5. Phishing Emails and Malicious Websites, 1 January to 31 May 2020**



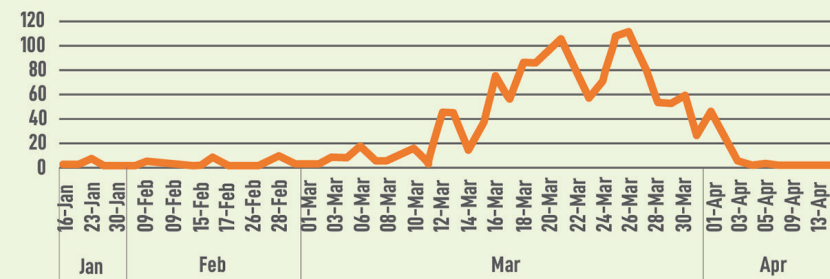
Source: TRISD Staff, TRISD Issue No. 3: Surveillance Report on COVID-19 Themed Cyber-Attacks

<sup>4</sup> Based on surveys sent to chief information security officers of select BSFIs to gather weekly and/or monthly data pertaining to key control measures and relevant statistics on COVID-19-themed cyberattacks throughout the ECQ and GCQ periods.

and malicious websites tapered off towards the end of the ECQ period, with figures even lower than January levels. This downward shift could indicate that countermeasures deployed by the BSP and the BSFIs during the ECQ were working as intended. However, it may also signify that cyberthreat actors are most likely just changing their tactics.

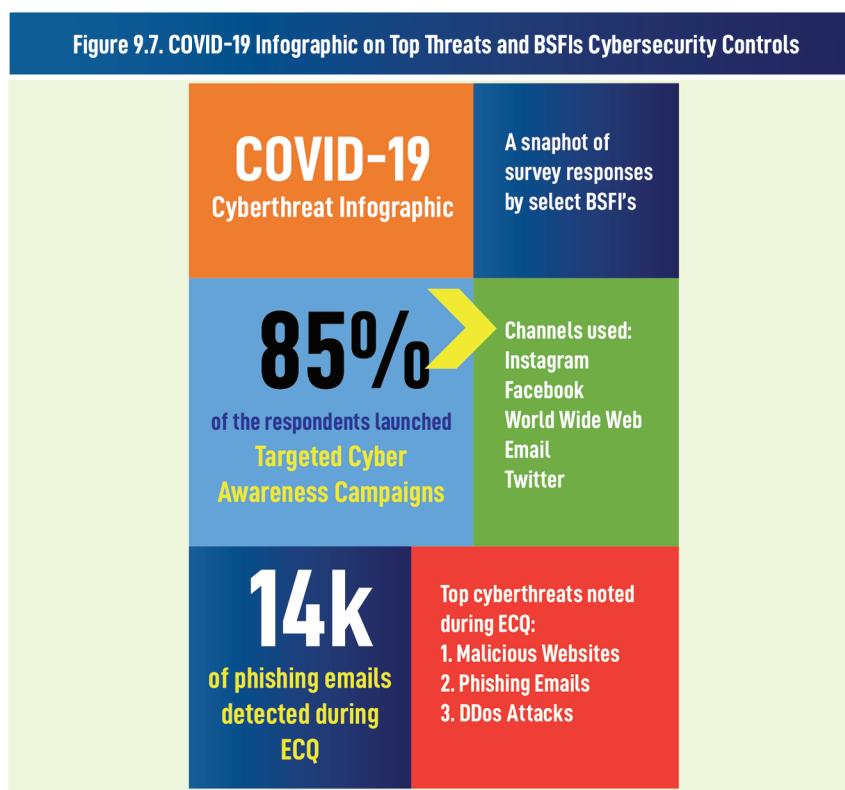
Looking at the global landscape, Figure 9.6 tracks the Philippine trend for malicious websites, with its peak in middle to late March as cited in a report by the FS-ISAC (2020). This corresponds to the height of the global pandemic, when fraudsters and scammers were quick to exploit the novelty of the situation, setting up to an average of 66 financially-themed, high-risk domains per day. Nonetheless, the number of malicious websites eventually plummeted in the light of countermeasures by the domain name registrars as well as increased takedowns by organizations.

**Figure 9.6. Creation of High-risk Domains with COVID-19 and Financial Theme**



#### 4.1 Initial industry responses

Figure 9.7 outlines the top threats at the onset of the COVID-19 pandemic as well as the cybersecurity measures and controls adopted by BSFIs. Launching of targeted cybersecurity awareness campaigns was the top countermeasure undertaken by BSFIs in response to COVID-19-themed cyberthreats. Twenty-nine or 85 percent of all respondents have initiated cyber awareness campaigns aimed at their clients, employees and key stakeholders. While considered a non-technical control, awareness programs serve as highly effective tools to combat phishing and social engineering attacks. The campaigns utilized all social media channels (e.g., Facebook, Instagram, Twitter), emails, SMS reminders and website advisories.



Source: TRISD Staff, TRISD Issue No. 1: Surveillance Report on COVID-19 Themed Cyber-Attacks

BSFIs likewise intensified surveillance and monitoring of these cyberthreats, primarily through their security operations centers (SOC). This is further supplemented by tighter network controls such as stringent firewall settings, endpoint protection and whitelisting of websites/applications, among others.

#### 4.2 Securing remote work arrangements

In order to support continued operations of mission-critical functions and provide financial services to their clients, BSFIs have adopted remote work arrangements in the wake of the ECQ. Such work arrangements normally entail the use of digital collaboration tools, connection to remote BSFI networks and use of personal devices by the remote workforce. While remote work arrangements are expected to alter business processes and structures, failure to appropriately secure the entire workflow, such as the use of unsecured communication channels or unmanaged use of personal devices, may introduce new cybersecurity threats and risks. In this regard, the BSP has advised the BSFIs and the public to undertake necessary measures to securely manage work-from-home (WFH) arrangements.

#### 4.3 The big shift to zero-trust operational model

With the prevalence of remote work arrangements, security is no longer confined within an institution's technology infrastructure as it now extends to an array of endpoints being accessed by its remote workforce. IT and security professionals are faced with the hard truth – cybersecurity is more daunting than ever as the number of threat vectors become overwhelmingly massive.

In order to minimize the risks, BSFIs should reconsider their cybersecurity strategies and assess the feasibility of shifting to a zero-trust operational model. This means that access to BSFI resources will have to be continuously verified and authorized by implementing security protocols such as multi-factor authentication (MFA) and biometric technologies. BSFIs should evaluate whether implementing zero-trust identity and access management procedures can address the growing cyber risks in the post COVID-19 setup.

#### 4.4 Protecting the last mile

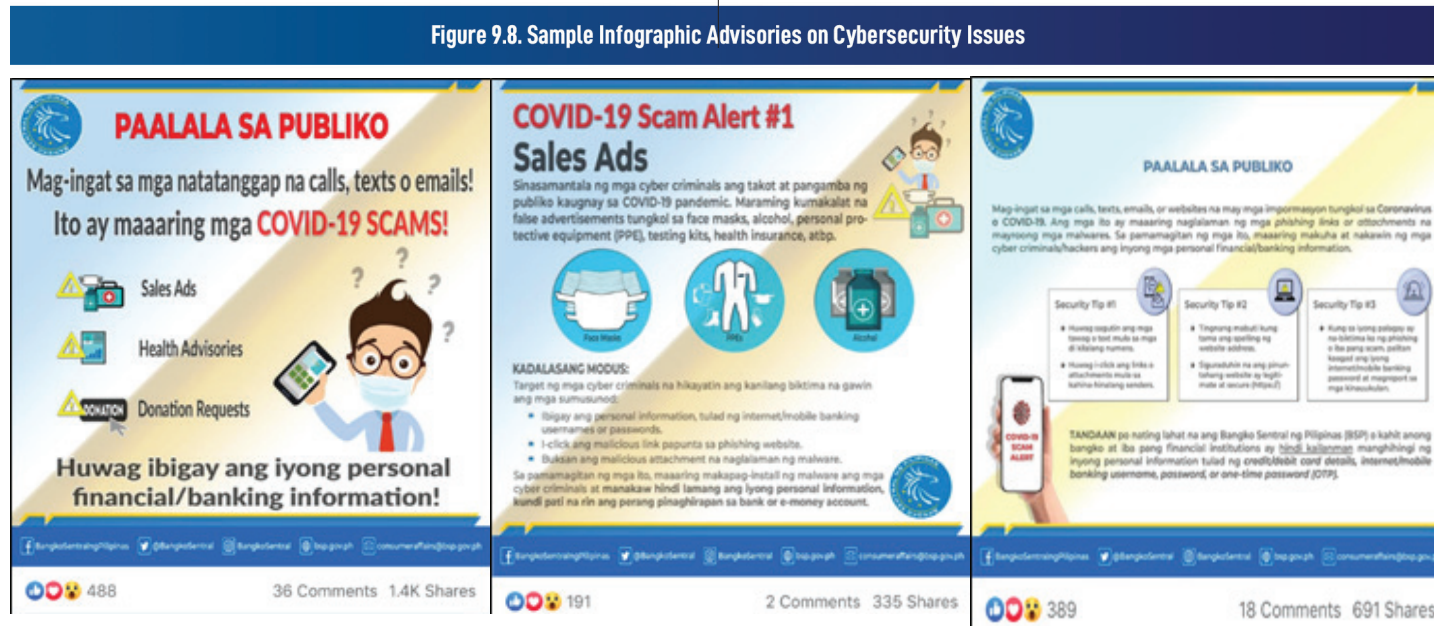
At the heart of digital transformation and heightened cyberthreats are the financial consumers who are at the receiving end of both the advantages of digital platforms as well as the risk of cyberfraud attacks. In dealing with new digital customers as well as existing clients trying out digital financial services for the first time, BSFIs understandably focus on making these platforms easier to use and providing customer service and technical support to ensure customer buy-in and loyalty. On the other hand, increased exposure to these digital platforms also makes financial clients the primary targets of cyberfraudsters. Thus, it is imperative that BSFIs also equip their financial consumers with the right tools, information and know-how not only to properly use these digital financial channels but also to avoid being victims of cyberfraud and scams.

As part of their consumer protection programs, BSFIs should carry out continuing education and cybersecurity awareness campaigns to advise financial clients on

cyberhygiene and safe computing practices in using the institutions' electronic financial products and services. Said programs should be constantly updated to address emerging threats and risks as well as the changing needs and priorities of the consumers. In cases where financial consumers fall prey to the evolving tactics of cyberthreat actors and fraudsters, consumer redress mechanisms should be in place to guide the reporting, notification and availing of recourse options to recoup or minimize losses.

Since the start of the ECQ, the BSP has rolled out cybersecurity awareness campaigns targeting the BSFIs and the banking public focused on COVID-19-themed cyberfraud and scams. These cover topics ranging from tips on how to avoid becoming a victim, security tips on WFH arrangements and continuous reminders on keeping personal financial information confidential. To ensure wider reach and catch public attention, infographic advisories (Figure 9.8) were posted on BSP's social media handles namely, Facebook, Instagram and Twitter during and after the ECQ.

Figure 9.8. Sample Infographic Advisories on Cybersecurity Issues





#### 4.5 Advancing cyber resilience amid the pandemic

The onset of the pandemic – with all the attendant operational constraints, economic challenges and the incessant battle to keep cyberthreats at bay – has underscored the importance of an effective technology and cybersecurity risk management system. Moreover, the crisis also highlighted the value of a risk-based and targeted approach to ensure that strategies, control measures and responses are commensurate to the nature, degree and magnitude of the threats involved. For instance, a security awareness campaign and education program designed for a specific client profile (e.g., millennials or young professionals) – with specific focus on the types of threats and risks facing them – would be a more effective countermeasure compared to generic advisories sent to all clients irrespective of their profiles and needs. Likewise, depending on the volume and exposure to high-risk activities/transactions, robust and multi-layered security defenses such as MFA controls may be necessary to limit the ability of attackers to carry out the fraud. On the other hand, BSFIs with significant exposure and interconnection with payment gateways and networks may need to invest in sophisticated fraud management systems that can flag transactions with unusual spikes or irregular patterns vis-à-vis the established customer profile or attributes as well as new forms of financial crime.

As highlighted in BSP Circular No. 982 (Bangko Sentral ng Pilipinas, 2017), sustained situational awareness and threat monitoring capabilities in this changing and uncertain landscape are key enablers for BSFIs to institute appropriate countermeasures as threats and risks arise. Like the call of the national government to unite in this battle against COVID-19, all BSFIs must collaborate and work together to have a collective, coordinated and strategic response to proactively manage emerging and persistent cyberthreats.

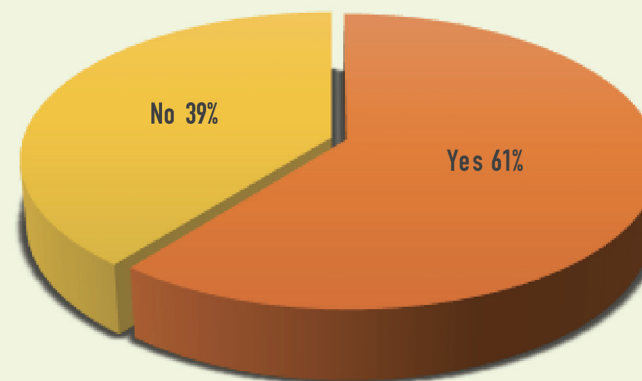
To achieve cyber resilience in the midst of a pandemic, BSFIs must include cyber-related attacks and incidents in their business continuity planning process. Apart from cybersecurity concerns, BSFIs' business continuity readiness has been put to the test during the pandemic, severely challenging their operational capabilities. If improperly managed, the increased demand for digital financial services and remote working arrangements may take a toll on the BSFIs' technology infrastructures and systems. Other issues that may be encountered during the ECQ period include the unavailability of key IT or operations personnel and critical third-party service providers (TSPs). Although service degradation may

be inevitable in a crisis scenario, anticipation of these issues, development of a mitigation plan or strategy and implementation of compensating controls will help minimize disruption.

#### 5. A closer look at the impact of COVID-19 on fintech firms

As the companies try to cope with these turbulent times, most of them have no choice but to unleash their survival instincts. The boards and senior managers of these firms believe that the pandemic has caused minor impact on their corporate governance practices. The companies have carried out their stockholders' and board meetings via teleconference, as allowed by the rules of the Securities and Exchange Commission (2020). Their independent control units have also conducted virtual walkthroughs and audits and have not reported issues due to the pandemic.

Figure 9.9. Changes in Strategic Direction



Source: TRISD Staff, Results of the Baseline Assessment on the Impact of COVID-19 Pandemic to the Regulated FinTech Industry and Critical Operators of Payment Systems, September 2020

With economic contraction and changes in consumer behavior, EMI/VCE firms have redefined their strategies by (a) introducing virtual platforms or new



products that can minimize face-to-face contact; (b) heavily refocusing on areas that can drive growth; and (c) forging meaningful partnership. Some of their innovative ideas include the increase in wallet limit, partnership with the various government units for the distribution of relief and subsidies including SAP and integration of payment portals to facilitate the continuous flow of funds. Amid these creative concepts, the pandemic still hurt some of the EMIs/VCEs due to closure of branches or temporary suspension of bitcoin exchanges, isolated adoption of “no work, no pay” schemes, including the retrenchment of employees, and postponement of store openings. Collectively, these challenges made them realize the importance of introducing new products suitable to the new normal, strengthening business continuity framework and pursuing digitalization initiatives. This way of thinking is also the gist of a Harvard Business Review article (Guillen, M., 2020) that highlighted the importance of pivoting to business models conducive to short-term survival along with long-term resilience and growth. It emphasized the need for disintermediation by going directly to the buyer’s buyer, supported by changes in marketing, logistics and information technology, particularly e-commerce platforms.

The adverse effect of the COVID-19 pandemic on their key business lines not only led to the dramatic shift in strategic direction, but also revealed the state of the EMI/VCE industry. Financial and operational impact on fintech firms varies depending on the market niche they are in, variety of products and level of digitization initiatives. Essentially, respondents with retail customers and delivery services did well during the pandemic while those catering to enterprises, travel (including ride-hailing services) and entertainment suffered a major dent to their operations. Respondents whose consumers rely on OTC transactions were also negatively affected.

For the rest of 2020, respondents expect to rebound owing to the transition<sup>5</sup> to a relaxed community quarantine in Metro Manila effective June 1, 2020. With the reopening of the economy and government’s thrust encouraging Filipinos to use cashless transactions, a number of fintech firms showed a positive business outlook. On the flip side, respondents with affected target markets and whose customers primarily rely on OTC transactions foresee less favorable business prospects for the year.

<sup>5</sup> This is a shift from modified enhanced community quarantine to general community quarantine

### ***5.1 Rethinking innovative solutions amid the pandemic***

To brace for the extreme effects of the COVID-19 health crisis, EMIs/VCEs are (a) gearing towards new product developments that meet the demand of customers under the new normal; (b) monitoring controllable expenses; and (c) veering away from traditional marketing activities that would require physical contact with people. To attract potential customers, they are boosting marketing campaigns in social media and Google advertisements. Respondents that employ OTC channels have been working to integrate with banks to facilitate digital funding of e-wallets.

As the continuity of operations is on the line, respondents look at succession planning differently. More than ever, they adopted evaluation methods that rated leaders based on their ability to (a) keep succession plans on track with ready now successors; (b) re-allocate trained people to other parts of the organization; and (c) manage the gap brought about by limitations of third-party outsourced providers. A case in point is an EMI that adjusted its hotline operating hours and reassigned some internal manpower to complement a TSP for call center operations at the height of the ECQ.

Given the restricted mobility in the supply chain, certain respondents experienced some downtimes or degraded service level with their critical TSPs. Despite these, the early interventions of the respondents such as vendor assessments, heightened monitoring of key risk indicators and execution of their contingency plans paid off. Thus, EMIs and VCEs were able to surmount the pandemic challenges and contribute to greater stability of the financial system.

### ***5.2 The challenging path to digital transformation***

The path to digital transformation is not a smooth journey for both banks and EMIs/VCEs. For one, cultural resistance within their organizations remains a primary hurdle that may take considerable time, effort and resources to overcome. Over-reliance on legacy technology and insufficient in-house skills continue to confront banks, limiting their opportunities to leverage digital platforms and services. Replacing outdated platforms entails a certain amount of downtime while insufficient skills can delay the deployment of IT projects. On the other hand, EMIs/VCEs find that limited budgets and inadequate internet connectivity are major hurdles to reaching their target markets. Likewise, the

government also needs to step up its efforts to support the digital transformation initiatives of BSFIs. For instance, updating revenue regulations that are attuned to a digital business model (i.e., allowing for electronic documents as proof of revenue and adoption of e-invoicing) would greatly propel the use of technology among BSFIs.

Investing in the right technology and tools, involving all departments in developing the strategy and investing in staff training are the identified critical success factors towards digital transformation. Partnering with fintech firms may also be a viable option to fast-track digital transformation as noted in a report by the European Banking Authority (2018). Although the report was made before the pandemic, forging partnerships with fintech firms can enable BSFIs to quickly innovate and ramp up their digital transformation initiatives.

## 6. BSP's COVID-19 regulatory response and initiatives

Ahead of the government's imposition of the ECQ, the BSP has issued several policies reminding BSFIs to put in place COVID-19 pandemic response plans. Such plans were meant to primarily safeguard the health and safety of BSFIs' employees and customers as well as address operational challenges while ensuring that basic financial needs of the public are being met. On top of these policy measures, the BSP facilitated the practical needs of the BSFIs such as securing IATF IDs and RapidPasses for their mission-critical personnel.

Initially, daily surveys were sent to the BSFIs to gather critical information on the status of their operations indicating their working arrangements during the ECQ period, working hours, extent of operational capacity, number of opened/closed branches and other relevant data. These critical information were fed into the supervisory processes of the BSP, allowing supervisors to promptly identify and act upon areas of key concerns. Figure 9.10 lists down the menu of supervisory and policy responses undertaken by the BSP to address COVID-19-related concerns and issues covering three key priorities, as follows:

- a. *Conducive environment for digital innovation.* The degree and level of execution of digital transformation and technology innovation spell the difference between BSFIs who survive or even thrive in this pandemic situation and those who do not. To further stimulate and provide a conducive

environment for digital financial services to flourish, the BSP granted regulatory reliefs, including relaxed Know-Your-Customer (KYC) requirements that paved the way for more convenient digital onboarding of clients. The BSP took a step even further by waiving applicable license fees for BSFIs who wish to offer electronic payment and financial services. This is supplemented by policy issuances urging BSFIs to augment their existing capabilities and implement appropriate strategies to address the increasing demand for digital financial services.

- b. *Vigorous cybersecurity measures.* As a key supervisory priority, the BSP intensified its cyber surveillance efforts through daily monitoring of major cyber incidents and disruptions, and initiating routine surveys on COVID-19-themed cyberthreats and attacks. The BSP likewise published several policy issuances with strong emphasis on employing vigorous and multi-layered cybersecurity controls and measures to ward off evolving threats. As cyberthreats span various industries and organizations, the BSP reinforced collaboration and active engagement with key stakeholders, including law government agencies. Specifically, the BSP sought assistance from the Philippine National Police and the National Bureau of Investigation to facilitate the investigation of cases directly referred by BSFIs and the subsequent prosecution and imposition of penalties in accordance with the "Bayanihan to Heal as One Act." As cybercriminals face the full consequences of the law, the BSP hopes that these measures serve as effective deterrent and warning that will contribute to further deepening overall cyber resilience in our country.
- c. *Dynamic consumer protection mechanisms.* True to its mandate as a champion of the financial consumers, the BSP pursued concrete steps so that consumer welfare remains protected and digital financial needs are met especially amid the pandemic. The BSP pushed for the temporary suspension of fees and charges imposed by BSFIs on the use of online and e-money platforms as a way of helping customers transact digitally. Consequently, the BSP embarked on focused and aggressive cybersecurity awareness campaigns to alert and warn financial consumers of emerging cyberthreats and scams. BSFIs were likewise advised to ramp up their customer service and redress mechanisms to protect consumers and minimize fraud losses.

Figure 9.10. Menu of COVID-19 Supervisory and Policy Responses Deployed by the BSP

<b>CO</b> nductive environment for digital innovations	<b>VI</b> gorous cybersecurity measures	<b>D</b> ynamic consumer response mechanisms
<p>Relaxed Know Your Customer requirements to facilitate access to formal financing channels.</p> <p>Waived fees related to the grant of license or authority to provide Advanced EPFS.</p> <p>Issued guidelines and reminders to augment existing capabilities of BSFIs and enable them to implement appropriate strategies to address the increasing demand for digital channels and effectively manage the attendant risks.</p>	<p>Increased cyber surveillance activities, thru close coordination with BSFIs, on potential cyber threats and preventive counter measures.</p> <p>Issued a series of Memoranda reminding all BSFIs to stay vigilant and employ multi-layered security defenses against financial crimes amidst COVID-19 pandemic.</p> <p>Reinforced collaboration with key stakeholders, including law enforcement agencies.</p>	<p>Urged BSFIs to suspend fees and charges on the use of online banking or e-money, including fees imposed on the use of InstaPay, PesoNet, other fund transfer services, and ATM interbank transactions.</p> <p>Rolled out cybersecurity awareness campaigns through social media blasts for both the BSFIs and the banking public.</p>

Source: TRISD Staff, TRISD Initiatives and Deliverables, September 2020

## 7. Post-pandemic reality: Technology innovation and cybersecurity in the new economy

As the financial services industry navigates the new economy, new uncertainties and difficulties loom in the horizon. As daunting as the future may seem, the BSP shall continue to forge ahead and undertake policy and supervisory responses touching on the following key areas whose first letters spell "COVID":

- **CO**nductive environment for digital innovation;
- **VI**gorous cybersecurity measures; and
- **D**ynamic consumer protection mechanisms.

While it seems paradoxical to coin BSP's policy and supervisory responses after the very problem that confronts us, it is only by facing COVID-19 challenges head on can the industry progress towards lasting stability and recovery. The BSP had done this through baseline assessments of COVID-19's impact to the BSFIs and their financial clients as well as thorough surveillance of the operating and cyberthreat environment. From providing the necessary regulatory reliefs to fostering greater digital innovation, issuing coherent cybersecurity and technology policies, to ramping up cyber awareness campaigns for financial consumers, the BSP made sure that supervisory actions were risk-informed, data-driven and intelligence-led.

The changing landscape compels BSFIs to rethink their business models and strategies as well as redesign their financial products and services suitable to the new normal environment. BSFIs should stand ready to harness digital transformation opportunities while observing sustained vigilance against cyberthreat actors. More than ever, the BSP and the BSFIs should go the extra mile in protecting and ensuring the interest and well-being of the financial consumers.

Indeed, these are extraordinary times where the BSP and BSFIs are called upon to collaborate more closely and pursue pioneering and cohesive solutions so that financial services remain safe, innovative and resilient as the industry smoothly transitions to the new economy.

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# Financial Digital Rails and Financial Inclusion

CHAPTER  
**TEN**

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## 1. Financial inclusion: An urgent agenda for the new economy

The Bangko Sentral ng Pilipinas advocates financial inclusion to promote a strong economy and a high quality of life for all Filipinos. With inclusion, more individuals and businesses use financial services to help them earn income, build wealth, manage risks and recover from downturns. In turn, when many people use these services, the economy and the financial system become more resilient and sustainable. Financial service providers are able to tap a wider and more diverse client base, improving the stability of the institutions and the system. Economic growth is sustained as the broader segments of businesses and the population become productive and resilient economic agents.

As a policy agenda, financial inclusion emerged from the microfinance movement which recognized the latent creditworthiness of the entrepreneurial poor. With the appropriate product and credit methodology, microfinance proved to be a viable undertaking. The recognition of microfinance in the General Banking Law of 2000 (RA 8691) and the BSP's enabling rules and regulations led to its mainstreaming in the banking system. As of end-2019, 154 banks were engaged in microfinance, making outstanding loans of ₱27.3 billion to 2.4 million of our country's microentrepreneurs.

Expanding the premise of microfinance, financial inclusion recognizes that individuals – especially the poor – and their enterprises need a range of financial services. In order to provide these services, financial institutions must see and understand this market segment.

The initial product that can be the first step toward financial inclusion is a transaction account – a convenient means to store, receive and move funds. While not many Filipinos are able to save, almost everyone makes payment transactions, whether as a sender or receiver. Providing universal access to a safe, convenient and affordable means of payment, through a transaction account, should therefore be an initial goal of financial inclusion. This way, even a low-income individual can take part in the digital economy and benefit from the efficiencies and opportunities in digital payments.

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The BSP's steady efforts to promote financial inclusion and digital payments have started to bear fruit. Based on the results of the 2019 Financial Inclusion Survey, account ownership among adult Filipinos grew from 23 percent in 2017 to 29 percent in 2019, equivalent to 5 million Filipinos opening an account within the two-year period. More important, account ownership among the poorest almost doubled from just 14 percent in 2017, well below the 23 percent national average that year, to 27 percent in 2019, closer to the national average.

The improvement in account ownership has been largely driven by the uptake of e-money accounts which leaped from just 1 percent in 2017 to 8 percent in 2019. In parallel, the share of accountholders who use their account for payment transactions – such as fund transfers and bills payment – has also more than doubled to 39 percent in 2019 from only 18 percent in 2017. These figures, already encouraging as they are, do not yet reflect the developments driven by the COVID-19 pandemic which demonstrated in the clearest terms the benefits and necessity of digital payments.

### 1.1 Building the foundations of inclusion for the digital economy

At the height of the restrictions on people's movements imposed during the pandemic, the country saw a spike in digital onboarding and digital payments. More than 4 million new accounts were opened through digital channels, and new online sign-ups and app downloads for digital financial services (DFS) from January to April 2020 doubled from the same period the previous year. InstaPay and PESONet transactions also followed suit, surging both in volume and value. In terms of the number of transactions, InstaPay and PESONet respectively increased by 84 percent and 24 percent in April and May, when the Enhanced Community Quarantine (ECQ) was in full effect. PESONet, in particular, saw a 325-percent increase in the month of May alone.

The ready and rapid shift by consumers and businesses to digital payments when the pandemic hit would not have been possible without the foundations laid by the BSP for inclusive digital finance over the last four years. With the rise of mobile phone ownership, internet users and digital natives in the country, the BSP issued a series of policies designed to harness the full potential of digital technology to bridge the inclusion gaps and provide access, cost and convenience that have long kept many Filipinos at the fringes of the formal financial system.



Recognizing that a transaction account is the gateway to digital finance, the BSP has sought to democratize account ownership by introducing the basic deposit and restricted accounts. The no-frills Basic Deposit Account (BDA) was designed to make a transaction account accessible, affordable and within reach by certain segments of the population. These include those who only have a barangay certificate as proof of identification and who are unable to meet the minimum maintaining balance of a regular deposit account. The BDA has seen impressive uptake since it was introduced in 2018. As of the first quarter of 2020, 4.5 million depositors had such accounts with 120 banks, a significant growth from only 339,000 depositors in 2018.

Complementing the BDA is the expansion of cash-in and cash-out (CICO) points such as cash agents and dressed-down bank branches or branch-lite units (BLUs), which are crucial to helping people with no bank accounts make the transition from cash-based to digital transactions. Cash agents in particular have grown in number exponentially, with at least 17,000 operating nationwide to date. Located in neighborhoods, communities and public places such as wet markets, cash agents and BLUs provide convenient, friendly and accessible channels for financial transactions. For instance, the market vendor or microentrepreneur need not make time-consuming and costly trips to the bank, but instead may deposit their day-to-day earnings or withdraw cash for business expenses at their nearest agent.

The third pillar of the inclusive digital finance policy put in place by the BSP was the National Retail Payment System (NRPS), which laid the groundwork for interoperable digital payment rails. InstaPay and PESONet were launched under the NRPS, enabling any account-to-any account small value fund transfers. Through these digital payment rails, people can now easily send money to a family member, pay bills, settle fees and make purchases with just a few taps on their phone. BSP also worked closely with industry partners to launch QR Ph, the national QR code standard, to promote digital payments particularly among small merchants and vendors. In making digital payments available, affordable and convenient for payment transactions, account ownership becomes a necessity not only for those with extra money to save but for anyone who sends, receives and pays money, no matter how small.

These foundations for an inclusive digital finance ecosystem have proven vital in the face of community quarantines against the pandemic. Amid the restrictions on physical mobility and face-to-face interactions, people and businesses have been turning to digital channels for their daily financial activities. They have done so with ease due to the availability of e-wallets, mobile and online banking, and other contactless modes of payment.

The BSP therefore intensified coordination with various government agencies to support and facilitate the adoption of digital payments by various sectors, particularly the low-income households and the informal workers. The BSP worked closely with the Department of Social Welfare and Development (DSWD) to implement the account-based distribution of emergency cash subsidies under the second tranche of the Social Amelioration Program (SAP). As a result, 7.3 million SAP beneficiaries had opened transaction accounts by the first week of August 2020. Prior to that, the BSP and DSWD also partnered to convert limited-purpose cash cards, used in the distribution of cash grants under the Pantawid Pamilyang Pilipino Program (4Ps), into full-service transaction accounts.

The Department of Labor and Employment (DOLE) also collaborated with the BSP to promote financial inclusion and digital payments in the labor sector. On 3 August 2020, the DOLE issued Labor Advisory No. 26-20 which aims to promote the use of transaction accounts in the payment of wages of private sector workers and employees, including the domestic helpers or *kasambahays*.

The BSP is also coordinating with the Department of Transportation (DOTr) to implement the Automated Fare Collection System (AFCS), which aims to promote cashless fare payments in the transport sector, particularly rail and roads. The two agencies are working together to develop the rules and infrastructure to enable any transport media (e.g., smartcards such as Beep, EMV payment cards and other form factors like QR code) to be used in any bus, train or PUV equipped with an AFCS card reader.

Beyond promoting the use of digital payments by the vulnerable sectors, the BSP supports the development of the digital infrastructure critical to expanding the reach and scope of digital finance. One such infrastructure is the Philippine Identification System (PhilSys), which aims to provide every Filipino a reliable

digital ID. The PhilSys will not only address the lack of acceptable ID but also significantly reduce the cost of client onboarding and other financial transactions through its e-KYC feature. The BSP is actively developing useful applications for PhilSys to promote financial-inclusion as the appointed chair of the Interagency Committee on Use Cases, a body created by the PhilSys Policy and Coordination Council, of which the BSP is also a member.

As the country weathers the impact of the pandemic and prepares for its after-effects, the challenge now is how to sustain the momentum of this great digital shift to enhance the breadth and depth of financial inclusion in the country.

### 1.2 Financial inclusion as a pillar of social and economic resilience

To deliver its goals of broad-based economic growth, financial inclusion should support the agriculture sector and the micro, small and medium enterprises (MSME). These sectors provide income and employment to majority of the population and a significant contributor to the country's productivity. Yet, despite their strategic economic importance, the MSME and agriculture sectors continue to face the twin challenges of limited access to finance and insufficient incomes. According to data, loans to MSMEs amount to only 6.1 percent and 8.8 percent of total loans in the banking system and total businesses, respectively.<sup>1</sup> A Philippine Statistics Authority (PSA) report indicated that farmers and fisherfolk recorded the highest poverty incidence among the basic sectors in 2018 at more than 30 percent and 25 percent, respectively.<sup>2</sup>

These conditions were exacerbated by community quarantines, causing more than half of MSMEs surveyed to record zero sales and even stop operations,<sup>3</sup> according to a poll by the Inter-Agency Task Force for the Management of Emerging Infectious Diseases. To a lesser, but still notable degree, the agriculture sector also suffered losses from the pandemic, with producers from CALABARZON, CAR and Central Luzon heavily affected.<sup>4</sup> The restrained movement of goods across borders also forced farmers to sell at bargain prices, with excess supply either given away or left to spoil.<sup>5</sup>

1 Bangko Sentral ng Pilipinas. (2019). Financial Reporting Package.

2 Philippine Statistics Authority. (2018). Poverty Among the Basic Sectors in the Philippines. Retrieved from <http://www.psa.gov.ph/poverty-press-releases/nid/162541>

3 Inter-Agency Task Force for the Management of Emerging Infectious Diseases – Technical Working Group for Anticipatory and Forward Planning (IATF – TWG for AFP). (2020, May). We Recover As One. Accessed from <https://www.neda.gov.ph/wp-content/uploads/2020/05/We-Recover-As-One.pdf>

4 IATF TWG We Recover As One Report. (2020). Retrieved from <http://www.neda.gov.ph/wp-content/uploads/2020/05/We-Recover-As-One.pdf>. To assess the economic outcomes of the ECQ, NEDA, on behalf of the IATF-TWG for AFP, launched three separate surveys from April 5 to April 8. There are 389,859 respondents for the consumer survey, 6,863 respondents for the agriculture sector survey and 44,097 respondents from the micro, small and medium enterprises (MSMEs) for the industry/services sector survey.

5 Experiences of Center for Agriculture and Rural Development Mutually Reinforcing Institutions (CARD MRI) farmer-clients. Philippine Daily Inquirer. (2020, April 06). Looking beyond the outbreak. Retrieved from <https://business.inquirer.net/294206/looking-beyond-the-outbreak>

Aware of these sectoral problems, the BSP introduced temporary regulatory relief for MSMEs such as: the inclusion of their new loans in the computations of banks' e-reserve requirements; temporary reduction in the credit risk weights of MSME loans; and zero risk weights for MSME loans with government guarantee, among others. Moreover, the BSP is taking additional steps through a three-pronged approach, in line with its financial inclusion mandate, to put in place a more sustainable and longer-term solution.

The first of these is the **promotion of innovative financing mechanisms**. Under this approach, the BSP supports the development of supply chain financing (SCF), which allows businesses to turn receivables and inventory flows as well as supply chain relationships to working capital. Through SCF products such as reverse factoring, MSMEs with no credit history may secure favorable terms of bank financing based on the creditworthiness of their large corporate buyers. Similarly, already on-going is the ADB-supported agriculture value chain financing (AVCF) being piloted in five rural banks across the country<sup>6</sup>. Guided by BSP Circular No. 908 in 2016, the participating banks have identified and are starting to finance farmer groups and agribusinesses based on value chain analysis of pre-identified commodities. Lessons from the pilot project will be used as inputs to policies, bankers' toolkits and training programs.

The second approach is the **improvement of digital and financial infrastructure** by addressing the risks and cost issues that have made lending to MSME and agriculture a high-risk and low-margin proposition. As such, BSP has advocated the passage of critical legislations for market-enabling infrastructures. These include the Philippine Identification Systems Act (RA 11055), or PhilSys, as the country's digital ID platform that will facilitate onboarding and digital finance innovations, and the Personal Property Security Act (RA 11057), or PPSA, that will encourage the use of inventories, crops and other non-real property assets of MSMEs as acceptable loan collateral. Complementing the PPSA is the proposed bill to strengthen the warehouse receipt system which aims to support farmers and agribusinesses in securing bank loans and managing commodity price fluctuations.

The BSP is also working with Japan International Cooperation Agency (JICA) to develop a credit risk database (CRD) for the Philippines that uses financial and non-financial data (e.g., type of industry/sector, business location, etc.) as well as default-related information (e.g., record on arrears, bankruptcy, etc.) to build statistical models that can be used to predict the creditworthiness of

6 Rural Bank of San Leonardo in Luzon; Rural Bank of Sta. Catalina in Visayas; and Producers Bank; 1st Valley Bank; and Rizal MicroBank in Mindanao.

MSMEs. Similarly, the BSP actively promotes the credit surety fund (CSF), a credit enhancement scheme which aims to give MSMEs access to non-collateral bank financing by way of surety cover issued jointly and severally by the parties of the CSF.<sup>7</sup> Likewise, the BSP facilitates the organizational development and capacity building of CSF cooperatives all over the country.

Finally, the BSP's third approach is **bridging the information and data gap** for more evidence-based policy-making and address information asymmetry in the market. A key initiative is the demand-side survey of MSMEs, jointly conducted by the BSP and ADB, which seeks to augment existing statistics and come up with a more comprehensive profile and segmentation of MSMEs. As the survey determines key constraints to MSME development and growth, results can lead to a more detailed and updated assessment of the sector. Towards the same goal, the BSP is also facilitating strategic partnerships in the industry. For instance, the Negosyo Center of the Department of Trade and Industry (DTI) partnered with Microfinance Council of the Philippines, Inc. (MCPI), and Alliance of Philippine Partners for Enterprise Development, Inc. (APPEND) to facilitate information sharing. This will enable Negosyo Centers to refer clients to various financing providers and help microfinance institutions (MFIs) design products and services appropriate to MSMEs' needs.

As the country pushes for a swift post-pandemic economic revival, the BSP is fully committed to support the MSMEs and the agriculture sector as priority targets of its financial inclusion efforts. In supporting these strategic sectors which have been left even more vulnerable in this pandemic, we will build a more resilient, sustainable and inclusive new economy.

## 2. Digital literacy as a core competency in the new economy

The unprecedented COVID-19 pandemic has changed the global financial landscape forever. The more resilient and agile DFS that can be accessed conveniently through mobile phones and computers at a relatively low cost are emerging as the default way of doing business. These DFS, which encompass online account opening, money transfers, e-payments solutions and other tech-enabled financial transactions, reduce or even totally eliminate the need for face-to-face interactions. This new reality is compelling financial institutions

and their network of fintech partners to pivot towards more efficient and safer digital solutions. Such an environment underscores the indispensable need for consumers to be digitally literate. Developing the competence and confidence of consumers to transact within the digital finance ecosystem will allow them to continue enjoying convenient and accessible, yet contactless and cashless, financial services. Such competence will enable Filipinos to carry on with much needed productive activities, thus mitigating the economic impact of the ongoing crisis and supporting a faster and more inclusive recovery.

The BSP defines digital literacy as a competency in relation to financial literacy. Financial literacy is the level of knowledge about financial concepts that are useful for a person to make financial decisions. On the other hand, digital literacy is the ability of a consumer to use a variety of DFS with self-assurance and full trust in their benefits. Digital literacy, in the context of financial services, has the following dimensions<sup>7</sup>:

- **Knowledge of DFS:** Consumers are aware of the existence of DFS, understand how they are used and can compare pros and cons of each product type;
- **Awareness of DFS Risks:** Consumers understand potential pitfalls of DFS usage, such as phishing, spoofing, personal data theft, hacking and other cyber risks;
- **Digital Financial Risk Control:** Consumers are able to secure their transactions from cyber risks attendant to DFS through appropriate cyber hygiene practices, such as strong password protection, multi-factor authentication, data privacy standards and cybersecurity protocols;
- **Knowledge of Redress Procedures:** Consumers know their basic rights as DFS users, and what to do when they encounter usage errors, or fall victim to cyber fraud and abuse.

Even without the pandemic, digital literacy is a necessary skill in the 21<sup>st</sup> century. Lacking the skill, consumers will find it hard to cope with the exponential digitalization of industries, the increasing complexity of financial systems, the variety of digitally accessible and inter-linked financial products and services, and the myriad of DFS providers and platforms available in the market. All these were

<sup>7</sup> Morgan, P., Huang, B. and Trinh, L. (2019). The Future of Work and Education for the Digital Age: The Need to Promote Digital Financial Literacy for the Digital Age. G20 Japan Policy Paper. Retrieved from <https://www.g20-insights.org/wp-content/uploads/2019/06/t20-japan-tf7-3-need-promote-digital-financial-literacy.pdf>

born out of advances in technology – the internet, social media, cloud computing, big data analytics, blockchain technology, biometric identification, among others. As financial systems and services evolve with technology and become the norm in this new economy, so should consumers' capacities to take advantage of their full benefits. Digital literacy accords consumers with the aptitude and skills to adapt and thrive in this digital era.

### **2.1 BSP digital literacy program: Objective, implementation strategy and partnership framework**

The BSP recognizes the need to build the digital literacy of Filipino consumers. Surveys show that Filipino adults lack awareness and trust in DFS due to fears of hacking, data privacy and loss of money. Internet banking and mobile banking significantly lag behind other modes of transactions for all types of accounts.<sup>8</sup> The BSP digital literacy program thus addresses the knowledge gaps behind consumers' uncertainty toward DFS. This program supports the policy objective of digital financial inclusion and forms part of the broader financial education advocacy of the BSP.

Through the digital literacy program, consumers are informed and educated about DFS; reduce their vulnerability to usage errors, scams and frauds; mitigate risk of loss and costly mistakes; ensure positive customer experiences and outcomes; and protect consumer welfare. The long-term objective is to increase consumer trust and confidence in the digital finance ecosystem. Consisting of strategic communication campaigns, the program encourages massive usage of DFS by consumers across all sectors – individuals, corporations, businesses and government institutions.

One component of the digital literacy program is the #SafeAtHome with e-payments campaign, which encourages banked and newly-banked consumers to try e-payment solutions such as PESONet and InstaPay during the pandemic and beyond. Another component is the cybersecurity awareness campaign, which ensures that consumers remain vigilant in observing cyber hygiene practices to protect their accounts and online transactions. Informed by consumer

sentiment analytics, these campaigns are designed for delivery through social media platforms and traditional media engagements. Campaign assets and key messages are freely shared with fintech and banking industry associations for use in their own information drives. This unified set of messages, when amplified by BSP together with key partners and stakeholders, increases recall and resonates more widely among Filipino consumers.

The program relies on multi-sectoral partnerships, with the BSP taking lead. The Bank welcomes technical support from development partners, and practices collaborative program implementation with major banking associations, fintech associations, cybersecurity expert groups and financial institutions with highly digitized operations. By engaging like-minded partners, the BSP optimizes opportunities and channels to spread digital literacy and cybersecurity messages, bringing all stakeholders closer to achieving the shared goal of a cash-lite society.

To date, the program's communication campaigns are gaining ground. Based on social media scanning, the most engaged posts on PisoLit's Facebook and Instagram pages are reminders to try e-financial transactions, followed by saving tips and money management messages. Content on security in using e-payments prove salient on PisoLit's Twitter feed. PisoLit is the BSP-managed, financial education-focused account on social media, and used as the primary delivery channel for the #SafeAtHome with e-payments campaign. Press releases related to e-payments, cyber hygiene and other digital literacy messages also enjoy wide coverage by traditional media and online news sites, with a height of 138 total pick-ups at one point. The BSP continues to spread these messages, and will recalibrate as needed to ensure their relevance during, and even after the pandemic.

### **2.2 BSP financial education partnerships: Digital literacy hand-in-hand with financial literacy**

Digital literacy is among the competencies that the BSP aims to cover in its financial education programs. Financial education, the systematic process of acquiring financial literacy enables people to better manage their financial lives and optimize the benefits of accessing financial services. Digital literacy and

<sup>8</sup> BSP. (2019). Financial Inclusion Survey. Retrieved from <http://www.bsp.gov.ph/downloads/publications/2019/2019FISToplineReport.pdf>

financial literacy become more important as more Filipinos get on board the digital financial platforms, particularly those who are less informed and educated. The need for these competencies is even more pronounced amidst the economic effects of COVID-19.

With or without a pandemic however, the BSP considers financial education a key component of building an inclusive financial system. Through it, the BSP hopes to raise generations of financially literate Filipinos with confidence to use a range of financial services, including DFS; and capable of making prudent financial plans, building reserves, accumulating assets, managing debt and exercising their rights and responsibilities as financial consumers. The underlying objective is to establish a financially healthy and economically empowered Filipino citizenry contributing productively to the Philippine economy. Such a citizenry is vital for the country to overcome the negative effects of the COVID-19 pandemic on the livelihoods and financial status of individuals, households and businesses.

The BSP approach to promote financial education is characterized by strategic partnerships. The partnership framework is anchored on the principles of objective compatibility, shared responsibility and maximized resources. Together with selected institutional partners from the public and private sectors, the BSP implements scalable, sustainable programs with multiplier effects that have potential to exponentially expand reach. Specific audiences are targeted, clear terms of engagement are established and key performance indicators are agreed upon. The BSP collaborates with partners in developing audience-specific modules, enabling financial education trainers and developing evaluation mechanisms. BSP partners include government institutions, industry associations, foundations of financial institutions and other non-profits whose advocacies on financial education, financial inclusion or consumer protection are aligned with their corporate social responsibility objectives.

Ongoing programs are focused on sustained, scalable and measurable provision of financial education sessions for targeted sectors. When fully institutionalized, these financial education programs are estimated to reach millions of audiences, particularly overseas Filipino workers; civil servants and members of the armed forces; and underbanked sectors such as MSMEs, fisherfolk and beneficiaries of government's cash transfer programs. Special focus is given to learners and

teachers through programs that integrate financial literacy concepts, skills and behaviors in the basic education curriculum for all grade levels, as well as in regular trainings for teachers' personal and professional development. Digital literacy is among the key messages promoted in all these programs.

Given the new norm of online learning, the BSP is pivoting its financial education activities toward virtual delivery. For example, the BSP FinEd Stakeholders Expo, originally designed as an annual gathering of financial education partners and advocates, has been transformed into webinars to be livestreamed on social media. Similar redesigns are ongoing for capacity building trainings of partners and financial literacy sessions for target audiences, so that they can be delivered using online platforms and digital learning tools. Other modules are being devised to be conducted by trainers already onsite in low-income communities such as fisherfolk villages that lack internet connectivity. The BSP is preparing to develop an e-learning platform focused on financial literacy, anticipating that the future of education will largely be shaped online.

### ***2.3 Digital literacy, financial literacy and financial health***

The BSP is pursuing digital literacy alongside financial literacy to help Filipinos achieve financial health. Financially healthy persons can prudently manage day-to-day needs; have the farsightedness to prepare for the future of their families; are resilient in coping with effects of external shocks; and are able to take advantage of opportunities that allow them to meet financial goals.<sup>9</sup> These are the same behaviors critical for Filipinos to survive the COVID-19 pandemic.

As the pandemic pushes Filipino consumers towards greater DFS usage, it also makes them realize the importance of prudent money management. The lack of digital literacy and financial literacy could lead to distress. The BSP considers the pandemic a teachable moment. There is urgent need to elevate digital literacy and financial literacy to guide the Philippine population towards better financial decision-making and behavior.

Financial health, just like physical health, takes time, effort and discipline to build, and it has to be nurtured throughout a person's lifetime. Digital literacy and financial literacy are lifelong habits that must be cultivated. Consumers' ability to access and use DFS will continue to serve as crucial foundations in keeping

<sup>9</sup> Center for Financial Services Innovation. (2017). Beyond Financial Inclusion: Financial Health as a Global Framework. Retrieved from <https://finhealthnetwork.org/research/global-financial-health-framework/>



Filipinos financially healthy in the new economy. The BSP will continue to provide the supportive policies, programs and enabling environment to build a financially healthy citizenry as the economy recovers after the pandemic.

### 3. Building consumer trust through consumer protection

Consumer protection is crucial in promoting a digital financial ecosystem. A consumer that has access to information that accurately represents the nature and structure of the digital product or service, its terms and conditions, as well as its fundamental benefits and risks is empowered to make informed decisions and participate in a digital financial economy. Along with financial education and financial inclusion, having in place a consumer protection framework that inculcates market discipline and provides an effective redress mechanism is an essential ingredient for the financial empowerment and building of trust of consumers in the financial system.

The BSP's statutory commitment under the New Central Bank Act, as amended, to promote broad and convenient access to high quality financial services is implemented by Circular No. 1048 Series of 2019, which spell out BSP regulations on financial consumer protection (FCP Framework). Geared towards enhanced financial consumer welfare and promotion of financial inclusion, the FCP Framework establishes the guidelines and expectations from BSP-supervised financial institutions (BSFIs) to institutionalize consumer protection as an integral component of corporate governance and culture as well as risk management.<sup>10</sup> Included in FCP is the implementation of market-conduct regulatory approach towards consumer protection which comprises both on-site and off-site assessment of the compliance by BSFIs with financial consumer laws and regulations<sup>11</sup>.

Recognizing the rights of financial consumers and to ensure their protection as enablers of smooth and orderly functioning of the financial system, the BSP created the Consumer Empowerment Group (CEG) under Center for Learning and Inclusion Advocacy (CLIA). The CEG is tasked to lead the formulation of policies, regulations and standards that will promote fair conduct business for the financial

sector as well as and provide a venue for the public to seek redress against BSFIs. With this, the CEG implements the BSP's consumer assistance mechanism (CAM), an avenue provided by the BSP for financial consumers to escalate their concerns against BSFIs when they feel aggrieved by its conduct, products and services, and overall handling of their complaints. The CAM is also a tool used by the BSP to ensure that BSFIs are responsive to the concerns of their clients.

#### 3.1 Consumer protection during the pandemic times: Complaints data

The implementation of the ECQ in March 2020 resulted in major disruptions in the economy as well as the daily life of Filipinos. Access to traditional financial services were hampered, and many consumers found it hard to pay back financial loans and obligations as emergency expenses rose and incomes fell. Of the approximately 8,000 complaints escalated to the CEG from January to June 2020, about 30 percent were pandemic-related and necessitated urgent handling. The complaints ranged from issues that pertain to lending and credit card, and over half were complaints about internet and mobile banking channels.

In order to mitigate the effect of the pandemic, the BSP encouraged financial consumers to use e-payment services such as PESONet and InstaPay to comply with mobility/physical distancing restrictions, reduce COVID-19 infection risks and partially address difficulties of providing cash supply to ATMs and bank branches.

#### 3.2 Challenges and concrete actions to provide effective recourse

Taking decisive, transparent and timely actions to protect and empower financial consumers in the Philippines based on their right to complain were among the challenges faced during the pandemic period. There was a clear need for coordination between the BSP and BSFIs to address urgent issues such as the availability of cash in ATMs, access to banks, deferment of loan and credit card payments, and check clearing.

With mounting financial consumer concerns and limitation in mobility, a blend of consumer protection strategies was adopted by the industry. Financial institutions ensured that secure and fast IT systems and technology will support handling of financial consumer concerns from home while safeguarding the privacy of complaints data and correspondence. The BSP strengthened its coordination with industry associations such as the Bankers Association of the Philippines (BAP) and Credit Card Association of the Philippines (CCAP) to ensure that clients are provided clear information relative to assistance/relief measures and banking

<sup>10</sup> BSP. (2019). BSP Regulations on Financial Consumer Protection; Guidelines and Procedures Governing the Consumer Assistance and Management System of BSP-Supervised Financial Institutions; and Amendments to the Manual of Regulations for Banks and Non-Bank Financial Institutions. Circular 1048. Retrieved from <http://www.bsp.gov.ph/downloads/regulations/attachments/2019/c1048.pdf>

<sup>11</sup> BSP. (n. d.). Market conduct regulation. Retrieved from [http://www.bsp.gov.ph/about/advocacies\\_fin\\_fcag.asp](http://www.bsp.gov.ph/about/advocacies_fin_fcag.asp)



services, and that complaints channels remain accessible to the public during the ECQ. The BSP's consumer assistance mechanism continued to operate under alternative working arrangements and prioritized processing of COVID-19 related financial concerns.

The BSP also focused on developing and implementing a communication plan to, among others, empower financial consumers and inform them of the availability of the BSP's consumer assistance mechanism and advisories. The Bank aimed to educate consumers about emerging financial consumer concerns, including e-payments and online financial transactions to reduce their vulnerability to risks of fraud and scams.

### ***3.3 Consumer protection under the new economy: Chatbot and capacity building***

As the BSP made essential strides in developing the digital payments landscape in the country which facilitated transactions and economic activity during the pandemic, it is also gearing up with a more effective and efficient redress mechanism. As part of the BSP's advocacy to promote consumer protection, as well as its thrust to make use of technological advances in improving the performance of its functions, the BSP aims to strengthen its handling of complaints from the public through an enhanced consumer assistance management system (CAMS) with chatbot functionality.

The chatbot, now named BSP Online Buddy or BOB, improves the management of financial consumer concerns and expands the reach of the consumer assistance mechanism to more Filipinos. The chatbot will not only automate repetitive and manually laborious tasks but will also democratize access to BSP through wider channels and enrich the visibility of customer experience and business practice through the intelligence gathered from the CAMS. The chatbot will bring the BSP closer to the people. Using artificial intelligence and machine learning, it will respond to consumers concerns in real-time and cut the turnaround time in responding to financial consumer concerns.

Buoyed by these anticipated benefits, the BSP is moving to retool and build the capacity of the consumer assistance team to handle and manage the chatbot, better monitor customer experience and strengthen market conduct supervision. Aware that the BSP can learn from the industry as well as other supervisory agencies, the team ensures that the processes and solutions are well documented to facilitate exchange of knowledge and experience to push forward the technological progress needed to support strengthened financial consumer protection in the digital age.

While this pandemic brought up new challenges for the banking industry, it has also created opportunities that the BSP can tap to further improve its services and deliver on its mandate. As we move towards the new economy, the BSP will continue to focus on digital financial services while ensuring that consumers' trust will remain in the banking industry through effective consumer protection.

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# Case Studies in Organizational Support for Alternative Work Arrangements

## CHAPTER ELEVEN



The COVID-19 pandemic has upset organizational arrangements in human resource (HR) management, information technology (IT), management audit, procurement process and communication strategies. Suddenly, the future of work is here. In navigating the new and changing terrain, organizational models need to adapt management practices and culture to new technologies. They should also continue to uphold ethical standards and values, foster growth-enabling skillsets and fulfill fundamental aspirations for affirmation and well-being at the workplace, even if physically disconnected. This chapter presents case studies on how five BSP units — Human Resources, Information Technology, Management Audit, Procurement Office and Communications Office — adapted their organizational support systems and processes to cope with the unprecedented challenges presented by the pandemic.

## 1. HR lessons from the COVID-19 pandemic

**Jayzle D. Ravelo<sup>1</sup>**

Caution, adaptability and resilience characterized the BSP's HR response to the COVID-19 pandemic. Following reports on the Philippines' first suspected case of COVID-19 in January 2020, the BSP monitored the situation more closely, the same way it did when the H1N1 pandemic hit across the world in 2009. As cases in different countries outside of China began to rise, the BSP's vigilance escalated as it saw fit to impose restrictions on official business trips, cancel institutional events and strongly discourage employees' personal travels.

But the events that followed were unprecedented. On 12 March 2020, the BSP Governor announced his self-quarantine and the two-day work suspension at the BSP's Head Office and Security Plant Complex. The two premises were disinfected as a precautionary measure against the spread of the virus. This was after Governor Diokno and other government officials were exposed to a confirmed COVID-19 case. On the second day of the suspension, President Duterte declared a state of national calamity on account of COVID-19 and imposed an enhanced community quarantine (ECQ) for a month in the National Capital Region and the rest of Luzon. In varying degrees, restrictions on movement have been extended up to this day.

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### 1.1 The BSP's experience in telecommuting

COVID-19 pandemic forced organizations to participate in a nationwide experiment on the viability of work-from-home (WFH) as a primary work arrangement during the lockdown. The following are some of the key insights on the BSP's experience in telecommuting:

#### a. Risk management structures

A key aspect of the BSP's COVID-19 response is the presence of a formal structure that deals with risk management and interdepartmental coordination.

An organization design strategy that the BSP has adopted is the provision of an in-house capability to deal with various governance issues such as risk management and business continuity, which tend to be overlooked with too much focus on operations or delivery of services. The BSP's Risk and Compliance Office (RCO) takes on these two main functions and advises management on ways to deal with various types of risk and crisis situations, such as a pandemic. Through the RCO's knowledge of risks and organizational resiliency, the BSP was able to plan for contingencies crucial to the BSP's response to the pandemic.

Noting too that the COVID-19 pandemic is an exceptional risk for which the responses have not been codified in organizational resiliency manuals, it was necessary to constitute an *ad hoc* COVID-19 task force. The Incident Management Team and the Task Force, which are headed by the Deputy Governor of the Corporate Services Sector and composed of the heads of units in charge of functions involving risk and compliance, human resource

management, security and transport, legal, health and wellness service and the BSP Employees' Association, have helped ensure that the crucial information and actions of critical units are discussed, addressed and conveyed to all BSP employees in a timely manner.

#### **b. Organizational adaptability**

Until this year, the BSP was not very keen on exploring WFH arrangements. Working remotely was a glove that did not seem to fit the demands of public service and the nature of governmental functions being performed by the BSP. As it turned out, WFH was inevitable, as the government-imposed lockdown in Metro Manila and the entire Luzon compelled business and government agencies, the BSP included, to suddenly shift to remote work arrangements.

The sudden change brought about by the COVID-19 pandemic pressed the BSP to modify its preconceived notions and traditional work structures for many years. Adaptability has been a BSP core competency, such that the necessity of being able to respond to uncertainty and change has been inculcated in every employee. Thus, within weeks from the start of the lockdown, BSP employees were able to adapt to the new work arrangements. In fact, in a survey conducted by the Human Resource Sub-Sector on work arrangements during the ECQ, more than 60 percent of department heads said that they were able to complete 75-100 percent of their work deliverables despite the sudden shift to remote work.

#### **c. Balancing service and employee well-being**

Even as WFH became the rule and working onsite the exception (resorted to mainly for frontline and mission-critical services), there are areas of operations that still require personnel to be at the workplace. These include currency production, cash servicing, market operations, payment systems operations and security services. For these class of employees, it is necessary for HR to recognize and address their fears and concerns.

Through the efforts of the BSP COVID-19 Task Force, precautions to avoid virus transmission were immediately put in place. Personal protective equipment (PPE), vitamins and sanitizing alcohol were distributed. More intensive cleaning and disinfection of premises were carried out more frequently, and advisories and

reminders on frequent handwashing, physical distancing and other protocols to prevent infection were communicated through email and posted in conspicuous places in BSP offices.

Because government restrictions forced food services and public transportation to cease operations, it was also deemed necessary to provide employees with food and shuttle services. Hazard pay was also given to the members of the skeleton work force.

To allay the concerns of employees on how COVID-19 would impact their incomes and ability to meet emergency expenses, the BSP assured employees that salaries and benefits would be paid continuously. It added that flexibility would be adopted in the procedures for attendance monitoring, as basis for pay. Institutionalized allowances and bonuses were also released earlier than schedule. These measures are anchored on the view that employee productivity improves when their basic needs (i.e., physiological and safety) are met in a timely and efficient manner (e.g., without the burden of complying with tedious administrative procedures).

#### **d. Long distance supervision and the empowerment of line managers**

WFH arrangements are unfamiliar to most BSP employees, especially the supervisors whose more common tools for overseeing their staff are face-to-face meetings and one-on-one checkups. The sudden "disconnection" from colleagues, both real and perceived, necessitated the adoption of online forms of interaction such as Microsoft Teams, Cisco Webex or Zoom as well as learning asynchronous communication and looking for substitutes to casual office conversations that serve as helpful venues for knowledge sharing and resolving minor operational issues.

Webinars on managing remote employees were also set up for supervisors, just as soon as online tools for making remote work possible, such as Office 365, were made available to BSP employees.

Going through the adjustments, policies governing WFH were kept broad enough to cover and accommodate the different requirements of the various functions

within the BSP. The policies also took into account the situation of employees at home, such as those with children needing care or home schooling in view of the school closures.

The BSP also made sure that psychological services are available to employees, as the vanishing boundaries between work and personal life could take a toll on mental and emotional health, resulting in burnout.

### 1.2 Role of HR

HR's most important role, especially in these recent months, is to help the workforce adapt to changes. Key to supporting the staff and achieving organizational goals amid the challenges brought by COVID-19 are HR interventions that drive continuity, focus and connectivity.

As medical experts do not foresee the pandemic slowing down just yet, the HR, in collaboration with the BSP COVID-19 Task Force, shall remain proactive in assessing, acting on, and adjusting as necessary to the needs of its greatest asset – its employees. The aim is to enable them to work effectively and efficiently, especially at this time of global health crisis.

## 2. Management systems audit process in changing times

**Maria Rossette R. Martal, Angelito B. Lopera, Emmie-Lou Siongco-Aquino and Ryan P. Cureg<sup>2</sup>**

As part of the BSP service excellence program in 2003, the Systems and Methods Office (SMO) led the bankwide initiative to design, develop, implement and improve management systems (MS) covering the various operations of the BSP. The systems that were developed, approved and implemented followed the ISO 9001<sup>3</sup>, ISO 14001<sup>4</sup> and ISO 45001<sup>5</sup> standards. Certification of the approved MS to international standards requires the conduct of internal audit, otherwise known in the BSP as independent quality assessment (IQA). The assessment is conducted

on all departments and offices with existing MS once a year based on ISO 19011<sup>6</sup>. It is part of SMO's mandate to ensure an integrated enterprise-wide effort to develop and maintain efficient systems and procedures. The IQA also aims to provide recommendations to promote business effectiveness and efficiency while striving for innovation flexibility and integration with technology.

The SMO has embarked on an agile operations methodology from process documentation to execution starting 2019. To realize this vision, SMO invested in building the capacity of its technical personnel by hiring training providers and benchmarking on best practices, including the Union Bank of the Philippines Scrum Masters. Equipped with good training, the SMO design team was able to map the end-to-end process of SMO in which IQA process is but one process ready for automation.

SMO further strengthened its core by acquiring a tool that would help the BSP automate its processes in support of the BSP's strategy map 2020-2023 on digital transformation. These efforts enabled the office to respond to challenges brought about by the COVID-19 pandemic. Along the journey, SMO experienced handicaps in accessing data, resource persons and infrastructure. However, the office overcame these limitations, thanks to the skill and technical competence of its personnel and their capability to adapt to any given situation.

Faced with extraordinary circumstances, the general welfare of BSP's personnel is of paramount concern, thus regular "Health Check" of the workforce became a habit. The SMO also continued to operate under extraordinary circumstances while undertaking unconventional measures.

1. **Review of the work plan** – This is where the four pillars of business continuity program – assessment, preparedness, response and recovery – shall be of utmost benefit. Thus, SMO reassessed its work program for the year and made adjustments taking into consideration available manpower and other resources.
2. **Resource planning** – As the SMO accounts for its manpower resources, the office also makes an inventory of personnel skill sets and match these with the amended work plan, ensuring the adequacy of competent technical personnel to deliver the organization's targets.

<sup>2</sup> Maria Rossette R. Martal (Deputy Director), Angelito B. Lopera (Bank Officer V), Emmie-Lou Siongco-Aquino (Deputy Director) and Ryan P. Cureg (Acting Deputy Director) are from the Systems and Methods Office (SMO).

<sup>3</sup> International standard for Quality Management Systems (QMS)

<sup>4</sup> International standard for Environmental Management Systems

<sup>5</sup> International standard for Occupational Health and Safety Management System

<sup>6</sup> International Guidelines for Auditing Management Systems



3. **Benchmarking and best practices** – Since the BSP is transitioning to a new work environment with a totally different atmosphere, the SMO looked at how other offices and industry practitioners implement and transition to the “new economy arrangement” (NEA). Our third-party auditors and certifying-body partners served as reliable benchmarks on innovative auditing practices such as the conduct of “remote audits” and “capability assessments” (feasibility of conducting remote audit). Apart from industry partners, the internet, by way of news feed and articles, also became an abundant source of best practices in coping with the pandemic.
4. **Policies and procedures** – SMO continues to review and enhance its internal policies, guidelines and procedures. The office continued with plans to (a) adapt end-to-end process approach to quality management system (QMS) design and development; (b) employ risk-based approach to auditing; and (c) enforce the enhanced IQA process that includes the conduct of “remote auditing” which was initially planned for implementation in the regional offices and branches. All these revisions or adoption of new practices, of course, adhere to existing internal policies related to NEA, document information classification guidelines, use of e-signature and use of mobile platforms, among others. The SMO also reinforced internal policies on reporting status of deliverables through the weekly work plan and weekly accomplishment reports.
5. **Leveraging technology** – Manual activities of review and collaboration, and the printing and release of communications, were replaced with the use of applicable tools in Microsoft Office 365. Face-to-face meetings have been replaced by virtual meetings through Microsoft Teams, Zoom, Webex and other authorized online platforms. IT resources, mobile platforms and cloud technology were extensively used in the conduct of meetings, interviews and audits.

Transitioning to the “new normal” is a work in progress but SMO continuously improves its systems by soliciting feedback from stakeholders on relevant issues and challenges. Moreover, SMO constantly fosters an atmosphere of consultation and participation among its personnel to solicit the best ideas that will enable SMO to adjust its systems and procedures in a calibrated manner until a sustainable and reliable level is reached. Instead of merely minimizing risks involved during these trying times, SMO opted to also seize the opportunities that come along with the crisis.

### 3. Overcoming the pandemic: Responses, challenges and lessons in procurement

*Ana Theresa B. del Rosario-Buen, Elvira B. Villanueva, Lord Eileen A. Sison-Tagle and Cassey E. Ferrer-Palmos<sup>7</sup>*

Procurement in the Philippines is governed by a set of laws and regulations,<sup>8</sup> settled jurisprudence and conventional practices. Shaped by years of curbing some excesses, preventing graft and corrupt practices and supplier favoritisms, procurement is undertaken with stiff compliance with procedures and the application of non-discretionary criteria. Straightforward as it may seem, each and every successful procurement is a result of rigid processes and subprocesses.

#### 3.1 Pre-pandemic

In the BSP, the last quarter of 2019 saw the completion of year-long preparation, planning, budgeting and approval processes for items and projects to be purchased by end-user departments. The 2020 budget and annual procurement plan (APP) had been approved, and the departments were gearing up for a shift to cash-based budgeting where the items in the APP, except for authorized multi-year projects, had to be procured, implemented, completed and paid for within the current year, without crossing over to the next. For the first time in years, the BSP instituted a uniform deadline for filing of programmed purchase requisitions (PRs) in the first quarter of 2020, which is a marked change from the continuous filing of PRs that perpetually stretch until the last day of December.

In December 2019, the BSP hosted its Procurement Opportunities Fair, an annual gathering of suppliers, contractors and consultants keen to provide goods and services to the country’s central monetary authority.

Insofar as emergency preparedness is concerned, included in the BSP’s 2020 annual procurement plan are the following: emergency survival “Go Bags,” emergency hard hats, PPE, complete set fire-fighting suit with self-contained breathing apparatus (SCBA), evacuation chair/stair chair glider, circular saw,

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<sup>8</sup> Rep. Act No. 9184 (2003) or the Government Procurement Reform Act, and its 2016 Revised Implementing Rules and Regulations primarily govern procurement in the Philippines.

rescue tripod, remote area lighting system, spine board with head immobilizer and spider strap, rescue helmet with head lamp and visor, various medicines and supplies, fire suppression systems and maintenance and upgrade of BSP facilities. Every year, the BSP sets aside a ₱25-million contingency fund in the approved budget for emergency response during natural calamities, such as earthquakes, typhoons, volcanic eruptions<sup>9</sup> and the like.

Still, despite careful planning and preparation for a wide range of natural emergencies and calamities, nobody foresaw a public health emergency of immense proportion.

### 3.2 State of public health emergency

The year started with two confirmed COVID-19 cases involving Chinese nationals entering the country, one of whom was registered as the first death due to the coronavirus outside China on 2 February 2020. A month after, on 8 March 2020, the President declared a state of public health emergency throughout the Philippines, following the first officially reported case of local transmission of COVID-19 in the Philippines. Soon after, on 14 March 2020, the President placed the National Capital Region and other cities and municipalities under community quarantine<sup>10</sup> to take effect on 17 March 2020. To serve the best interest of the BSP and the public, on 12 March 2020, the BSP Governor issued a memorandum to all BSP officials and employees on precautionary measures to control the spread of COVID-19 disease.

### 3.3 Emergencies emerged: Competitive market and scarcity of supplies and resources

#### i. Incident Management Team supplies

The Incident Management Team (IMT) is charged with the management and addressing emergencies in the BSP. In responding to the pandemic, the IMT was the first to file PRs to contain and mitigate the transmission of COVID-19 within its workforce and to mobilize assistance in the provision of basic necessities to

employees reporting for work at the BSP as part of the skeleton work force.

When the President declared a state of public health emergency throughout the Philippines in March, the Procurement Office (PrO) was already purchasing 7,000 pieces of N95 face masks through negotiated procurement in emergency cases. Said emergency procurement was completed in one day. Seven days thereafter, the IMT filed a PR for various canned goods (i.e., tuna, corned beef, luncheon meat, sausage), 1,500 packs of instant noodles, 1,800 bottles of 500ml purified drinking water, 55 sacks of well-milled rice, 600 bars of germicidal/anti-bacterial soap, 3,000 sachets of shampoo, 300 pieces of pail, 300 pieces of ladle, 15 rice cookers, 200 pieces of mattresses, 100 pairs of pillows, 3,000 pieces of troclosene sodium tablets and 300 bottles alcohol-based hand sanitizers.

It was a challenge to scout for supplies. Most of suppliers' offices were closed during the period of quarantine. To continuously process the emergency requirements, PrO checked suppliers' office details in the yellow pages and social media (e.g., Facebook, Instagram), and negotiated directly with the manufacturers (e.g., mattress, mixed fruits) through personal contacts and referrals.

On average, procurement of the emergency items was completed and executed in two days. For basic commodities that can normally be bought from grocery stores, the IMT picked up the item by paying in cash as the sale of basic goods is available only until supplies last.

#### ii. Health, medicines and tests supplies

The Health and Wellness Department (HWD) filed emergency PRs for 5,000 pieces of multi-vitamins A, C, E and Zinc and 20,000 pieces of Ascorbic Acid tablets, and one lot for reverse transcription polymerase chain reaction (RT-PCR) tests for COVID-19 for BSP-head office and Security Plant Complex (SPC) personnel. The long-established partnership with medicine suppliers within the Malate area in Manila area expedited the procurement of medicines. The RT-PCR COVID-19 tests, which underwent negotiations with Philippine Red Cross (PRC), was completed in 58 days in view of the delays encountered by PRC in the submission of eligibility documents (i.e., omnibus sworn statement, income/business tax

<sup>9</sup> On 12 January 2020, the Taal Volcano erupted after laying dormant for 43 years. BSP's inventory of N95 facemasks was exhausted as these facemasks were distributed to the workforce.

<sup>10</sup> Enhanced community quarantine (ECQ) was declared over the entire island of Luzon until 12 April 2020. Following this, a memorandum circular was issued by the Executive Secretary implementing, among others, work from home arrangement for the Executive Branch and the suspension of mass public transport services and other businesses that do not render critical services.

return and signed terms of reference).

Even after the downgrading of community quarantine levels, PrO further processed HWD's emergency PRs for 30,000 pieces of cloth face covering, COVID-19 IgM/IgG antibody (Ab) rapid testing services for the BSP head office and SPC, various medicines (e.g., oral rehydration salts, cetirizine dihydrochloride, paracetamol tablet) and RT-PCR testing services for BSP regional offices and branches.

### iii. Facilities and maintenance

The Facilities Management and Engineering Department (FMED) filed PRs for 44,000 liters of diesel fuel for generator sets and motor vehicles in the BSP head office as well as for disinfection of BSP buildings by misting. Immediate procurement of said requirements was necessary to mitigate and prevent loss of life due to the threat of COVID-19 and the possible transmission among employees and visitors at the BSP. In view of the NEA, PRs for solid polycarbonate clear panels, sneeze barriers, elongated toilet seat covers and installation of sensor-type hand sanitizers were filed and processed under negotiated procurement in emergency cases to prevent the exposure of BSP's front-liners and employees. Acrylic panels were installed at various counters within the BSP head office premises.

### iv. Information technology requirements

To ensure continuing services to BSP stakeholders and to meet the demands of work-from-home arrangements, laptops, video and audio soundbars for video conferencing, Microsoft Windows 10 Professional (WinPro 10) operating licenses and Symantec Endpoint Encryption licenses were immediately procured. Without the version updates and upgrades that keep the PC environment safe and stable for business uses, the BSP would not have upgraded the main operating system of its PCs (Windows OS) due to compatibility issues, and this may have left the endpoint PCs vulnerable to malware attacks, application flaws and security

breaches that could have caused loss of service and/or damage to properties.

Compared with other industries in the market, many suppliers in the IT industry were open during the community quarantine to supply and deliver the needs of BSP. However, the difficulties often lie in the submission of updated documents.

### v. Transportation and other services

The Inter-Agency Task Force for the Management of Emerging Infectious Diseases (IATF-EID) Omnibus Guidelines on the Implementation of the Community Quarantine in the Philippines states that during the implementation of general community quarantine (GCQ), public transportation will only be available at 50 percent capacity, hence it would be challenging for the BSP workforce to use public transportation. Also, based on Department of Health (DOH) Administrative Order No. 2020-0015 dated 27 April 2020 (Guidelines on the Risk-based Public Health Standards for COVID19 Mitigation) on the minimum requirements for offices and workplaces, the employer is required to provide adequate shuttle services for its workforce to prevent infection and exposure of vulnerable individuals. The Security Services Department (SSD) filed its PR for transportation services for BSP employees at the head office and SPC. The shuttle service contract is for a period of six months, renewable at the option of the BSP. In total, 21 buses were contracted for the BSP head office and three buses were allotted for SPC.

The BSP also hired 20 outsourced drivers to ensure the continuous operations of mission-critical functions at the BSP, and to provide transportation requirements to the BSP's skeleton workforce for six months.

## 3.4 Procurement amidst work stoppage

### i. Manual to online processes

The constraints in mobility of people and transport, limitations in the conduct of face-to-face meetings and the inability of bidders to submit the required documents, did not put BSP's procurement to a standstill. To enable continuous procurement of crucial requirements, procurement advisories and guidelines

were instantly drafted and issued.

In April, the Bids and Awards Committees (BAC), the PrO and the Information Technology Office (ITO) and its departments had deliberated on and finalized the BSP Interim Guidelines on the Conduct of Procurement Activities During the Enhanced/General Community Quarantine and Similar Work Situations even before the Government Procurement Policy Board (GPPB) issued Resolution No. 09-2020 on 7 May 2020. The most salient feature of the said interim guidelines is the submission of secured bids online or through email. On 5 May 2020, the BACs, through the PrO, referred the BSP Interim Guidelines to the GPPB-Technical Support Office for evaluation and consequent approval, if warranted. In line with this, the BAC-Secretariat – Head Office, issued an advisory dated 9 May 2020 containing the detailed instructions on the conduct of procurement activities by the BACs through online platforms. Consequently, said advisory was disseminated to prospective and participating bidders.

On 25 June 2020, ITO issued the certification stating that the BSP has the capability to implement the electronic submission of bids pursuant to Section 4.2 of GPPB Resolution No. 09-2020. Shortly thereafter, on 6 August 2020, the Governor approved the BSP Guidelines in the Conduct of Procurement Activities during a State of Calamity. The same was issued through Office Order No. 2020-0982, series of 2020, and took effect on 21 August 2020.

## ii. Documentary requirements of bidders

Emergency procurement in the BSP was fast-tracked with the adoption of a straight-through form, the Authority and Proof of Purchase (APoP). First used by the PrO in 2020 for the procurement of N95 masks, the APoP is a one-page document containing all the relevant details of processing, such as the written confirmation of the emergency sought to be addressed,<sup>11</sup> the recommendation by the procuring office or unit and the approval of the purchase by the duly authorized Head of Procuring Entity (HoPE) and the contract documents evidencing the purchase. Years prior to the pandemic, the conduct of emergency procurement had been delegated to the PrO in the head office, the Department of General Services (DGS) in the BSP Security Plant Complex and the

<sup>11</sup> The requirement for a written confirmation of emergency by the Head of Procuring Entity before undertaking negotiated procurement-emergency cases was removed under GPPB-NPM No. 003-2020 dated 23 March 2020.

administrative units in the regional offices and branches.

The pandemic also brought to fore some lawful practices that were previously not maximized – the use of electronic documents and electronic signatures. The e-commerce law took effect on 19 June 2000 but this has not been fully utilized in government agencies, including the BSP, which preferred physical copies of documents with hand signatures over electronic ones. With high dependence in online modes of communication, the acceptability of electronic documents and electronic signatures in procurement and biddings has gained wider traction.

Other adopted measures were:

- a. Instead of face-to-face meetings, pre-bid conferences are conducted thru video conferencing;
- b. Required formalities in documents, such as notarization, apostille and certified true copies, can be accomplished after the emergency had ceased but before payment; and
- c. Payments for bidding documents, bid security and performance and warranty securities can be made online.

## 3.5 Procurement under new economy arrangements: Moving forward goals

The COVID-19 pandemic, despite its dire consequences, accelerated the progress of procurement processing, making it faster and responsive. Procurement under the BSP's new economy arrangements has adapted well in coping with the emergency. It is very likely that the new-found efficiencies of the current processes will become the norm even after the public health emergency had ceased.

## 4. Accelerated innovation and digitalization

**Archellis A. Villena, Raul A. Andag and John L Regala<sup>12</sup>**

Before the onset of the COVID-19 pandemic, the BSP Chief Information Officer (CIO) presented the plan for a digitally-transformed BSP at the BSP strategic planning conference on 28 November 2019. In the CIO's opening statement, the need for agile adjustment amid rapid technological changes was emphasized, including changes in people, culture, organization and processes. A month later, the Information Technology Office (ITO) organized an IT strategic planning conference to produce the information systems strategic plan (ISSP) for 2020-2023. The plan was critical in the implementation of the ITO's response to the impact of COVID-19.<sup>13</sup>

After the nation adopted stricter measures in response to the pandemic, the BSP, in turn, through the Governor's direction<sup>14</sup>, implemented different alternative work arrangements, e.g., work-from-home (WFH), skeleton force, among others, to ensure continued and uninterrupted operations and services.

Demand for ICT resources before and during the enhanced community quarantine (ECQ) has not only increased rapidly but also went beyond the usual ICT requests. The first few weeks of the ECQ has accelerated the innovation and digitalization initiatives of ITO, such as the implementation of cloudification initiatives and initial deployment of digital signatures using BSP public key infrastructure, with close monitoring and heightened alerts in the areas of cyber and IT security.

This surge in ICT demand across BSP during the ECQ with the majority of the BSP workforce adopting WFH arrangement added to the constraints on time and available IT and manpower resources. To meet such demands, the ITO implemented an "IT triage"<sup>15</sup> to fulfill the ICT-related request of business users. ITO prioritized technical support for mission-critical departments and offices

with further focus on those that directly support essential central banking operations expected to be available during ECQ, while also prioritizing critical BSP internal operations.

### 4.1 BSP's adoption of cloud services – Office 365 (O365)

The BSP, as part of the ITO's strategic direction on digital transformation, finally adopted full cloud services into its ICT portfolio in the latter part of 2019. Pilot deployment activities for selected BSP users were done from the fourth quarter of 2019 to February 2020 before the bankwide rollout, when the migration of BSP users is in full swing. The initial deployment of O365 services covered cloud-based communication tools that were significantly more responsive to WFH. With cloud services providing a simpler deployment model, it enabled more BSP personnel to enjoy mobile computing and teleworking capabilities.

Beyond Outlook for email and Teams for real-time communication and collaboration, other enhancements in technological capabilities introduced by O365 are as follows:

- *Bring Your Own Device (BYOD)* – The average number of devices per person was projected to reach 4.3 in 2020 (Waring, 2014). This can be considered an accurate forecast given the ubiquity of mobile devices that can be owned by a single individual. Managing devices now boils down to who is using the device. In the BSP's setting, the use of O365 applications and services on any supported device is possible so long as an employee's identity is authenticated on the device.
- *Personal Cloud Storage* – It is common practice for employees to store files on portable USB storage or forward these to personal e-mails if they need to continue their work outside the office. However, this has the unintended consequence of placing data on a non-standard medium. With O365 now part of the BSP's managed mobile environment, OneDrive, as its bundled service for personal and shared cloud storage, was allowed for bankwide use to hurdle the constraints of remotely accessing working files residing in on-premise systems.

<sup>12</sup> Archellis A. Villena (Director), Raul A. Andag (Deputy Director) and John L Regala (Director) are from the Information Technology Office (ITO).

<sup>13</sup> The ISSP 2020-2023 defines the BSP's information systems strategy for the next four years, with transitory activities that will eventually lead to the envisioned target states. The ITO laid out its blueprint to streamline application systems, enable cloudification of IT infrastructure and strengthen cybersecurity capabilities. A governance system for IT was issued to provide a framework for effective governance in the implementation of identified projects in the ISSP.

<sup>14</sup> Memo to All BSP Employees from the Office of the Governor signed and dated 14 and 16 March 2020.

<sup>15</sup> Triage in IT means "the assigning of priority order to projects on the basis of where funds and other resources can best be used, are most needed, or are most likely to achieve success." Kevin Miller. Release Triage: Managing Your IT Emergency Room With A 4-Step Process. <https://www.20creek.com/mba-guide-to-it/episode-30.html>, <https://www.pluralsight.com/resource-center/guides/it-er-management>.



- *Electronic Submission and Receipt of Bids (e-bidding) with O365* – The Government Procurement Policy Board (GPPB) released an issuance<sup>16</sup> authorizing government agencies to employ e-bidding until the modernized Philippine Government Electronic Procurement System becomes operational. The BSP CIO issued a certification to the GPPB on 25 June 2020 to attest the BSP's capability to implement the electronic submission and receipt of bids.

Service provisioning of the foregoing for users is still subject to prerequisites and vetting of respective department or office head per prescribed policy and guidelines.<sup>17</sup> The expansion of O365 services for cloud-based group storage to replace on-premise network drives is the next feature being explored. But with BYOD and OneDrive, the BSP must update its *Data and Information Classification* (DIC) inventories and formulate information security policies that factor in the cloud environment. The IT Security Group (ITSG) is currently reviewing and validating effectiveness and adequacy of O365's cloud security controls, particularly the built-in access and information security features while the BSP's DIC and information security policies are being updated.

#### 4.2 The new economy arrangements (NEA)

The NEA was introduced as a means for the organization to adapt to the current global situation post-ECQ. The ITO ran a survey from 28 May to 19 June 2020 to gather information on planned work arrangements, among others, to be adopted by the BSP under the NEA. Table 11.1 shows the results as expressed by the heads of departments and offices as the targeted respondents, with the major issues raised and the ITO's observations and recommendations.

The data gathered will be used as inputs for an IT strategic program that will support the NEA, to be considered in the update of the ISSP 2020-2023. This update will also accelerate the strategies of the ITO to realize its target states faster and support the ITO's roadmap towards a digitally-transformed organization.

<sup>16</sup> GPPB Resolution No. 09-2020 dated 20 May 2020.

<sup>17</sup> Mobile Device and Teleworking WFH Policy dated 7 April 2020, and Guidelines on the Use of OneDrive Application under Office 365 dated 2 June 2020.

Table 11.1. NEA Survey Major Issues

Issue raised	Observations / Recommendations
1. Internet connectivity	<ul style="list-style-type: none"> <li>• Pocket Wi-Fis were provided to selected mission critical departments and offices during ECQ.</li> <li>• On-premise Internet connectivity, this will be upgraded to higher bandwidth and wider/expanded reach in terms of more area with Wi-Fi network.</li> </ul>
2. Access to on-premise data/files	<ul style="list-style-type: none"> <li>• Files can now be placed on the BSP's managed cloud environment</li> <li>• Team sites on O365 will be deployed for a common online workspace of depts/offices</li> <li>• Information security policies should be formulated and disseminated</li> </ul>
3. Access to application systems	<ul style="list-style-type: none"> <li>• VPN users will be expanded, with applicable baseline staff percentage allocations</li> <li>• Business continuity plans should be revisited to account for the new working arrangements</li> </ul>

Source: Internal (MS Forms) survey with BSP Dept/Office Heads

#### 4.3 Cyber resilient institution

With the surge in BSP employees working from home and the demand for remote connectivity increased, the BSP's cyberthreat landscape changed as well as its cyberrisks expanded. In response, the ITO conducted the following initial and continuing activities:

- Performed security hardening of laptops issued to BSP mission-critical departments and offices to support the alternative work arrangements;
- Promoted secure remote communication practices by issuing advisories to facilitate secure conference calls; and
- Close monitoring of cyberthreats from threat intelligence sources, and through collaboration with internal BSP business units, other government agencies and central banks, to proactively mitigate cyberthreats and execute a timely response to cyberattacks.

Moreover, the ITSG submitted a proposed cybersecurity management plan for the NEA, which provides strategic direction for the BSP towards building a cyberresilient institution while continuously carrying out its mandate under the new work arrangements.



The cybersecurity initiatives are aligned with the ISSP 2020-2023 and industry-accepted international standards<sup>18</sup> following the principles of security in the information technology and the BSP Risk Management Framework. The said initiatives are grouped under the following strategies:

- i. Immediate Adaptive Cybersecurity Defense Implementation that needs to be fast-tracked to support the immediate requirements of remote users;
- ii. Cybersecurity Resiliency Initiatives include technology based-initiatives that would address identified cyberrisks to bolster the existing security defenses of the BSP while maintaining its adaptive cyberdefense strategy; and
- iii. Cybersecurity Capability Build-up provides for the continuous improvement of cybersecurity processes while leveraging on its human capital.

Continuous cybersecurity process improvement enables a holistic approach in mitigating identified cyberrisks, optimizing the value of technology and using an end-to-end solution in resolving similar, related or transversal risks. No set of controls can achieve complete security, and additional management action is pivotal in monitoring, evaluating and improving the efficiency and effectiveness of cybersecurity controls to support the BSP's strategic objectives.

<sup>18</sup> National Institute of Standards and Technology (NIST) Cybersecurity Framework Version 1.1  
ISO/IEC 27001:2013 IT – Security Techniques – Information Security Management Systems Requirements  
ISO/IEC 27002:2013 IT – Security Techniques – Code of Practice for Information Security Controls  
Open Web Application Security Project (OWASP) Risk Assessment Methodology  
ISO 31000:2018 Risk Management Principles and Guidelines

## 5. BSP's communication: Sustained issues management mode

*Elisha Garcia-Lirios<sup>19</sup>*

The BSP has stepped up to the unique communication challenges of the COVID-19 pandemic by delivering timely, comprehensive and reliable messages on a wide range of its initiatives. These aim to provide a steadying hand to the financial system and reinforce whole-of-nation efforts to bolster the economy amid the global health emergency. Guided by the Office of the Governor, the BSP's communication team switched to "sustained issues management mode" as it addressed emerging mainstream and social media concerns amid the BSP's commitment to price stability and financial stability while looking after the welfare of its personnel.

While much of the banking system referred to the start of the COVID-19 crisis as of 17 March 2020, or when the ECQ was first declared in the island of Luzon, the BSP Communication Office (CO) actually began its crisis communications work a week earlier—the day the Philippines recorded its first case of COVID-19 infection. This started a series of messages that continued through much of the ECQ and the community quarantines that were declared in the months that followed. As in any crisis, communication needed to be cautious, measured and updated with the latest information from within and outside the organization.

The second weekend of March was to become the last "normal" weekend for many at the BSP, especially for the Bank's Incident Management Team (IMT) and Corporate Services Sector (CSS). The IMT and the CSS would provide key information support and overall leadership in the BSP's COVID-19 response. It was important for the BSP to show its thought leadership in managing policy responses to the unprecedented global predicament. Within a period of two weeks from the declaration of the first community quarantine, the BSP would unveil a set of measures to support the national government in its fight against the virus and cushion its negative effects on the larger economy. These were announced in quick succession in the early days of the crisis, with much of the lead coming from the Office of the Governor.<sup>20</sup>

<sup>19</sup> Ms. Elisha Garcia-Lirios is the Acting Director of the Communications Office.

<sup>20</sup> Key initiatives included a cumulative 175 basis points cut in policy rates, a reduction in the reserve requirement ratio of banks, opening of a window for purchases of government securities in the secondary market, a reverse repurchase agreement and advance dividends to the national government. The policy rate was reduced four times in four months to 2.25 percent—by 25 bps on February 6, and by 50 bps each on March 19, April 16 and June 25, 2020.

It was important for the CO to create a comprehensive information material that would underscore the multi-faceted approach that the BSP had taken in addressing the pandemic and in making its actions immediately known to and easily understood by the public. A categorized, summarized and easily updated format was needed for ease of access, readability and understandability. From largely maintaining institutional trust, the CO's main tasks would expand overnight to include reassuring the public of the BSP's presence, active participation and timely responses to the COVID-19 crisis while grappling with challenges related to personnel, IT equipment, connectivity and safe platforms through which team members could coordinate and share information.

### 5.1 Engagement with the public

Social media emerged as a crucial venue for communication amid the pandemic. As the primary regulator of the financial system, the first order of each day for the CO would be to inform banks of BSP services that are available to them such as day-to-day treasury, check clearing and cash requirements during the initial community quarantine. The CO came out with a series of social media cards on available banking services during the quarantine period as well as on the important role of bank personnel in keeping the economy functioning amid the pandemic.

The infographic on the BSP's initiatives was continuously updated and served as a transparency measure on the BSP's coherent and immediate responses to the crisis. An example is the digital payment requirements of a population that had been "locked down." The CO helped disseminate information on the zero transaction costs for interbank fund transfer payment facilities, InstaPay and PESONet,<sup>21</sup> issued consistent reminders on the availability of this facility through mainstream media and promoted healthy electronic banking practices through the BSP's social media accounts.

There was also a need to continue dialogue with business groups and assure the public of the BSP's continuing work in other aspects of central banking. Thus, the Governor continued to deliver speeches during the various community

quarantine periods through online video conference calls with industry associations, social and civic organizations, academic groups and media companies. The BSP maintained its presence as the country's primary economic content provider on various topics that affected the public through GBED Talks, a twice-a-month press chat with the BSP press corps and broadcast media representatives. Through these long-form types of interactions, the BSP was better able to articulate its stance while soliciting comments and clarifications from specific interest groups, either through an open forum or a question-and-answer session. These platforms have also helped the BSP improve the media and the public's long-term knowledge and understanding of central banking issues.

### 5.2 Communication lessons from the ongoing crisis

#### Open and clear messaging

Narratives from the pandemic evolved fairly quickly from addressing the immediate requirements of analysts, bankers and financial market participants to providing the information needs of the general populace. While the former needed assurance that the government continued to function well and would ably provide for the country's needs, the latter solicited responses for their most basic needs—the safety of bank deposits and the welfare of families. For both, the overarching theme has been to consistently convey confidence and trust in the BSP's actions (Checkley and Piris, 2020).

Maintaining public trust through various initiatives that underscore its integrity and competence remained at the heart of BSP communication, whether in a crisis or not. Recognizing the BSP's importance as a credible source of information on the economy, it was important for the CO to gain the support from various sectors operating within the BSP. This partnership helped expedite the processing of interview requests and public inquiries, many of which were complex in nature.

Efforts to improve coordination among agencies involved in the supervision of financial institutions, as well as within the Philippines' economic team, should also be noted. A united stance is vital to assure the public of cooperation and understanding among agencies belonging to the Financial Stability Coordinating Council or the Development Budget and Coordination Committee (DBCC), particularly in media events with specialized audiences.

<sup>21</sup> Initiative led by the BSP and the Philippine Payments Management, Inc.

### Audience-centered communication

During a crisis, it is paramount to acknowledge the importance of audience perception. Differences in perception could lead to exaggerated responses that trigger possible flight or fight reactions (Jabal, 2018). There may even be irrational reactions to unusual situations that many may consider unfamiliar, such as the months-long lockdown in the country. Thus, open and clear communication is at the center of efforts to reduce uncertainty, assuage fears, provide alternatives and express empathy.

Communication materials should contain the correct amount of relevant information for specific audiences. The Bangko Sentral aims to meet the requirements of the public by offering solutions that fit the problem. This translates to sticking with available facts and choosing to wait for confirmed policy initiatives before transmitting these to the public.

A large part of the CO's task involves translating technical central banking jargon into easily understandable and relatable content on mass media.<sup>22</sup> The CO's media relations team continued to ensure that media requests for interviews and different forms of engagement were pursued during the pandemic period, including unprecedented media access to the Governor himself through a messaging application.

With the pandemic also came fake news and unfounded assertions on mainstream media, social media and various informal chat groups. After verifying that these allegations were either false or misleading, the BSP issued formal advisories or social media cards with the correct information to prevent their further spread.

For credit rating agencies, economists, bankers, foreign investors and other central banks, the BSP sought targeted opportunities to discuss policy initiatives it had taken during the pandemic. These came in the form of online meetings, speeches and written messages focused on specific areas of concern.

<sup>22</sup> Different communication modes were utilized – audio, video and QR codes on social media cards; consistent and scheduled advisories; news summaries and features on central bankers.

### Paths to greater preparation

The support and authority given by the Office of the Governor have proven crucial in ensuring that internal and external communication would remain consistent during the COVID-19 pandemic and even afterwards. To operationally strengthen the team during the pandemic (Sieliezienieva and Bondarenko, 2019), the CO was provided authority to vet specific communication materials meant for public consumption.

Another area where the CO may strengthen itself further is in establishing protocols among different units of the BSP to ensure that reporting lines and responsibilities are clear especially during time-sensitive crisis situations. This will be addressed through the identification of subject matter experts within the BSP, as well as a review of existing policies to reduce procedural constraints, improve decision making and hasten the finalization, release and dissemination of messages.

There will be a continuing need for the matrix of messages that is easily adaptable for use across all platforms and customized according to different audiences, both in and outside of the BSP. There will also be demand for sets of frequently asked questions about BSP issues, mandates and advocacies.

Sustained monitoring of media exposure, including frequency and content, will serve in providing analysis on the effectiveness of BSP messages, the identification of areas for improvement and the formulation of recommendations to further strengthen the BSP's communication capabilities.

Lastly, the BSP will be served well by an honest assessment of its own performance in the communication realm. This would entail evaluating the effectiveness of communication materials, channels and initiatives, and truly learn from challenges that the institution encountered during the pandemic.

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# Forward Planning for Strategic Crisis Response

Eloisa T. Glindro, Marites B. Oliva and Lilia V. Ellosa\*

CHAPTER  
**TWELVE**



## 1. Introduction

A crisis is a time of extreme difficulty that necessitates making hard decisions. An economic crisis, regardless of scale and origins, ultimately requires resources and a strategic response. The current COVID-19 pandemic has revealed enduring vulnerabilities that would test the suitability of domestic policies. Economies lacking governance structures that are adept at policy-making will tend to suffer deeply.

A crisis, therefore, underlines the necessity of forward planning. Pressing questions confronting policymakers during a crisis pertain to the pace and strength of near-term recovery as well as the likely medium-term repercussions. Thus, acting decisively in the early phase of any crisis is critical in changing its course and severity. Even if favorable pre-crisis conditions offer policy flexibility, the policy space will eventually get tighter if a crisis drags longer than anticipated. Conditions could rapidly deteriorate, and no economy could afford to have its “immune system” seriously compromised. That may generate serious socioeconomic and political difficulties that could not be easily undone. Thus, crisis mitigation and crisis resolution require adroitness in understanding its fundamental cause, contextualizing it within the rapidly changing and uncertain operating environment, and assessing available and suitable policy levers for implementation.

Central bank policies are indispensable facets of macroeconomic crisis response actions. Bolstering the capacity for policy maneuvers during downturns requires monetary policy to work in lockstep with financial policy framework for crisis prevention and resolution (Blanchard and Summers, 2017). This is to prevent the immediate illiquidity risk from turning into a perilous insolvency crisis. A healthy synergy with fiscal policy is likewise necessary to ensure that future monetary actions will not be dominated by fiscal concerns.

Even if an ideal mix of policy levers exists, real-world application is still fraught with challenges, especially for emerging market economies (EMEs) that are vulnerable to the vagaries of the global economy. Deterioration in economic conditions can trigger the financial amplification effects that can precipitate sudden stops. Thus, no economy can let its guard down. Market surveillance and preparation of the policy arsenal need to be sharpened even more. Lost lives and livelihood are too big a price to pay for inaction and haphazard policy actions.

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## 2. Unconventional monetary policies: a fundamental rethink or a fundamental caveat?

The 2008 global financial crisis (GFC) has profoundly changed the thinking about central banking. Many central banks in advanced economies provided massive bridge financing to sectors that have been previously outside their ambit. Many of the unconventional monetary policy (UMP) measures have not yet been fully unwound when the COVID-19 pandemic struck. While the jury is still out on the effectiveness of UMP, the severity of the economic impact of COVID-19 has prompted many central banks, including those from EMEs, to cross the Rubicon and embrace unorthodox measures, setting a precedent for future monetary policy commitments.

Maintaining price stability conducive to economic growth and welfare constitutes the core of central bank mandate. Stable prices safeguard the real purchasing power of money and facilitate long-term planning and effective functioning of markets. To achieve this policy objective, adjusting the short-term interest rate is the standard monetary policy taken by central banks. They do so through domestic open market operations and standing credit and deposit facilities. Other conventional monetary policy measures include direct instruments such as reserve requirements and lender of last resort to distressed financial institutions.

The advent of liberalization, financial globalization and digitalization has had deep implications on the conduct of monetary policy. As financial crises become more frequent, securing financial stability has become an equally essential policy pillar of central banks and financial supervisors. Monetary policy anchored on price stability is a necessary but not sufficient condition for achieving financial stability. Financial instability can diminish the traction of monetary policy as what happens during periods of deep economic contraction. Siklos (2014) emphasized the need to rethink the general view that price stability and small output gaps are sufficient to guarantee financial system stability.

In an economic crisis where conditions can rapidly deteriorate, lending rates may be slow to adjust due to risk premia or reluctance to lend, resulting in credit rationing. The inertia in reviving credit intermediation may progressively drive policy rates to its effective lower bound<sup>1</sup> (Papademos, 2006). Cutting rates below a certain threshold could reduce credit supply, especially new productive loans, if lower interest rate margins erode bank profits and net worth. Moreover, if

<sup>1</sup> Not necessarily the zero-lower bound as there are jurisdictions with negative policy rates already.



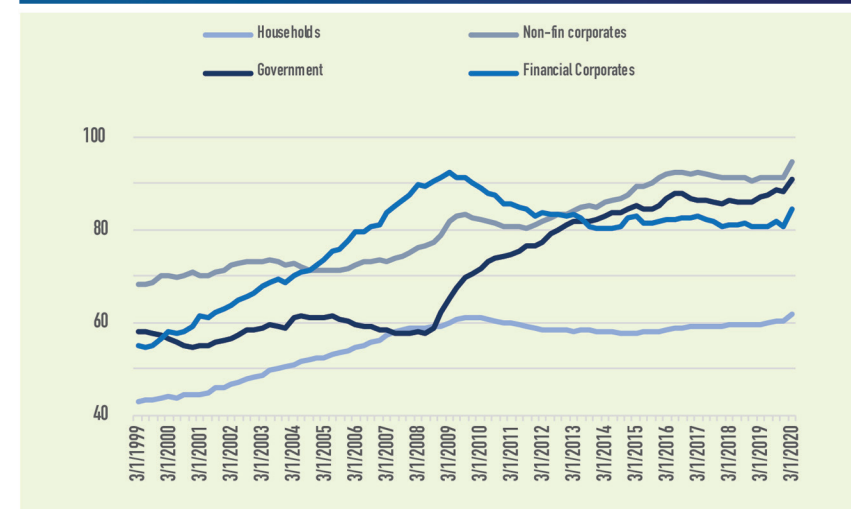
banks are constrained to reduce deposit rates below a threshold, monetary policy is unable to shift consumption to the present, suppressing the “intertemporal substitution channel” (BIS, 2019a).

A relevant question to ponder is whether there is an optimal sequence in the deployment of crisis policy response measures. Thus far, the world has seen diverse approaches to attendant risks and challenges. There are no hard and fast rules because an economic or financial shock has differential impact across economies. Initial conditions and policy flexibility differ. Monetary policy is now, more than ever, faced with non-neutral policy trade-offs in the face of multiple secondary shocks at play.

A small emerging market economy like the Philippines is invariably affected by developments in the global economy and the global financial system. Now that the world is simultaneously suffering from the onslaught of the COVID-19 pandemic, EMEs need to tread carefully. Korinek and Mendoza (2014) and Mendoza (2010) made an insightful study on the dynamics of sudden stop, which is highly relevant in the case of the COVID-19 pandemic. They found a pattern of strong real exchange rate appreciation prior to sudden stop episodes, after which the real exchange rate collapses and a gradual recovery ensues. Such dynamics were not evident in advanced economies. They also observed marked asymmetry in the distribution of macroeconomic aggregates during sudden stops, a characteristic not evident during episodes of sudden large capital inflows and economic expansions. Moreover, they found that the fall in total factor productivity accounts for a sizeable drop in output during a sudden stop rather than a decline in measured capital and labor.

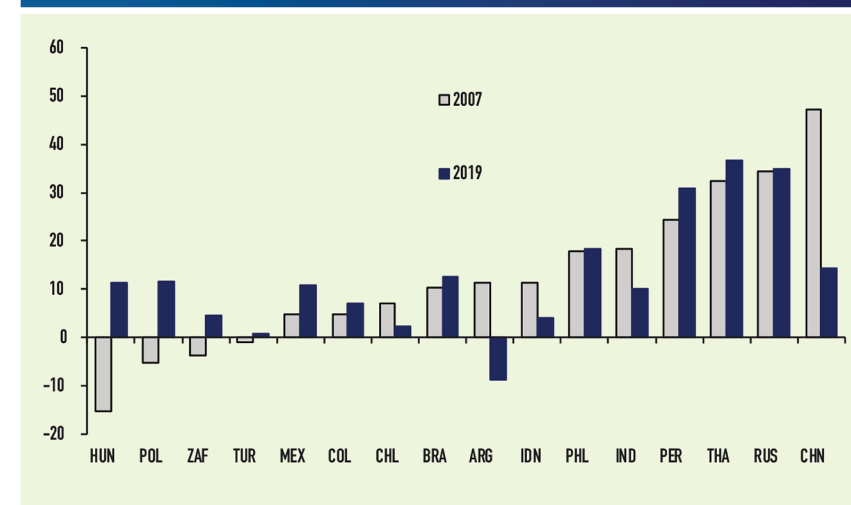
Capital outflows were peaking around March 2020 with portfolio debt and equity investments reaching US\$83.3 billion in March 2020, the largest since the GFC (IIF, 2020a). Nonetheless, capital flows eased at US\$15.1 billion inflows in July 2020, although equity flows (excluding China) posted only marginal gains (IIF 2020b). Two stylized facts characterize the eve of the pandemic. First, global sectoral debt has risen since the GFC, with governments and non-financial corporates exhibiting stronger uptrends (Figure 12.1). Second, emerging markets have had higher reserve adequacy than they did prior to the GFC (Davis, 2020) as shown in Figure 12.2. The incidence of sudden stop and debt upsurge resulting from the COVID-19 shocks may not be apparent yet as the world has yet to see the full extent of the fallout. However, the duration and depth of the crisis could trigger another wave of capital outflow and increase in debt as economic recovery prospects still stand on shaky ground.

Figure 12.1. Global Sectoral Debt (% of GDP)



Source of basic data: Global Debt Monitor Database of the Institute of International Finance (as of July 2020)

Figure 12.2. Reserve Adequacy in Selected EMEs (% of GDP)



Reproduced from Scott Davis (2020), Federal Reserve Bank of Dallas. Source of basic data: World Bank

**A close look at UMPs.** UMPs pertain to unorthodox tools deployed by central banks when conventional monetary policy tools are insufficient to address a problem at hand. UMP measures specifically aim to manage the cost and availability of financing for a particular sector such as banks, households and non-financial corporations (Smaghi, 2009). Many of the UMPs are already in the toolkit of central banks. They become unconventional, in breadth and scale, when they serve as the primary mechanism for achieving the central banks' objectives (RBA, 2020).

There are three broad categories of UMP measures as expounded in Smaghi (2009) and Ishi et al. (2009): liquidity easing, credit easing and quantitative easing. *Liquidity easing* is a conventional measure of central banks, but it becomes unconventional when liquidity provision is stepped up to cover a wider range of foreign exchange and domestic financial markets. Meanwhile, *credit easing* is the direct or indirect provision of credit by central banks to a certain market segment to address liquidity shortages and spreads primarily due to credit markets breakdown. *Quantitative easing* seeks to affect the level of long-term rate of financial assets mainly through changing the market for risk-free assets. The box article differentiates among the different UMP measures.

A new variant of UMP measure is the setting of *negative interest rate policy (NIRP)*, which was first adopted by Denmark in 2012.<sup>2</sup> With deflationary spirals taking hold and conventional measures reaching their limits, NIRP is seen to resuscitate lending, push inflation up and revive economic activity (RBA, 2020). Another but less straightforward UMP is *forward guidance*, which is essentially the communication of policy intentions. It could be calendar-based or have explicit commitments on specific policy actions. The idea is to influence private-sector expectations of future policy rates and inflation, with the idea that such expectations affect current period activity. According to Moessner et al. (2015), the policy is time-inconsistent because once the crisis is over, the central bank has no incentive to deliver on generating inflation.

Based on the database compiled by Ishi et al. (2009) and IMF COVID-19 tracker, more UMPs were actively deployed during the GFC (Figure 12.3) when selected Asian economies more actively used measures to ease domestic liquidity and foreign exchange liquidity (Figure 12.4). Several months into the COVID-19 pandemic, more domestic-liquidity-easing and credit-easing measures (Figures 12.5) have been deployed.

## Different Types of Unconventional Monetary Policy Measures

*Liquidity easing* becomes unconventional when liquidity provision is undertaken on a massive scale. Examples are expansion of existing lending facilities to provide sufficient liquidity to a wider range of financial markets, lowering costs over longer horizons and expansion of the range of accepted collateral to support illiquid financial intermediaries. These provide confidence to financial institutions on access to liquidity, enabling them to continue the provision of credit to firms and households.

*Credit easing* can generally be conducted through the purchase of commercial papers, corporate bonds and asset-backed securities of targeted borrowers. In the case of *quantitative easing*, an example is the direct purchases of government securities to lower the benchmark market interest rates and boost economic activity. This is typically undertaken when policy rate is near zero. Otherwise, the balance sheet of central banks will expand larger than necessary, thereby increasing their risk exposure.

Another policy to deal with the effective lower bound is the *negative interest rate policy*, which represents a cost for placing excess reserves with the central bank. Some countries implement this measure to thwart deflationary currency appreciation. This was found to be effective in dealing with effective lower bound and could influence the expectation on future rates (BIS, 2019a). The policy has been adopted in a number of central banks such as Japan, Sweden, Denmark, Switzerland and the European Central Bank (ECB).<sup>\*</sup> Sweden's Riksbank has moved the interest rate from negative territory to zero by end-2019.

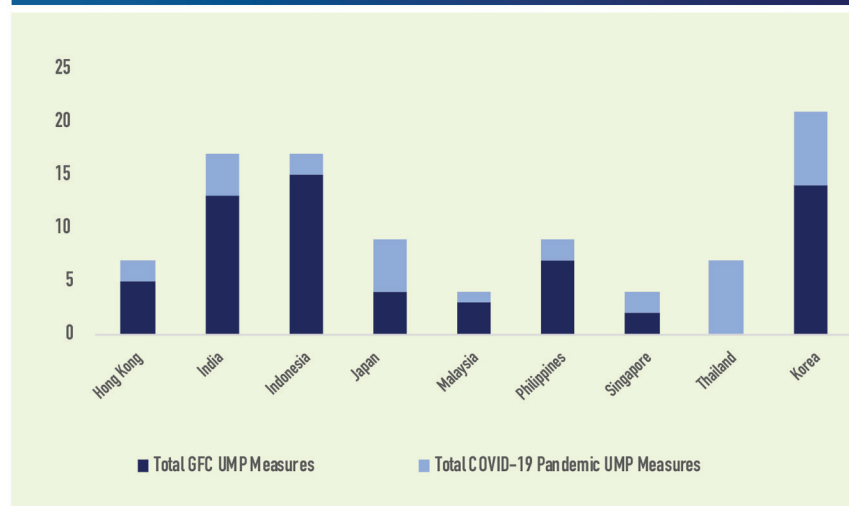
*Forward guidance* essentially encompasses communication of central bank policy stance and the views surrounding it. What is unconventional is that it entails commitment to a particular policy, conditional on specific economic conditions (RBA, 2020).

Sources: Smaghi (2009); Ishi et al. (2009); RBA (2020); BIS (2019a, 2019b).

<sup>\*</sup> While the main refinancing operations rate of the ECB is set at 0%, the deposit facility rate is currently at -0.5%.

<sup>2</sup> Negative policy interest rate was first implemented in Denmark in July 2012 followed by Switzerland in December 2014, Sweden in February 2015 and Japan in September 2016 (BIS, 2020b). While the main refinancing operations rate of the ECB is set at 0%, the deposit facility rate is currently at -0.5%. The negative deposit facility rate began in June 2014 at -0.1% (ECB, 2020).

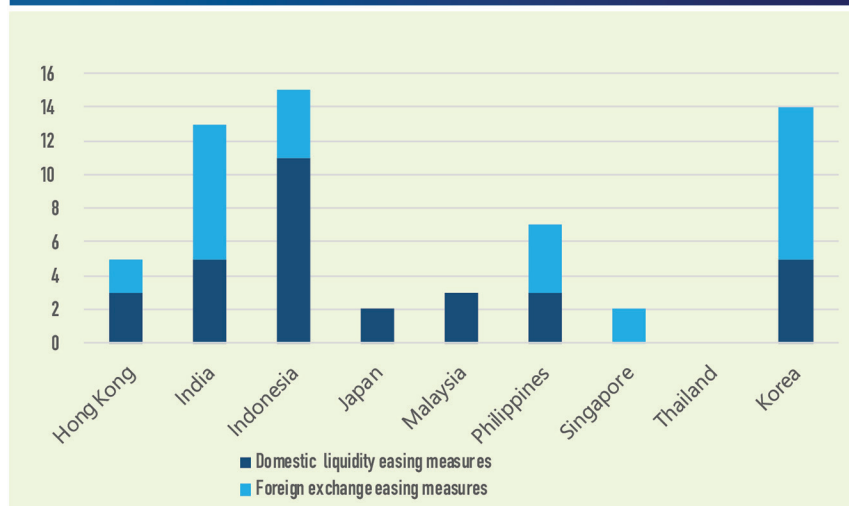
Figure 12.3. Comparative UMP Measures During the GFC and COVID-19 Pandemic



Note: The number of measures should not be interpreted as a precise gauge of the magnitude of policy responses.

Source: For GFC period: Ishi, et al. (2009), except for Japan which is based on Kuroda (2014) and Nakaso (2017). There are no reported measures for Thailand. For COVID-19 period: identified by the authors based on IMF (2020a), accessed in October 2020 and IMF Global Financial Stability Report: Bridge to Recovery, October 2020

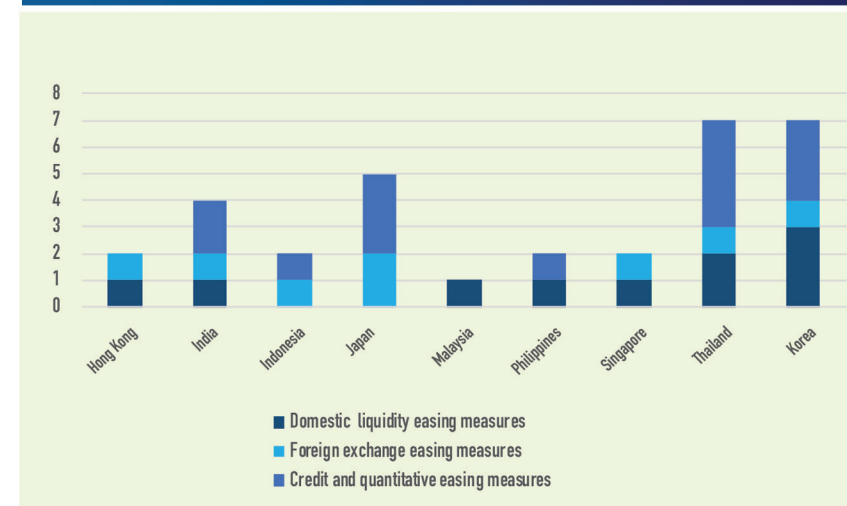
Figure 12.4. UMPs During the Global Financial Crisis



Note: The number of measures should not be interpreted as a precise gauge of the magnitude of policy responses.

Source: Ishi, et al. (2009), except for Japan which is based on Kuroda (2014) and Nakaso (2017). There are no reported measures for Thailand

Figure 12.5. UMPs During the COVID-19 Pandemic



Note: The number of measures should not be interpreted as a precise gauge of the magnitude of policy responses.

Source: Identified by the authors based on IMF (2020a), accessed in October 2020. IMF Global Financial Stability Report: Bridge to Recovery, October 2020

The implementation of UMPs, however, is not without caveats. Liquidity risk may be elevated if the private sector and the government expect the central bank to intervene whenever risk spreads increase. The ensuing moral hazard and mispricing or risks have serious ramifications on financial stability (BIS, 2019a). UMPs could also hinder the resumption of normal market functioning as central bank operations may substitute or interfere with them (Smaghi, 2019). For instance, if the central bank implements UMPs that directly deal with the non-financial private sector (i.e., central bank purchase of privately issued securities), the central bank is undertaking credit risk which is supposed to be the role of banks. In addition, this could lead to allocative distortions, not only in terms of sector (e.g., tourism, airline industry vs. manufacturing, retail trade), but also in terms of size (e.g., micro, small and medium enterprises vs. big firms) and geography (e.g., firms in Metro Manila vs. firms in Cebu or Davao).

### 3. Complementarity of monetary, macroprudential and exchange rate measures in crisis alleviation

The literature on economic policies and objectives suggests that there is a logical or natural correspondence between instruments and objectives (Blanchard et al., 2014). Monetary policy is for price stability objective, foreign exchange (FX) intervention is for excessive exchange rate movements and macroprudential measures (MPMs) are for financial stability concerns. Central banks have turned to FX intervention with the aim of buffering the economy from exchange rate shocks, and to macroprudential policies to address specific pockets of financial risks. This mapping has helped enhance monetary policy's credibility in maintaining price stability.

In the presence of multiple shocks, simultaneous and coordinated deployment of policy measures is indispensable. As the nexus between the economy and financial markets becomes more intertwined, macroprudential policies play a crucial complementary role in responding to changes in "domestic financial conditions and global financial shocks" (Adrian and Gopinath, 2020). The availability of macroprudential measures, capital flow measures and regulatory relief and forbearance measures are important underpinnings of a robust crisis response framework.

The BSP's reliance on MPMs is not misplaced and resonates with the trend among other EMEs, especially in Asia. In Bergant et al. (2020), the authors find that MPMs can lower the volatility of GDP growth, domestic credit and exchange rates, thereby relieving monetary policy of the burden of adjustment. A relaxation of macroprudential tools can help the financial system absorb the impact of the shock and ease a credit crunch that might have otherwise amplified the effect on the real economy. Such relaxation, however, is possible only if macroprudential buffers are in place, and useful only if the easing of the available buffers is expected to relieve stress or remove binding constraints on the provision of credit to the real economy (IMF, 2014; IMF, 2017)

The IMF-WB (2020) maintains that if conditions allow, the loosening of different types of tools can relieve stressors. Where the countercyclical capital buffer (CCyB) has already been activated, it can be relaxed to support the flow of credit to the economy and provide additional capacity to lend through a period of increased credit risks. Where the CCyB is not available, banks should be encouraged to use the capital conservation buffer (CCB).

Consideration can also be given to a relaxation of systemic risk buffers that are designed to protect against macroeconomic risks. For example, banks should be able to make use of their high-quality liquidity assets under the liquidity coverage ratio (LCR) to counter liquidity stress in local currency. A relaxation of reserve requirements (in domestic currency) can help alleviate liquidity pressures in banks. Foreign currency reserve requirements can be relaxed to mitigate FX funding pressures. Where countries have introduced additional LCR requirements in FX, they can allow banks to use the buffer, or loosen the requirement. A relaxation of sectoral tools (such as caps on loan-to-value ratios) can also be considered to support the provision of credit to households and firms.

At the onset of the COVID-19 pandemic, most countries have enacted emergency measures aimed at supporting the flow of credit to the real economy while mitigating the build-up of risks from asset quality deterioration (IMF-World Bank, 2020). These measures include: (i) prudential regulatory and supervisory measures to support banks in facilitating credit to the real economy; (ii) measures supporting borrowers and loan restructuring; (iii) operational and business continuity measures; and (iv) measures to strengthen payment systems. Box Article 2 provides a snapshot of the central banks' policy responses during the COVID-19 pandemic.

Thus far, national policy measures around the world have targeted the use of available bank capital and liquidity buffers. The aims are to support affected borrowers, promote balance sheet transparency and maintain operational and business continuity of banks as well as payment systems. However, some developing countries have fewer options at their disposal due to limited policy buffers, weaker implementation capacity and less-sophisticated regulatory

frameworks. When EMEs face capital outflows during and after a crisis, foreign exchange intervention can help stem capital flight. The International Monetary Fund (IMF) has spearheaded efforts to develop conceptual and quantitative models under the integrated policy framework to provide guidance on how the tools can be deployed to address central bank objectives (Adrian and Gopinath, 2020).

#### 4. Fiscal limits and the specter of fiscal dominance

Many EMEs have been able to undertake countercyclical fiscal and monetary policy over the past decade to stabilize economies, with little threat of fiscal dominance. Improvements in fiscal policy in EMEs appear to have increased the effectiveness of monetary policy (Montoro et al., 2012).<sup>3</sup> Nonetheless, monetary policy cannot afford a benign neglect of fiscal policy. During crisis, deficits and debts take center stage as internal sources of funds plummet while expenditure requirements for social amelioration and recovery efforts rise. The dilemma between financing crisis mitigation and resolution measures and addressing debt vulnerabilities becomes heightened.

Monetary policy always has fiscal implications. At the effective lower bound, monetary policy is also effectively the fiscal policy (Orphanides, 2018). While government debt financing by the central bank serves as a crisis management tool, it cannot be used as a permanent solution. It cannot substitute for the necessary fiscal adjustment. Otherwise, it increases the risk profile of the central bank's balance sheet, which could reduce financial soundness and financial independence of the country's monetary authority (Smaghi, 2019).

Public debt sustainability is largely contingent on the government's commitment to honor its current and future debt obligations (Debrun et al., 2019). High public debt is generally regarded as costly because of future fiscal costs and crowding out of capital. However, in the current environment of low interest rates, Blanchard (2019) posits that the fiscal costs are not large, and the welfare costs are probably small. He expounds that since  $r - g < 0$ <sup>4</sup> appears to be "the norm rather than the exception," debt can just be rolled over to support growth and new debt pays for the interest. Hence, the debt-to-GDP ratio will decline over time without the need to raise taxes ever.

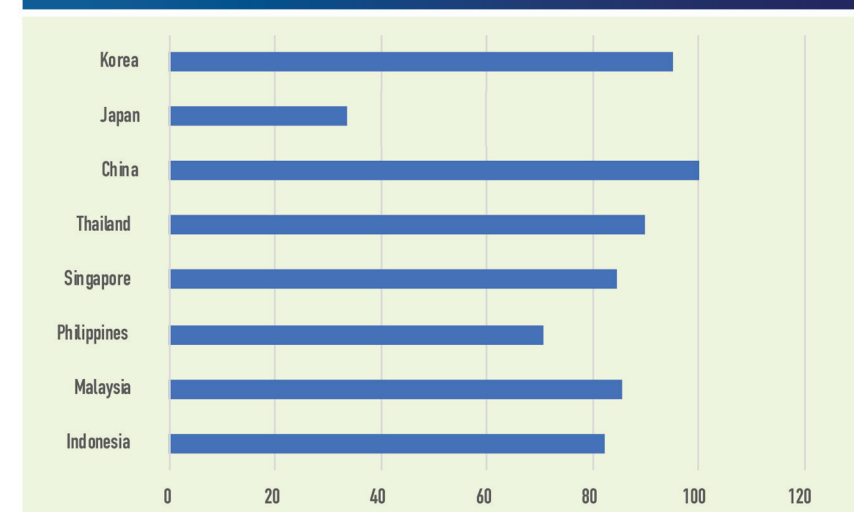
<sup>3</sup> Stronger fiscal positions were found to be weakly associated with lower equilibrium real interest rates, and smaller deficits with lower inflation.

<sup>4</sup>  $r$  and  $g$  are the nominal interest and growth rate of nominal GDP, respectively.

Wyplosz (2020) provides an argument to the contrary. He notes that for OECD economies which have long data span since the 1960s, the sustainability condition appears to hold for only about 49.7 percent of the time, with large standard deviation. The risk of procyclical policy going forward requires careful consideration, given the depth of the economic contraction from the ongoing pandemic. Availability of financing is inadequate to sidestep the confidence issue that may arise from lack of long-term fiscal consolidation. When  $r - g < 0$  is the norm, it is difficult to determine the threshold when debt dynamics becomes explosive (Ostry et al., 2011).

Applying the simple debt sustainability condition to selected Asian economies with available comparable interest rate data,  $r - g < 0$  holds most of the time (Figure 12.6). This, however, should be viewed with caution due to the very small observation set.

Figure 12.6. Proportion of Years When  $r - g < 0$  in Selected Asian Economies (%)



Authors' computation

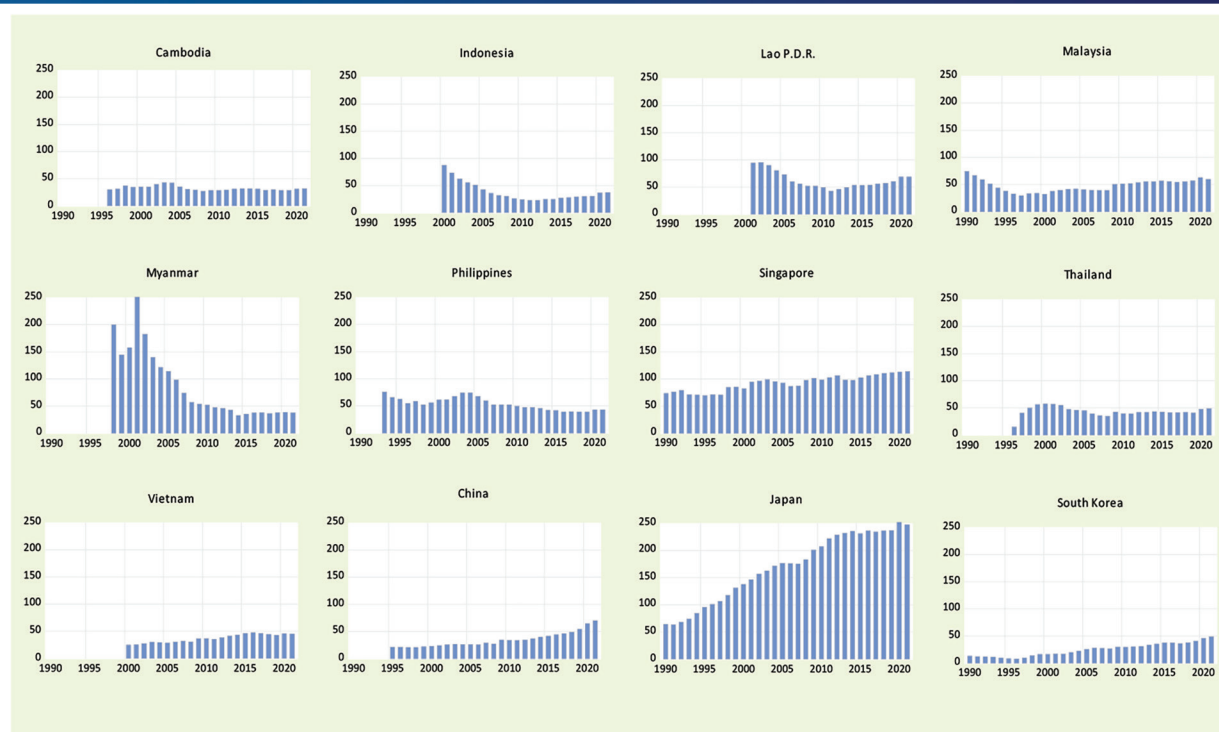
Sources of basic data: IMF-International Financial Statistics, Reuters

Interest rate is the 10-year Treasury bond rate

Moreover, most Asian economies generally have stable government debt-to-GDP (Figure 12.7) and small deficits in primary balance-to-GDP (Figure 12.8) prior to the COVID-19 pandemic. It would, therefore, be prudent for those with moderate debt levels to keep them as such. At the same time, access to

better financing terms must be used to address deep economic challenges and invest in the future (Boone and Buti, 2019). Dealing with lingering structural problems in taxation policy is equally important in pursuing equitable growth and development.

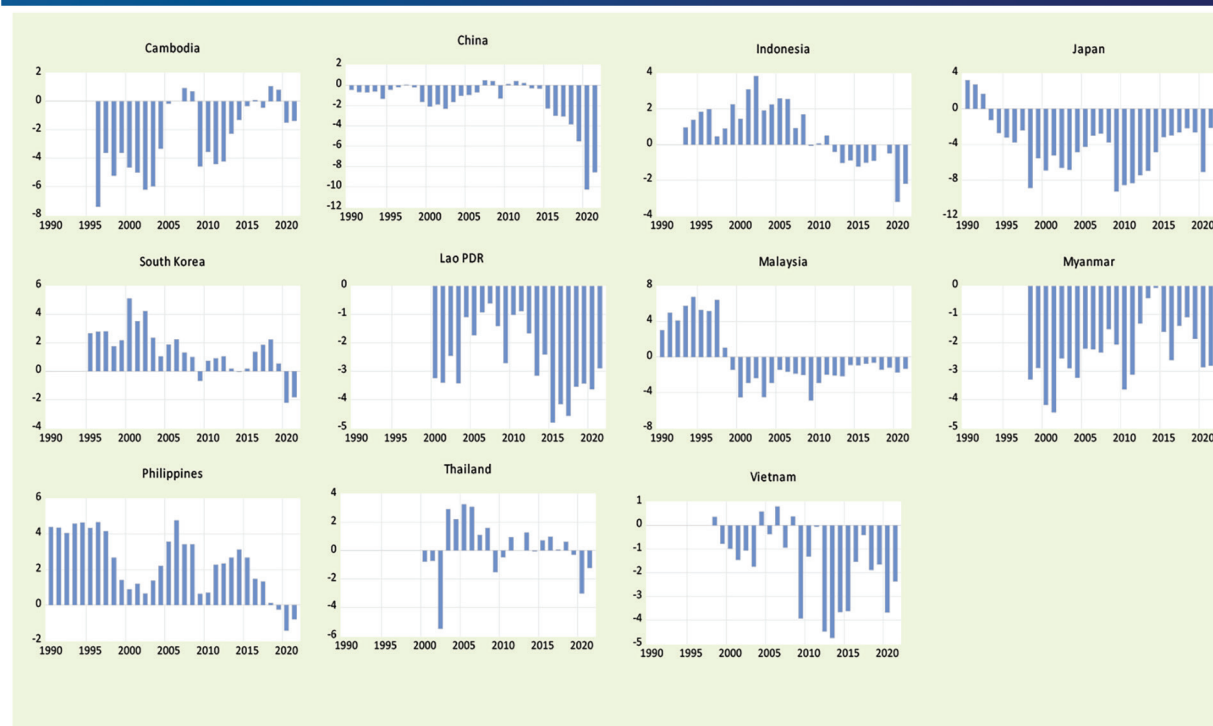
Figure 12.7. Government Debt-to-GDP Ratio in Selected Asian Economies (%)



Source of basic data: IMF Fiscal Monitor



Figure 12.8. Primary Balance-to-GDP Ratio in Selected Asian Economies (%)



Source of basic data: IMF Fiscal Monitor

## 5. The political and economic challenge of the policy normalization process

Given that current market conditions are shaped by expectations on future policy trajectory, clarity about the return from the crisis policy regime to long-established policy framework is pivotal and requires a finer balancing act. On one hand, premature withdrawal of support stymies recovery efforts and runs the risk of precipitating another downturn. On the other hand, a protracted period of support beyond what is reasonable for the economy creates dependency

and reduces incentives for the resumption of normal market conditions. The importance of consistent and dependable policy coordination, clear messaging and accountability are now, more than ever, critical in weaning the economy off the extraordinary policy support (Glindro et al, 2020a).

The socioeconomic gaps laid bare by the COVID-19 pandemic call for deliberate and focused reforms in the modernization of the health system to ensure efficient public health infrastructure and logistics system and resilient crisis preparedness framework; systematic arrangement for expeditious assistance to the most

vulnerable; and meaningful support for the restoration of economic activities and employment. Since the credibility of governments and institutions is at stake during crisis episodes, accountability and governance safeguards are paramount. Digital technology will be key to the strengthening of the government's monitoring and evaluation systems for policy actions (Diokno, 2020). Without these capacities, governments may not adequately assess how its policies affect the people and risk placing a disproportionate burden of the health and economic impacts of the pandemic on the vulnerable (Evans, 2020).

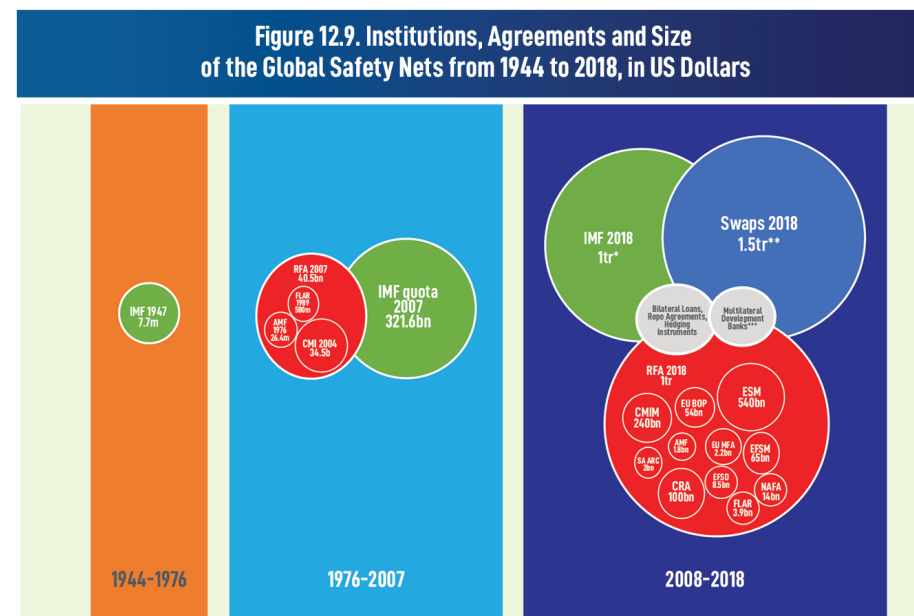
Central banks with both price and financial stability objective also face particular challenges amid policy conflicts. For instance, fast-rising inflationary expectations may prompt a central bank to increase policy rates. However, if credit conditions are precariously tight and the recovery process is still incomplete or weak, raising policy rate may just worsen financial conditions. As such, price and financial stability communication requires a finer balancing act in times of crisis – keeping market participants and the public informed, advising caution and promoting mitigating actions with clarity of purpose.

When conventional measures are significantly blocked, non-standard measures can offer support. While the unwinding of conventional measures is contingent on the medium- and long-term outlook for price stability, that of unconventional measures would depend on the impairment of the monetary policy transmission through the financial system and financial markets (Trichet, 2013).

## 6. Time for global reset of the international financial order?

Some experts have sounded a clarion call for the redefinition of the international financial architecture and monetary systems. They consider the existing financial safety nets woefully inadequate should the pandemic deepen amid brewing geopolitical tensions.

**Enlargement of global financial safety nets (GFSNs).** For a long time, the IMF has been the only available source of financing for majority of the world's countries. Since the GFC, GFSNs have grown, encompassing regional financial arrangements, bilateral currency swaps, bilateral short-term loans, crisis lending programs of multilateral development banks, repo agreements and central bank hedging instruments as shown in Figure 12.9 (Mühlich et al., 2020).



Source: Mühlich et al. (2020).

The COVID-19 pandemic may require significant increase in lending volumes from the IMF and regional fund, especially for developing and emerging economies. Segal and Gerstel (2020) of the Center for Strategic and International Studies (CSIS)<sup>5</sup> reported that international financial institutions (IFIs) have approved US\$117 billion in COVID-19-related support since 27 January 2020 as summarized in Table 12.1. The IMF has approved US\$77.1 billion, including emergency assistance and precautionary lines of credit, while the multilateral development banks (MDBs) have approved a total of US\$39.3 billion. Regional Financing Arrangements (RFAs) have not been a significant source of funding on a global scale to date.<sup>6</sup>

Among IFIs, MDBs have disbursed far more than the IMF. The lower disbursement by the IMF has been attributed to the precautionary nature of flexible credit line

<sup>5</sup> The CSIS Economics Program tracks commitments, approvals and disbursements by major international financial institutions (IFIs) to meet the massive financing needs generated by the COVID-19 pandemic and its economic fallout.

<sup>6</sup> Among the RFAs, only the Arab Monetary Fund has approved and disbursed financial support to four of its member countries in response to the current crisis. The European Stability Mechanism (ESM) and the Latin American Reserve Fund have both announced institutional commitments to support their members, but European countries have not yet tapped ESM financing. The Chiang Mai Initiative Multilateralization Agreement and Eurasian Fund for Stabilization and Development have not announced any COVID-19-related programs.

(FCL) arrangements with Colombia, Chile and Peru. The FCL is a lending program introduced in 2009 to mitigate external shocks and support market confidence in economies with strong economic fundamentals.

**Table 12.1. Global Financial Safety Net by Institution (in Billion US\$)**

Institutions	Approved	Disbursed	Disbursed/ Approved (%)
International Monetary Fund (IMF) <sup>a/</sup>	77.1	30.4	39.4
Multilateral Development Banks (MDBs)	39.3	37	94.1
African Development Bank (AfDB)	1.6	1.6	100.0
Asian Infrastructure Investment Bank (AIIB)	3.3	3.3	100.0
Asian Development Bank (ADB)	7.2	7.2	100.0
Development Bank of Latin America (CAF)	1.3	1.3	100.0
European Bank for Reconstruction and Development (EBRD)	1.9	1.7	89.5
European Investment Bank (EIB)	7.7	5.5	71.4
Inter-American Development Bank (IADB)	1.3	1	76.9
New Development Bank (BRICS Bank)	2	2	100.0
World Bank (WB)	13	13.4	103.1
Regional Financing Arrangements (RFAs)	0.6	0.6	100.0
Arab Monetary Fund (AMF)	0.6	0.6	100.0
<b>TOTAL</b>	<b>117</b>	<b>68</b>	<b>58.1</b>

Source: Data collected by CSIS based on public release through 19 June 2020.

a/ IMF data include Chile's, Colombia's and Peru's Flexible Credit Line Programs and debt relief for 25 of its poorest members approved by the Executive Board on 13 April 2020.

In terms of geographical distribution, IFI approvals have been largest for the Americas although disbursements made to Africa and Asia/Oceania have been larger.<sup>7</sup> Support from new MDBs has been noteworthy. The Asian Infrastructure Investment Bank (AIIB) and the New Development Bank, or BRICS Bank, pledged US\$10 billion each. The AIIB consists of eight programs with co-financing arrangements with other regional MDBs.

**A new global Marshall Plan.** In a commentary, Goldin and Muggah (2020) argue for a global Marshall plan to sustain governments and societies. They note that not all economies have sufficient resources and policy firepower to sustain COVID-19 support for any great length of time. The pandemic can worsen inequality within and between countries, and halt the pace of globalization. At the same time, it could accelerate the 4<sup>th</sup> industrial revolution and change the future of work. On one hand, it could foster the growth of new digitally-enabled business models that are seen to be more sustainably inclusive. On the other hand, the transformation could also diminish the comparative advantage of lower labor costs in low-income countries.

<sup>7</sup> To date, IFIs have approved US\$54.7 billion in funding for the Americas, reflecting the three IMF precautionary FCLs; US\$20.2 billion for Africa; US\$19.8 billion for Asia/Oceania; US\$17.7 billion for Eurasia; and US\$3.8 billion for the Middle East (US\$0.8 billion of announced IFI support is not targeted at a specific region).

On 1 May 2020, the Debt Service Suspension Initiative (DSSI) of G-20 nations became operational. The program is a time-bound suspension of bilateral government loan repayments for 76 International Development Association (IDA) countries and least developed countries (LDCs). After December 2020, the countries will have to pay the deferred principal and interest over three years.<sup>8</sup> The DSSI translates into savings of US\$11 billion in principal and interest payments to bilateral official creditors and US\$7 billion due to multilateral official creditors for 2020. These represent approximately half of the estimated US\$35.3 billion of external debt service payments across the DSSI-eligible countries due in 2020. Non-eligible middle-income countries, which have significantly higher external debt and are expected to incur larger deficits, are expected to pay US\$422.9 billion in debt service in 2020, of which only 22 percent is due to official creditors (Nye and Rhee, 2020). This is a potential stress point to watch out for.

Until a new “global Marshall Plan” becomes politically feasible at the multilateral level, economies that can consolidate and re-anchor efforts to fortify defenses through purposeful structural reforms must do so as soon as practicable. A reputation and record of stability-oriented policies are critical underpinnings of a resilient crisis preparedness framework.

**An EME global safe asset.** The domestic government bond can lose its safe-asset status during episodes of flight-to-safety. Thus, there is a need to increase the supply of safe assets (Brunnermeier and Huang, 2018; Gourinchas and Jeanne, 2012). Given that the accumulation of foreign reserves for precautionary purpose tends to be costly, Brunnermeier and Huang (2018) propose the issuance of sovereign bond-backed securities. The proposal entails pooling many sovereign bonds by a special purpose vehicle (SPV) and dividing the pool into several tranches. Pooling can raise the size of the senior tranche bonds, providing avenue for diversification. Even as the sovereign bond of an emerging economy might lose its safe-asset status after an adverse shock, a senior bond supported by several sovereign bonds does not. Hence, capital outflows are minimized. In their 2012 paper, Gourinchas and Jeanne warned that while increasing the supply of safe assets can lessen financial instability, the arbitrage opportunities between safe assets might create more volatility. Thus, some form of global insurance is still warranted.

<sup>8</sup> Participation of private sector creditors in the DSSI is still uncertain.

## 7. Conclusion

Building buffers during good times has become a policy mantra. Its value resonates clearly in any crisis mitigation and resolution efforts. However, when good times roll, exuberance makes it easy to take for granted the dangers and forget about the possibility of implosion or slow-burn from a truly exogenous shock like the COVID-19 pandemic. The policy approach of governments and central banks is largely shaped by initial macroeconomic conditions and the evolving sociopolitical milieu during the crisis period. The initial phase of the crisis, if not resolutely addressed, becomes a trigger for damaging economic and social fissures.

Proactive and forward-looking policies aimed at rebuilding confidence and shutting down the adverse feedback loop of low economic growth, financial fragility and fiscal crisis are fundamental elements of crisis preparedness. It is therefore imperative to have in place credible and comprehensive measures to pursue growth-enhancing policies, promote responsible fiscal position, support distressed financial institutions and mend financial position of households and corporates. The central banks, especially in EMEs, cannot engage in prolonged intervention in the government debt market without undermining central bank credibility (Carstens, 2020). The whole of government has the moral responsibility to protect its citizens and sustain the economic lifeblood for current and future generations through strategic direct measures and far-sighted reforms that reinforce institutional strength and maturity. To quote Goldin and Muggah (2020) “the COVID-19 pandemic provides a turning point in national and global affairs. It demonstrates our interdependence and that when risks arise, we turn to governments, not the private sector, to save us.” Strong institutions are needed to effectively address risks and carry out the reform imperatives.

## Central Banks' Responses to the COVID-19 Pandemic

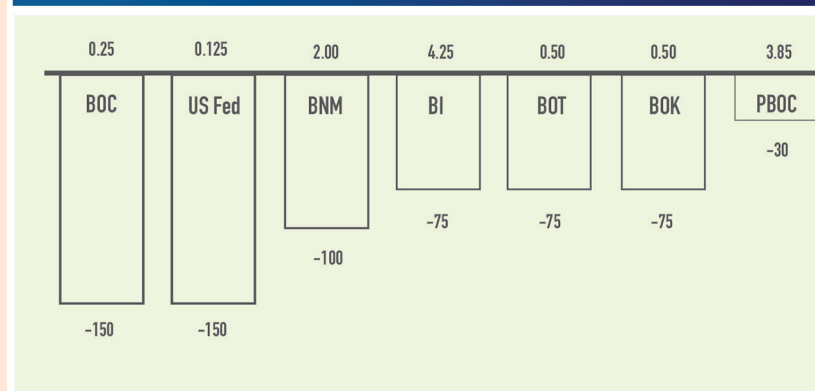
Mari-Len R. Macasaquit and Maria Jannie Luiza C. Baluyan

The COVID-19 crisis posed an unprecedented challenge that prompted central banks and monetary authorities across the globe to implement urgent policy measures. To arrest further economic downturn and liquidity strains, central banks took both conventional and extraordinary measures as they also stepped up asset purchases, increased credit support for firms and households, and adopted macroprudential and regulatory forbearance.

### 1. Policy rates and reserve requirements

Many central banks cut benchmark interest rates from January to June 2020 (Figure 12.1). The United States Federal Reserve (US Fed) led the charge with two off-cycle rate reductions, bringing key yields close to zero, holding its benchmark interest rate near zero through 2022. The Bank of England (BOE) slashed its main rate to a record low of 0.1 percent, while the Bank of Canada (BOC) lowered its key interest rate by 150 basis points (bps) to 0.25 percent. The Bank of Korea (BOK) likewise cut its base rate by a cumulative 75 bps to 0.5 percent. Asian economies such as Indonesia, Malaysia and Thailand also cut monetary policy rates at a cumulative 75 bps to 100 bps in the first six months of the year.

Figure 12.10. Central Banks' Cumulative Rate Cut and Benchmark Policy Rates, January to June 2020



Source: Bank for International Settlements

To complement the cuts in policy rate, a few central banks like the US Fed and Bank Negara Malaysia (BNM) lowered their reserve requirement during the onset of the pandemic. In March, BNM slashed its statutory reserve requirement (SRR) Ratio by 100 basis points to 2 percent, while US Fed eliminated its reserve requirements for all depository institutions.

## 2. Asset purchases

During the first quarter of 2020, central banks announced various long-term government asset purchases as part of their crisis management measures. To help keep the markets functioning, the US Fed and the Bank of Japan (BOJ) announced unlimited purchases of government bonds while the BOC launched an asset purchase program (APP)<sup>10</sup> for the first time and only specified a lower bound of CA\$5 billion (US\$3.7 billion) a week. Moreover, Canada's central bank established purchase programs for assets issued by municipal entities and local public authorities. To restore confidence and contain the widening of sovereign spreads, the European Central Bank (ECB) expanded its ongoing APP by committing to purchase an additional €120 billion (US\$135.2 billion) in private and public assets by end-2020 and subsequently allocating €1.35 trillion (US\$1.52 trillion) to private and public asset purchases under the newly established pandemic emergency purchase program (PEPP). PEPP is an expansion of the APP, which includes the purchase of sovereign debt, covered bonds, corporate bonds, commercial paper and asset-backed securities.

In Asia, to ease liquidity stress in their respective financial markets, the Bank of Thailand (BOT) purchased government bonds in excess of THB 100 billion (US\$3.2 billion) from 13-20 March 2020 to ensure the normal functioning of the government bond market. On the other hand, as of end-June 2020, Bank Indonesia (BI) bought a total of IDR 397 trillion (US\$27 billion) in government bonds directly from the finance ministry to fund the nation's economic recovery program, and participated in the purchase of a second bond worth IDR 123 trillion (US\$8.5 billion), which would fund loans for small- and medium-sized enterprises (SMEs).

## 3. Liquidity support

Temporary liquidity support measures were also implemented by a number of central banks, in line with their price and financial stability mandate. These include credit guarantee schemes, subsidized term funding and the creation of vehicles to acquire loans to support the continued operations of, and relieve the burden on, SMEs.

### a. Short-term funding markets

Various central banks boosted their short-term operations through facilities with maturity of less than 12 months to address initial liquidity shortages and to unlock market freezes. The US Fed, the BOC and the BOJ increased the amount of repurchase agreements offered and likewise lengthened their maturity. The US Fed also encouraged the use of its discount window and intervened to prevent funding strains on primary dealers by lending against investment grade debt. To relieve funding pressures on money market mutual funds, the Fed lent to depository institutions against assets purchased from those funds. Meanwhile, the ECB provided banks with bridge liquidity operations until the June allotment of the targeted long-term refinancing operation, and the BOE and the BOC activated their contingent term repo facilities. The People's Bank of China (PBOC) injected 80 billion yuan (about US\$11.3 billion) into the market through seven-day reverse repos. BI lengthened its repo tenor while the BNM boosted liquidity through its reverse repo operations and SRR adjustments.

### b. Long-term funding markets

Central banks also deployed long-term lending facilities, with maturity of over 12 months. The US Fed, BOJ and BOE established targeted lending programs to provide funds to banks, conditional on loan extensions to SMEs. The US Fed also reactivated the term asset-backed securities loan facility, and established a paycheck protection program liquidity facility against payroll loans guaranteed by the Treasury. The ECB introduced additional pandemic emergency longer-term refinancing operations while BOC lengthened the maturity of its lending operations with repos of up to two years' maturity. In Asia, the Monetary Authority of Singapore (MAS) allocated up to US\$60 billion of funding to banks through a new MAS US dollar facility as well as the MAS Singapore dollar facility for environmental, social and governance (ESG) loans. The BOT set up a THB 70-100 billion (US\$2.2-3.2 billion) corporate bond stabilization fund to invest in high-quality, newly issued bonds by corporates to assist in debt rollover.

### c. Swap lines

Many central banks also established, reactivated and renewed existing swap lines with counterparts. In March 2020, the BOJ, BOC, US Fed and ECB, in coordination with the Swiss National Bank, enhanced the provision of US dollar liquidity by lowering the pricing on the standing US dollar liquidity swap arrangements by 25 basis points. The US Fed also offered a swap facility to central banks with no existing swap lines through a new repo facility called FIMA (foreign and international monetary authorities), which will

<sup>10</sup> A non-standard monetary policy measure that involves large-scale purchases of government bonds to lower the interest rates or bond yields, support the monetary policy transmission mechanism and provide the amount of policy accommodation needed to ensure price stability.



allow monetary authorities to enter into repurchase agreements with the US Fed. In Asia, BOT and BOJ established a liquidity swap facility in Thai baht to complement an existing swap arrangement in Japanese yen, while BOK renewed its three-year bilateral swap line with BI.

#### 4. Macroprudential and regulatory forbearance

Monetary authorities and prudential supervisors granted various forms of relief measures, relative to established regulatory requirements, to reduce the burden to the banking sector and their clients (Figure 12.11). The US Fed encouraged depository institutions to use their capital and liquidity buffers to lend. The ECB Banking Supervision allowed institutions to operate temporarily below the Pillar 2 guidance, the capital conservation buffer and the liquidity coverage ratio. Meanwhile, Canada's Office of the Superintendent of Financial Institutions lowered the domestic stability buffer for domestic systemically important banks or D-SIBs. Central banks in the Asian region likewise issued several regulatory forbearance measures to alleviate pressure and help banks mitigate the impact of the pandemic. The measures come in the form of lifting of fees, relaxation of reportorial requirements, extension of regulatory deadline, easing of loan terms as well as capital and liquidity requirements. Other measures include suspension of banks' dividend payments for a year, flexibility in the classification requirements and expectations on loss provisioning for non-performing loans.

Figure 12.11. Summary of Regulatory Forbearance Measures, January to June 2020

	BOC/ OSFI	US Fed	PBOC	BOK	ECB	BI	BOT	MAS	BNM
Relaxation/Lifting of Fees		•	•		•	•	•		•
Relaxation of Reportorial Requirements	•	•		•	•	•	•	•	•
Extension of Regulatory Deadline	•	•			•	•	•	•	•
Easing of Loan Terms	•	•	•	•	•		•	•	•
Easing of capital requirements	•	•	•	•	•		•	•	
Easing of liquidity requirements	•	•	•	•	•	•	•	•	•

Sources: IMF Policy Tracker, Bank for International Settlements and official websites of the various central banks



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# The Role of Strategic Policy Coordination and Communication

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## CHAPTER THIRTEEN



Effective communication, forecasting and strategic policy coordination play significant roles in the BSP's response to the COVID-19 health crisis. The health risks brought about by the pandemic and the quarantine measures challenged the BSP's conventional approach to these activities. Nevertheless, the monetary authority adapted quickly to the challenges brought about by the coronavirus outbreak.

In this chapter, we discuss the BSP's communication, forecasting and intergovernmental coordination experiences amid the ongoing COVID-19 crisis, focusing on the unprecedented challenges that it faced and its response.

## 1. Communication during crisis

The BSP has taken into consideration lessons from prior crises in formulating its policies and processes, including its communication practices. The COVID-19 pandemic changed the ways in which the BSP communicates with its target audiences as well as with the broader public. The need to observe isolation and social distancing presented a unique challenge as emerging limitations on personnel, IT equipment and online connectivity and security all required adjustments in the ways people and organizations interact and communicate with each other.

Amid abrupt changes, central banks and other government institutions had to communicate early and often to address immediate market concerns, allay panic and encourage public cooperation. The BSP has stepped up to the challenge by delivering accurate, timely and easy-to-understand messages on a wide range of central bank initiatives.

### 1.1 Managing communication challenges during the COVID-19 pandemic

Amid the ongoing COVID-19 crisis, the BSP has so far identified three major communication challenges, as follows: (1) achieving clarity in communicating the BSP's new policy measures (e.g., extraordinary liquidity-easing and regulatory relief measures); (2) improving the relatability of messages to reduce market uncertainty; and (3) underscoring the BSP's complementary role in the national government's (NG) pandemic response.

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**Achieving clarity in communicating the BSP's new policy measures.** The COVID-19 pandemic required the BSP to act swiftly and decisively and to deploy certain non-standard measures such as:

- The repurchase (repo) agreement with the NG through the Bureau of the Treasury (BTr)<sup>1</sup>;
- Purchase of government securities (GS) in the secondary market (open market operations);
- Remittance of dividends amounting to ₱20 billion to support the NG programs, even if the BSP is no longer required to remit cash dividends to the NG and instead revert the amount as BSP equity; and
- The expansion of eligible assets deemed compliant with the BSP's reserve requirements to include newly-granted loans to encourage lending to micro, small and medium enterprises (MSMEs) and large enterprises.

However, the effectiveness of these non-standard measures depends on how clearly and credibly the BSP was able to explain to its stakeholders what the policy interventions entail and what they intend to achieve. In particular, the BSP needed to clarify, through clear and repeated messaging, that the repo agreement with the NG and the GS purchases in the secondary market essentially complements the NG's broad-based health and fiscal programs in mitigating the impact of the COVID-19. They are not akin to quantitative-easing measures aimed at reducing market interest rates as were done by other central banks. This was to allay market concerns over a potential expansion in the BSP's balance sheet and the monetary base, which could trigger public expectations of higher inflation in the future.

The BSP also responded to the challenge by identifying suitable communication channels and formats to reach a wide and diverse audience, such as the use of social media cards and infographics. It also considered the use of appropriate vocabulary and tone so that it can make its explanations more intelligible to the general public.

<sup>1</sup> This is the first time since the creation of the BSP in 1993 (RA 7653, as amended by RA 11211) that a provisional advance has been requested by the NG and granted by the BSP.

**Improving the relatability of messages to reduce market uncertainty.** The first objective of crisis communication prior to or during a panic episode should be to transmit confidence (Checkley and Piris, 2020). Thus, at the onset of the COVID-19 pandemic, the BSP immediately sought to intensify its communication activities so that it can address emerging market concerns related to price and financial stability. By enhancing its communication approaches in terms of format, content, language and timing, and aligning them with the public's information needs and level of understanding, the BSP was able to improve the impact of its messages. This enabled the BSP to respond quickly and more effectively to key issues such as the availability of financial services and qualifications on loan payments moratorium.

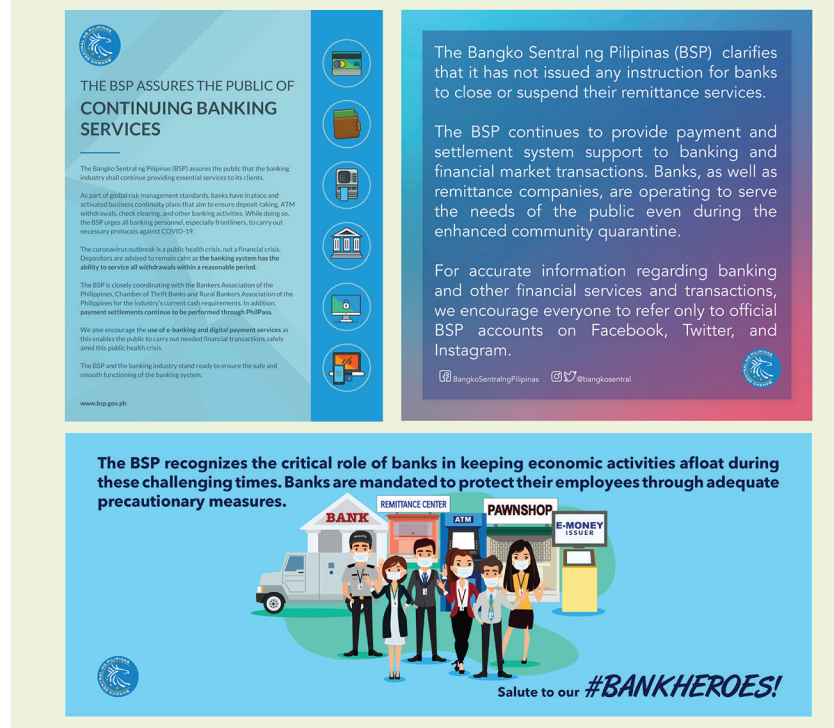
The BSP's core communication team, the Communication Office (CO), was immediately tasked to come up with statements to be issued to its stakeholders. These statements were aimed primarily at stabilizing financial market sentiment by emphasizing the BSP's firm commitment to the effective discharge of its mandates even amid the unprecedented crisis.

As the primary regulator of banks and other financial institutions, the BSP had to ensure the public of continued banking services despite the implementation of quarantine protocols. The first order of each day for the CO would be to inform banks of BSP services that are available to them via the release of advisories, particularly those posted on the BSP's official social media pages. BSP-supervised financial institutions (BSFIs) rely on these announcements for their day-to-day treasury, check clearing and cash requirements during the initial enhanced community quarantine phase (Lirios, 2020).

The BSP also assured the public of the continued provision of essential banking services while ensuring the safety of bank personnel. The BSP published a series of social media cards on available banking services during the quarantine. In March 2020, the BSP released a special social media card recognizing the important role of BSFIs in keeping the economy afloat during the health crisis.

Meanwhile, the passage of the Bayanihan to Heal as One Act resulted in inquiries from the media and the general public on issues related to the moratoria on loans and payment extensions. The BSP responded to these concerns through

**Figure 13.1. Selected BSP Social Media Cards on Continuing Banking Services**



Source: Official BSP Facebook page

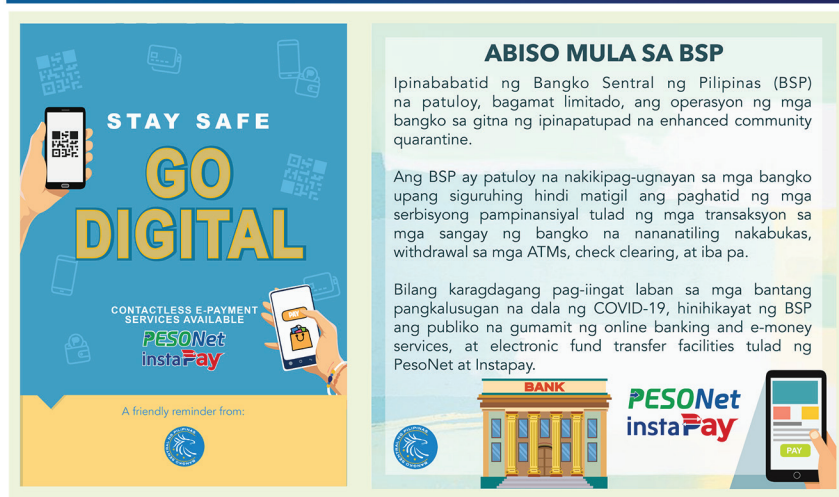
timely issuances of easy-to-understand advisories in its social media accounts and the BSP website. The media also helped the BSP in amplifying key messages on its efforts to relieve the burden on borrowers.

To complement the basic financial services offered by BSFIs and to ensure the continuity of payment transactions, the BSP encouraged the use of contactless e-payment services and electronic money (e-money). The BSP, as well as the Philippine Payments Management, Inc., would lead banks in declaring zero transaction costs for interbank fund transfer payment facilities, such as InstaPay



and PESONet (Lirios, 2020). The BSP launched campaigns on both traditional and social media platforms to promote online payment facilities as well as other electronic banking services as convenient, safe and secure alternatives to face-to-face cash or check transactions.

Figure 13.2. Selected BSP Social Media Campaigns to Promote E-Banking Services



Source: Official BSP Facebook page

### Underscoring the BSP's complementary role in the NG's pandemic response.

The BSP also pointed out in its communications that monetary policy is not the only game in town to combat the impact of the COVID-19 pandemic. The BSP had consistently highlighted in its messages that medical and fiscal policy interventions should remain at the forefront of the NG's response to the pandemic because of its nature as a shock to health and incomes. The BSP's extraordinary liquidity measures and regulatory relief efforts for financial institutions only complement the NG's broader fiscal and health initiatives to mitigate the impact of the pandemic on Filipino households and businesses.

Communication on the complementary role of the BSP's policy and regulatory relief measures such as the repo agreement with the NG and the purchase of GS in the secondary market proved to be a challenge for the BSP due partly to low public awareness on the institution's mandates. A public perception survey<sup>2</sup>

by private pollster Pulse Asia showed that only about 27 percent of surveyed Filipinos possess wide or sufficient degree of knowledge about the BSP as a government agency. Nevertheless, public trust in the BSP was fairly high with a "big trust" score of 66 percent while 30 percent of the respondents were unsure, and the remaining 4 percent have "small or no trust" in the agency. The level of public awareness and public trust is crucial in effective communication, particularly during crises when the effectiveness of policy responses depend largely on the confidence of the public on policymakers.

### 1.2 Communication lessons learned and preparing for the next crisis

The ability to cope with unique communication challenges was one of the important lessons that the BSP had learned during this period. By identifying and assessing the communication challenges amid the health crisis, the BSP was able to identify several communication practices that could be useful in the development of a stronger crisis communication framework.

In particular, responding to the information needs and preferences of a varied set of audiences required coherent and clear messaging. During the pandemic, the BSP also adapted quickly to necessary changes in communication practices and increased its flexibility to respond effectively and promptly to emerging developments and new information.

**Delivering clear and coherent messaging.** As much as the pandemic required a different mindset in terms of communication priorities, the BSP's mandates were unchanged. Thus, upholding public trust through various initiatives that underscore the BSP's integrity and competence remained at the core of BSP's communications.

Preserving the BSP's credibility amid an uncertain environment requires that the audience understands the rationale behind the policy decisions and regulatory measures implemented. Addressing the concerns of ordinary citizens and engaging them in relevant issues are important for enhancing public awareness and appreciation of the BSP's policies and actions. Through the BSP's strategic use of different communication formats during the crisis, it was able to reach its audiences more effectively. For instance, the CO simplified some of its communication materials and used the Filipino language in some social media posts to enable the BSP to reach a broader audience. Meanwhile, user-friendly explanations about economic concepts and infographics to

<sup>2</sup> Survey conducted from 3 to 8 December 2019



explain the BSP's policy actions improved public engagement with the BSP's communication materials.

In order to ensure information accuracy, the BSP also monitored and responded proactively to the propagation of "fake news". As argued by Trichet (2008), "central banks are prudent in their communication to always preserve their credibility in all circumstances." However, the proliferation of false information, particularly in social media sites and communication applications (i.e., Viber, Messenger) posed a risk to public trust on the BSP. Hence, amid a noisy social media environment, the BSP exerted efforts to monitor and verify posts and information on social media and various communication apps. The CO, in particular, responded actively to relevant public concerns by issuing advisories for mainstream media, social media posts and internal e-mail alerts to BSP employees (Lirios, 2020). Through the release of internal advisories, such as alerts against online scams and SIM card fraud attacks, the BSP was able to contribute to the improved awareness of its employees on relevant public concerns and emerging risks. Tapping the potential of its employees by equipping them with timely and consistent information on important central bank issues and ways to address these challenges helps the BSP in information dissemination. Since BSP employees receive the same internal information from one source, they tend to have the same understanding of key public issues. This, in turn, helps them to communicate confidently and consistently, in line with the BSP's intended messaging.

**Focusing on stakeholders' needs.** Throughout the crisis, the BSP has had to address the immediate information and data requirements of analysts, bankers and financial market participants as well as the queries from the general populace. Regardless of the audience profile, the CO has worked to ensure consistent messaging, designate appropriate spokespersons, confirm facts, disseminate timely information to varied audiences, relay feedback to relevant departments, promote greater understanding of BSP responsibilities and speak clearly at all times.

During the health crisis, the BSP was also able to look more closely into the suitability of its existing communication platforms and align them with the unique preferences of various audiences. The COVID-19 pandemic raised the importance of recognizing the basic information needs of the general public, particularly on issues such as the protection of deposits, access to overseas remittances and how to avail oneself of concessions from banks. For these issues, transparent and clear

communication remains at the core of the BSP's efforts to minimize uncertainty, assuage fears, provide alternatives and express empathy.

The CO came up with audience-centered initiatives during the pandemic. These include (1) audio, video and QR codes on its social media cards for the general public; (2) new content disseminated via corporate email that regularly provided advisories, news summaries and features on central bankers for BSP personnel; and (3) unprecedented access to the Governor himself through a messaging application for the media. To be able to monitor messages and comments on social media more closely, the CO also initiated the daily task of collating comments and classifying them into possible issues that may be forwarded to concerned BSP departments (Lirios, 2020).

Meanwhile, as the BSP's communications also target external stakeholders, the Governor and senior officials of the BSP accepted invites to online meetings and hosted virtual conference calls with various investors, fund managers and credit rating agencies. The BSP also accommodated foreign media interviews, particularly those that are intended to discuss the BSP's policy responses to the COVID-19 crisis. From March to July 2020, the Investor Relations Office (IRO) of the BSP was able to organize a total of 20 meetings, mostly virtual calls and teleconferences between investors and the BSP, and other economic agency officials. During the same period, the IRO was able to coordinate 22 media engagements, including interviews with *Bloomberg*, *CNBC*, *Wall Street Journal*, *Nikkei*, *Financial Times*, *Euromoney* and *The Banker*.

The BSP, through its International Relations Department, also conducted virtual meetings and held collaborative events with other central banks as well as regional and multilateral institutions such as the Association of Southeast Asian Nations (ASEAN), Executives' Meeting of Asia-Pacific Central Banks (EMEAP), International Monetary Fund (IMF), World Bank (WB) and the Bank for International Settlements (BIS). The BSP acknowledges the importance of maintaining open dialogue with these stakeholders as investors, foreign market analysts and other external audiences refer to the reports of these institutions to obtain a more objective view of the state of the Philippine economy.

Virtual fora were also hosted by the BSP for the local business community, diplomatic corps and the broader public through live video streaming in social media accounts of the economic and infrastructure agencies. These allowed the BSP to present timely and relevant updates and outlook on the macroeconomy,

measures pursued by the government in general to address the negative impact of the pandemic on economic activity and the government's economic recovery plan.

Meanwhile, despite the absence of face-to-face interaction amid the quarantine, the BSP was still able to conduct online learning sessions via webinars for educators, who can transmit the knowledge they have gained to their students and other members of their communities. Through the Economic and Financial Learning Center (EFLC), the BSP organized eight webinars from 25 June to end-July, with 1,457 participants. The BSP also launched a program dubbed as "Keeping in Touch while Keeping Distance" under new normal arrangements (NNA) to ensure the provision of information concerning economic and financial matters. The program aims to sustain the BSP's delivery of services to stakeholders while ensuring the safety and well-being of its personnel amid the pandemic. The program redesigned the delivery of learning and materials on economic education to the public through the use of different digital platforms such as web-based and online learning sessions for targeted audiences.

## 2. Challenges to macroeconomic modelling and forecasting during the crisis

Macroeconomic forecasting during normal times is already confronted with significant uncertainty. Turbulent periods such as the COVID-19 pandemic make the task even more difficult. Most, if not all, macroeconomic models employed by central banks and other policy institutions are not designed to directly capture the impact of public health outcomes and government responses to curb a health crisis, along with its effects on consumer and business sentiment, on macroeconomic variables.

Initially, the baseline outlook and alternative scenarios used to assess the possible impact of COVID-19 outbreak on the Philippine economy were based on past episodes of health crises, such as the severe acute respiratory syndrome (SARS) in 2003 and the Middle East respiratory syndrome (MERS) in 2015. The analysis considered mainly external channels such as the impact on trade, remittances, foreign investments and tourism. However, it became evident upon confirmation of local transmission of the virus and upon the implementation of strict

containment measures across countries in March 2020 that the pandemic would have deeper health and economic repercussions, requiring far larger and more drastic government measures to save lives and preserve livelihoods.

Understanding the nature of the macroeconomic shock caused by the pandemic and forecasting its effect over the short and medium term are critical to guiding the BSP's policy response. Armed with this knowledge, the BSP has employed a portfolio of models in its forecasting and policy analysis system. This approach provides the flexibility to use models that are appropriate for a specific problem or question. There is also sufficient scope to incorporate expert judgment by the staff and decisionmakers to complement the models in the toolkit.

Ross and Ross (2020) outline the means by which conventional macroeconomic forecasting can overcome the limitations imposed by a pandemic. First, high-frequency and other granular data can be used to estimate the short-term impact of the pandemic at the industry level. This part also looks at how quarantine measures imposed by governments have affected specific industries. The second step involves aggregating the high-frequency information to estimate the impact of demand and supply shocks. Assumptions on the impact of fiscal and monetary policy measures along with global economic developments are also set in this step. Finally, the estimated aggregate demand and supply shocks are incorporated into a macroeconomic model to generate forecasts of key macroeconomic variables, such as gross domestic product (GDP) and inflation, over the medium term. The BSP has adopted a similar process to generate macroeconomic forecasts during these very uncertain times. Nonetheless, these forecasts are still subject to considerable amount of uncertainty given the evolving nature of the pandemic.

Similarly, the global projection model (GPM) network took the view that the pandemic will have a significant atypical impact on global growth prospects. The COVID-19 crisis was modelled as a combination of shocks to potential output and the output gap, with larger weight given to the former.<sup>3</sup> Shocks were introduced rather than adjusting the calibration of the model to reflect the possible short-term nature of the pandemic.

<sup>3</sup> GPMN, June 2020 forecasts

## 2.1 Significant uncertainty and the role of judgment

Central banks, including the BSP, recognize uncertainty in monetary policy formulation and have adopted different tools to communicate it, such as the publication of fan charts as well as the use of forecast ranges rather than point estimates for inflation and other key major macroeconomic variables.

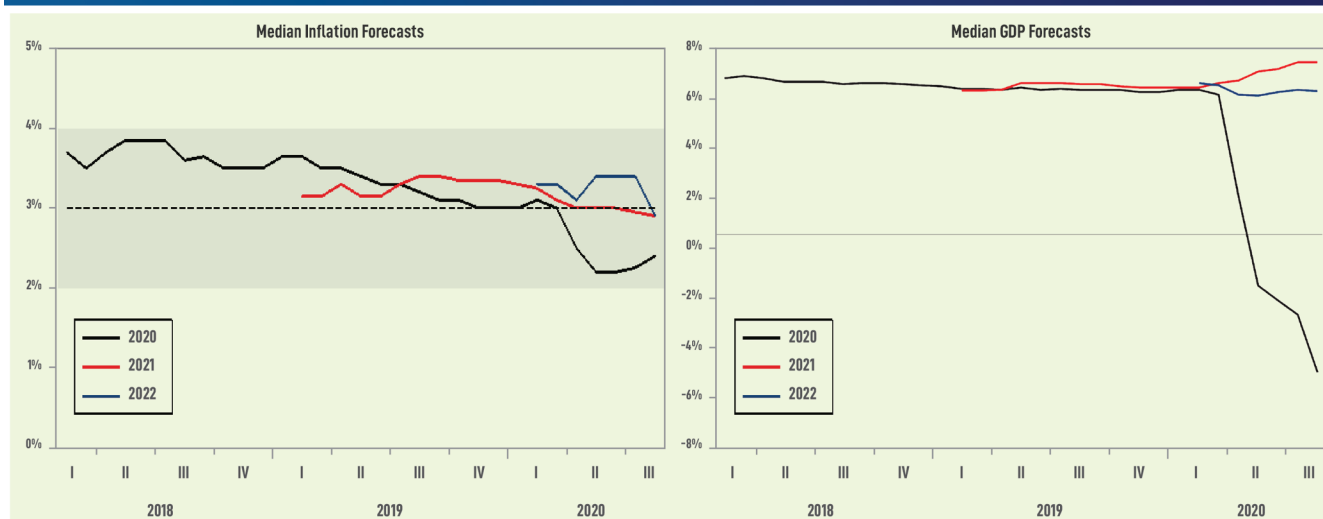
An evaluation of the Bank of England's fan charts for GDP and inflation showed that the forecasts following the global financial crisis (GFC) understated the probability of low GDP outturns and high inflation outturns (BOE-IEO, 2015). This indicates that existing methods that directly factor uncertainty into the projections tend to under-predict extreme events such as the case of the COVID-19 health crisis.

The uncertainty that COVID-19 brings to the macroeconomic outlook is particularly significant. Its economic impact has been unprecedented in terms of scale with deeper-than-expected output contraction in most parts of the world in the first half of 2020. It will not be uncommon to see downward revisions in the growth forecasts of monetary authorities and the private sector alike in

the coming months. At the same time, COVID-19 will figure considerably in the downside risks to growth and inflation in many countries, including the Philippines. Moreover, the resurgence of the virus (i.e., second wave) in many parts of the world that have successfully curbed the epidemiological curve earlier in the year has threatened the economic recovery that is just beginning to take shape by dampening consumer and business sentiments.

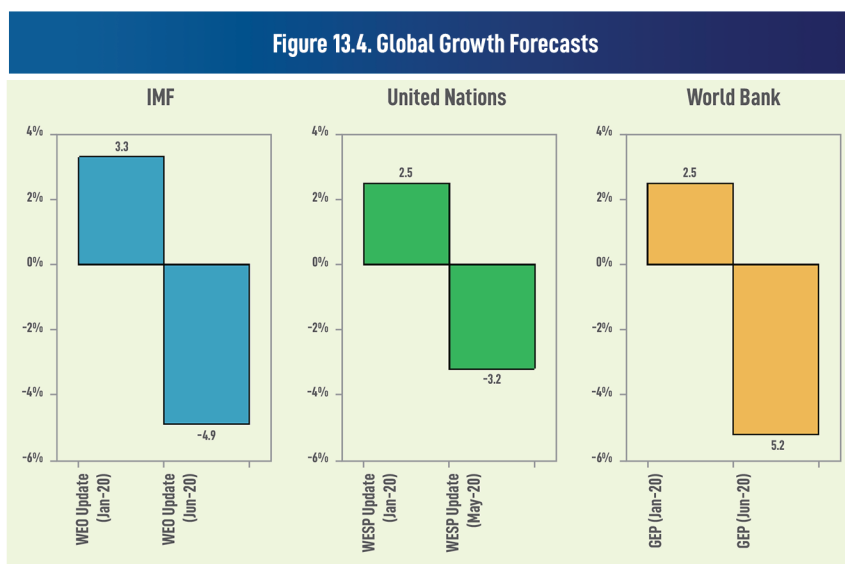
Prior to the start of 2020, private analysts surveyed by Bloomberg expected Philippine GDP to grow by more than 6 percent in 2020 from the year before. However, the expectations were revised downwards as the pandemic wore on. The median forecast for the annual change in GDP fell initially to minus 2.3 percent following the release of the first-quarter 2020 GDP data in May 2020 and subsequently to minus 6 percent after the release of the second-quarter 2020 national accounts in August 2020. The sharp drop in the median forecast was also accompanied by a higher dispersion among the individual forecasts, reflecting the increased uncertainty confronting forecasters. Meanwhile, although inflation expectations for 2020-2022 remained within the government's target range, the median forecast for 2020 dipped closer to the low end of the target range due to the decline in oil prices (Figure 13.3).

Figure 13.3. Bloomberg Survey of Professional Forecasters on Philippine Inflation and GDP Growth



Source: Bloomberg

Multilateral institutions also revised downwards their forecasts of global economic activity at an unprecedented scale. The IMF, United Nations and World Bank (WB) projected world GDP for 2020 to grow by 2.5-3.3 percent in their publications last January 2020. These forecasts were subsequently downgraded to declines of 3.2-5.2 percent after several months due to the severity of the impact of the pandemic on the world's major economies (Figure 13.4).



Sources: IMF. *World Economic Outlook Update*. January 2020 and June 2020.

United Nations. *World Economic Situations and Prospects*. January 2020 and May 2020.

World Bank. *Global Economic Prospects*. January 2020 and June 2020.

Pohlman and Oliver (2020) attribute the sudden and massive adjustments in the expectations of forecasters to (i) the speed of the impact of the pandemic and the subsequent responses of policymakers; (ii) how the pandemic has undermined the reliability of available economic data; and (iii) the process learning from the field of epidemiology. While the divergence in economic forecasts could narrow down in subsequent quarters as analysts' understanding of how the virus has affected economic conditions, a return to the pre-pandemic levels of consensus among forecasters could be unlikely. Moreover, forecasts are more likely updated at a higher frequency but with a lower degree of confidence as more information on the impact of the pandemic emerges.

## 2.2 Use of high-frequency indicators

The BSP uses a range of nowcasting models for GDP growth and its components to assess the near-term impact of the COVID-19 pandemic on domestic economic activity. These models depend on high-frequency indicators, such as the Purchasing Manager's Index (PMI), volume of production in manufacturing, electricity sales, government disbursements and other economic and financial variables. To assess the impact of the lockdown, the BSP has also used input-output (I-O) tables to determine the loss in the gross value added in the different sectors due to the quarantine measures. The nowcasts, together with external judgment from technical staff, are then incorporated as initial conditions for the BSP's medium-term forecasting models.

However, the COVID-19 pandemic had posed a challenge on the generation of reliable data used for monitoring and forecasting. The implementation of quarantine measures prevented or delayed the timely collection and release of important official statistics, which could introduce further uncertainty to the macroeconomic forecasts. The BSP, for example, could not conduct its expectations surveys of businesses and consumers in the second quarter of 2020 as prevailing quarantine measures restricted the mobility and availability of employees and respondents. The monitoring of price statistics by the Department of Agriculture (DA) and Department of Trade and Industry (DTI) were also hampered by the lockdown. Data on other relevant indicators such as tourist arrivals and spending were also suddenly unavailable or considerably delayed given the shutdown of airports and tourism-related establishments.

## 2.3 Ensuring the availability of and access to relevant and timely data

The analysis of the COVID-19 pandemic and its consequences underscores the importance of ensuring the availability of and access to information during crises. For the BSP and other central banks, statistical data and related analysis are a critical element in most functions such as monetary policy formulation, financial supervision, macroprudential policy, payment systems oversight and lender-of-last-resort functions. They are also often both a user and a producer of statistical data series.

Results of media analytics indicate that there have been numerous efforts in the Philippines to provide information on COVID-19 and the responses associated with different government agencies, LGUs, the academe as well as the media. However, information was sometimes inconsistent, incomplete, or vague (Inter-Agency Task Force Working Group, 2020).

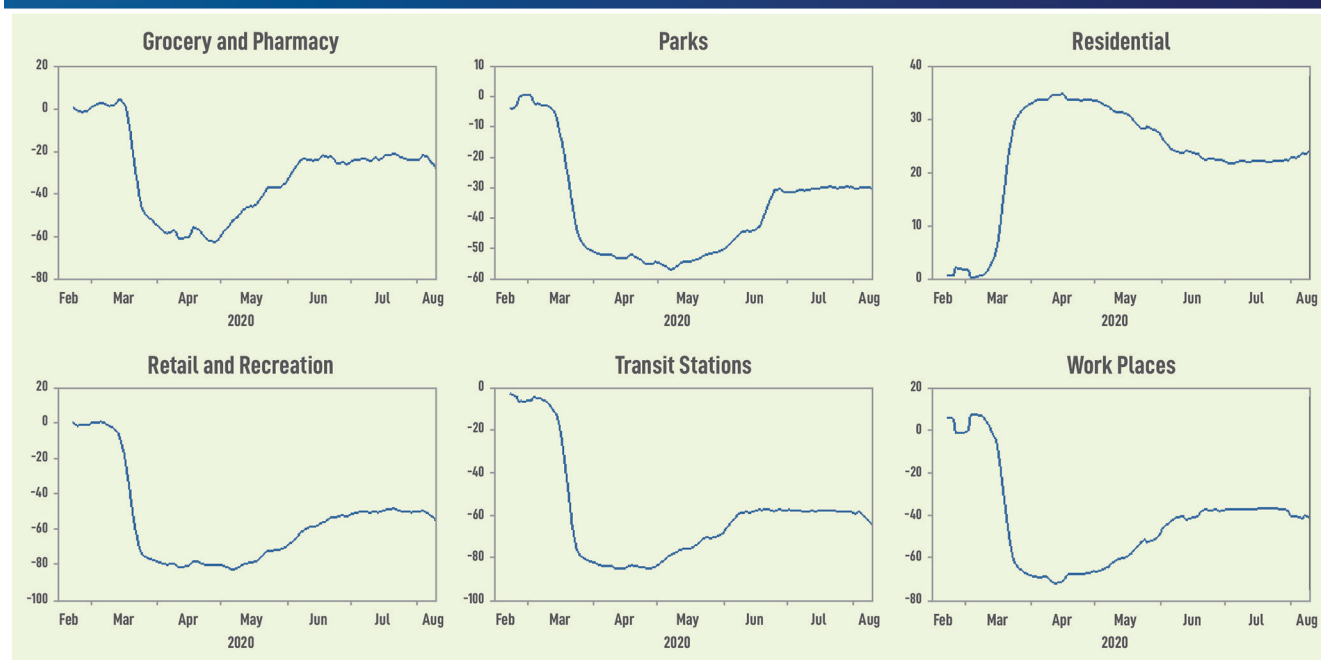
For its data requirements, the BSP continues to coordinate with other government agencies as well as the private sector. Key economic indicators and analytical reports provided by statistical authorities and policymaking bodies including the Philippine Statistics Authority (PSA), the National Economic and Development Authority (NEDA) and the Department of Finance (DOF), among others, allow the BSP to form reasonable assumptions for its data-dependent monetary policymaking process. The BSP has also worked closely with the private sector, particularly BSFIs, to gather data and reports that could help in the assessment of the status of the domestic financial system.

Meanwhile, the unprecedented nature of the crisis and the lags in the publication of official statistics presented the opportunity to use non-traditional data sources

such as Google's Mobility Reports (Figure 13.5) and price statistics from online grocery stores. The BSP's access to accurate information on public health as well as mobility reports, in addition to the usual key macroeconomic indicators, played a critical role in its swift and decisive policy responses to the pandemic.

The mobility indicators were incorporated in the generation of the sectoral nowcasts for GDP growth as they provided insights on how economic activity had evolved following the loosening of virus containment measures. In particular, the data show a marked decline in mobility as the pandemic struck beginning in March 2020. This suggests that Filipinos have preferred to stay at home amid the quarantine measures, which could have implications on households' propensity to spend and firms' investment decisions going forward.

**Figure 13.5. Google Mobility Indicators for the Philippines, February–August 2020**



Source: Google Mobility Reports

### 3. Coordination among fiscal, monetary and regulatory authorities during crisis and in the unwinding phase

The heterogenous regional and local impact of the COVID-19 pandemic has important consequences for the government's policy responses and crisis management strategy. The varied sectoral effects of the crisis underscore the need for stronger intergovernmental coordination and societal cooperation. The Organisation for Economic Co-operation and Development (OECD, 2020) characterized the dimensions of the heterogeneous effects of the COVID-19 pandemic into health or social impact, economic impact and fiscal impact:<sup>4</sup>

- **Health or social impact.** Some regions such as poor urban areas tend to have higher COVID-19 caseloads and mortality rates than in other areas.
- **Economic impact.** Regional economic exposure to the pandemic varies based on the location's exposure to global value chains and specialization in specific industries such as tourism and foreign trade.
- **Fiscal impact.** The impact of the crisis on subnational finance—i.e., increased expenditures and reduced revenues—is not uniform but expected to be long-lasting.

Government agencies and local government units (LGUs) are responsible for the critical areas of health care, disease containment measures and provision of social services, among others during the pandemic. Meanwhile, fiscal and monetary authorities are mandated to craft policies that would complement the government's health and social welfare responses to the pandemic. Since such responsibilities are shared among the different levels of the government, coordinated efforts are crucial.

Among policymakers, coordination helps in establishing the distinction as well as the complementarity between monetary and fiscal measures as well as other regulatory initiatives. However, when there is a growing nexus between fiscal and monetary policies, central banks need to maintain their independence and credibility, particularly during periods of elevated uncertainty. This can be achieved through (1) fiscal sustainability and (2) central banks' focus on its primary mandates (Carstens, 2020).

Fiscal sustainability must be assured to avoid perceptions that the central bank is monetizing the debt and thus endangering its price stability objectives. Achieving fiscal sustainability requires strong intertemporal fiscal strategies (i.e., effective public expenditure management, sound revenue policies) and ample support to boost the country's growth potential.

Meanwhile, central banks need to ensure that their policy actions are made in the context of the framework that supports their mandates. To address the economic impact of the pandemic, the BSP has justifiably adjusted monetary policy settings to support growth amid benign inflation outlook. At the same time, its mandates do not preclude it from working closely with fiscal authorities in a whole-of-government approach to address the socioeconomic impact of the pandemic.

The NG's Philippine Program for Recovery with Equity and Solidarity (PH-PROGRESO)<sup>5</sup> embody this coordinated, whole-of-government approach to combatting the pandemic, with clearly delineated objectives and responsibilities for the different government agencies and institutions. Line agencies are in charge of implementing emergency support for vulnerable groups as well as the procurement and distribution of resources needed to fight the consequences of the COVID-19 health crisis. Meanwhile, fiscal and monetary authorities are tasked to ensure ample liquidity and funding to help finance the relevant initiatives to keep the economy afloat. Congress is also involved, as it is enjoined to pass necessary legislation to support the NG's economic recovery plan.

#### 3.1 BSP's participation in DBCC meetings during the quarantine period

Interagency coordination meetings have become more frequent amid the pandemic, signifying the importance of coherent policymaking among the country's economic managers. For its part, the BSP has continued to actively participate in various meetings of the Development Budget Coordination Committee (DBCC) and its subcommittees. As a resource institution, the BSP provides recommendations on the set of medium-term macroeconomic assumptions to be adopted by the DBCC, including those on inflation, Dubai crude oil prices, peso-dollar exchange rate, interest rates and trade in goods and services, among others (DBM, 2020). These assumptions, in turn, are

<sup>4</sup> OECD. OECD Policy Responses to Coronavirus, The Territorial Impact of COVID-19: Managing the Crisis Across Levels of Government. 16 June 2020

<sup>5</sup> Put together by the country's economic managers including the NEDA and DOF, PH-PROGRESO or the Philippine Program for Recovery with Equity and Solidarity refers to the NG's recovery plan amid the COVID-19 pandemic. The program includes four pillars namely, (1) emergency support for vulnerable groups; (2) resources to fight COVID-19; (3) fiscal and monetary actions; and (4) economic recovery plan. Given the comprehensive nature of the program, it involves a number of line agencies such as the Department of Trade and Industry (DTI), Department of Agriculture (DA), Philippine Health Insurance Corp. (PhilHealth), Social Security System (SSS), Technical Education and Skills Development Authority (TESDA), Department of Labor and Employment (DOLE) and the BSP.



used as inputs in the generation of domestic growth projections by the NEDA and the fiscal program by the DOF, culminating in the crafting of the annual national budget.

Aside from its participation in intergovernmental meetings, the BSP also contributes to various DBCC publications, in line with the BSP's thrust to promote transparency and accountability. Finally, the BSP has also participated in online press briefings organized by the DBCC to address press queries relating to the BSP's macro assumptions and policies.

### 3.2 Coordination between the BSP and its other stakeholders

Through strong coordination with other government agencies, the BSP was able to draw the boundaries of its responsibilities while ensuring the public of its solid support for the NG's comprehensive response against the COVID-19 outbreak. By establishing its clear role as an independent central bank, the BSP also received timely and extensive support from international financial institutions such as the IMF, the Asian Development Bank and the BIS. Meanwhile, information exchange on how other central banks are responding to the effects of the COVID-19 crisis has also served as a learning platform for monetary authorities.

The BSP also coordinated closely with the private sector, particularly with banking industry groups, to ensure the availability of withdrawal and payments services despite the implementation of lockdowns in many parts of the country. The BSP maintained constant communication with the Bankers Association of the Philippines, Chamber of Thrift Banks and Rural Bankers Association of the Philippines for the banking industry's cash requirements during the pandemic (BSP, 2020). Moreover, through regular information exchanges with BSFIs, the BSP was able to respond more effectively to the banking needs of the general public and assess the soundness of the domestic banking industry.

### 3.3 Coordinated efforts to transition to the "new normal" state

Recognizing the importance of coordinated efforts during the pandemic as well as in the recovery phase, the government formed the IATF Technical Working Group for Anticipatory and Forward Planning (IATF-TWG-AFP). The group, which consists of the BSP along with other government institutions<sup>6</sup> and individuals from the private sector and academe, aims to characterize how the "new normal"

would affect each segment of the population. Based on this, the TWG will recommend programs and strategies to promote confidence in the health system through data analytics, recommend initiatives to rebuild consumer and business confidence and to adapt to a "new normal" state of economic activities.

Meanwhile, building on the work of the IATF-TWG-AFP, the NEDA-led Task Group on Recovery is leading the formulation and monitoring of the government's "Recharge PH" program.<sup>7</sup> The program aims to refocus, sharpen the design and accelerate the implementation of programs under the 2020 General Appropriations to mitigate the effects of the pandemic and help the domestic economy recover from the sharp GDP contraction in the second quarter of 2020. The subtasks groups (STGs) created under the program will ensure the complementation and convergence of efforts of government agencies and other task groups and provide coordinated recommendations to the National Task Force on COVID-19 (NEDA, 2020).

Bringing government agencies and LGUs under one umbrella to organize relief and recovery initiatives would help the NG save time, resources and effort. However, despite the government's concerted policy response against the health crisis, near-term and long-term challenges remain which would crucially depend on the evolution of the pandemic.

## 4. Conclusion

Strategic communications, forecasting and solid intergovernmental coordination complement sound policymaking. Fiscal policies need to be sustainable and responsive to the pandemic shock, without jeopardizing future economic growth. Governments may create intertemporal fiscal strategies, managing future spending and crafting sound revenue policies. At the same time, the government should implement structural reforms to buoy potential growth rates, minimize the closure of healthy businesses and orient fiscal policies towards investment, maintaining global supply chains and protecting free trade. (Carstens, 2020).

Meanwhile, central banks need to remain credibly focused on maintaining macroeconomic stability, with actions consistently in line with price and financial stability mandates.

<sup>6</sup> Led by NEDA, the IATF-TWG-AFP consists of the following: BSP; Departments of Science and Technology, Trade and Industry, Education, Health, Budget and Management, Finance, Agriculture, Tourism, and Information and Communications Technology; National Intelligence Coordinating Agency; and University of the Philippines Resilience Institute.

<sup>7</sup> The Recharge PH Program is to be implemented within 2020 and into 2021 and will be reflected in the Updated Philippine Development Plan 2017-2020

Nevertheless, the COVID-19 pandemic has taught policymakers that policy is most effective when it is clearly understood and believed by the public. For the BSP, coherent and credible information about the considerations behind monetary policy decisions, including explanations and forecasts on inflation and economic activity, help in enhancing the public's understanding and appreciation of monetary policy and in anchoring inflation expectations. For central bank communications to be credible, messaging needs to be consistent and clearly aligned with policy actions and the agency's mandates. Consistent and credible

messaging, in turn, requires strong coordination within the institution as well as among various external stakeholders, including other government agencies and the private sector.

Moving forward, an optimal exit strategy should be one that is induced by a favorable macroeconomic environment (Carstens, 2020). Nevertheless, such scenario can only be attained through careful planning, solid intergovernmental coordination and credible communication which encourages whole-of-society cooperation.

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# **Conclusion: Central Banking in the New Normal**

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CHAPTER  
**FOURTEEN**



## 1. Introduction

The impact of shocks on the economy can be either temporary or long-lasting. Temporary shocks can either require stabilization policy or simply facilitate markets' adjustment back to equilibrium. For example, transitory disturbances such as supply or demand shocks necessitate management tools, including monetary policy, which can be adjusted to help achieve objectives such as price stability.

On the other hand, long-lasting shocks can be structural, for which a rethinking of the current ways of doing things would be more advisable. For instance, when macroeconomic and financial disturbances reach a scale and complexity that alter the structural relationships between key economic variables, authorities may need to embark on a delicate balancing act of anchoring long-term expectations while flexibly addressing the crisis at hand. In this case, it would be crucial for central banks to be mindful of the hierarchy between the two key elements of monetary policy strategy: objective and conduct (Coeure, 2013). A credible central bank with a firm and stable commitment to its monetary policy objective can employ flexibility in the conduct of monetary policy to address specific economic shocks. For instance, the US Fed, confronted with the effective zero lower bound, resorted to massive asset purchases or quantitative easing (QE) to provide the much needed monetary stimulus for the US economy (Fernandez, 2015). Thus, non-conventional monetary policies such as the quantitative easing (QE) employed by the Fed in the wake of the global financial crisis (GFC) would not result in unanchored market expectations. However, such policies can still be viewed by the market as a departure from the established strategies of monetary policy.

Numerous conventional and non-conventional policies have been implemented in response to the multitude of shocks to the global economy in the last century.

- The abandonment of the Gold Standard by then US President Franklin Roosevelt in response to the economic collapse in the wake of the Great Depression in the 1930s paved the way for activist Keynesian policies, particularly increasing economic output by boosting aggregate demand through government deficit spending in times of low private investment or consumption.

- In the aftermath of the GFC, the US Federal Reserve (Fed), in an attempt to stimulate economic activity while restrained by the zero lower bound, embarked on unconventional monetary policy involving large-scale purchase of securities from the market to increase money supply and encourage lending and investment.

Likewise, the Philippine economy was not spared from significant shocks in the recent decades. In 1997, even as the contagion that developed into the Asian financial crisis (AFC) exposed systemic vulnerabilities in the country's domestic economy, specifically on the financial system, external payments and fiscal imbalances, policy makers mitigated the impact of the crisis through measures to enhance transparency, conform prudential regulations with international standards and adopt administrative regulations to strengthen the banking and financial sectors (Alburo, 1999).

In 2008, since the impact of the GFC on the Philippine economy is relatively subdued due to less exposure of the country's financial markets to derivatives and structured products (Guinigundo, 2009), the BSP employed conventional monetary policy measures such as policy rate reductions and liquidity-enhancing measures. However, to promote stability in the banking sector and boost consumer confidence in banks, deposit insurance per account was doubled from ₱250,000 to ₱500,000 a few months after the onset of the crisis.

This year, the global economy, including that of the Philippines suffered the unprecedented shock of a health crisis brought about by the COVID-19 pandemic. Almost all the countries in the world are affected by the virus. The public health emergency is not expected to last forever, but central bankers need to think of new ways to respond to the effects of the pandemic while remaining committed to their mandate. There is a need to reassess the speed of monetary actions. In the past, calibrated and measured actions took into consideration the impact of previous policy actions on the economy. The current shock requires a fast response. In terms of risk management, authorities must prepare for the worst scenario.

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Traditionally, central banks have generally focused on three main objectives or functional roles, namely: 1) maintain price stability subject to a monetary regime in operation; 2) promote financial development and safeguard financial stability; and 3) achieve stability and support the government's financing needs during crises (Goodhart, 2010).

Over time, the balance between these tasks has shifted in favor of the first two functions. However, the recent unfolding of COVID-19 pandemic has once again underscored the role of central banks as agents of macroeconomic stability during crisis periods. The health emergency has turned out to be unlike any other crisis we have observed in recent history. While the pandemic is foremost a global health crisis, the necessary measures to contain the spread of the deadly virus have severe economic and financial consequences. Thus, it has morphed into a two-pronged health and economic crisis (Berglof & Farrar, 2020).

First, the pandemic has quickly escalated to what Baldwin and Weder di Mauro (2020) refer to as "everybody's problem." Total positive cases as of 31 August 2020 has reached 25.2 million, affecting more than 188 countries worldwide.<sup>1</sup> To contain further transmission of the virus, most of these countries have imposed lockdown and social distancing measures. These disruptive steps have inevitably led to immediate financial and economic difficulties.

The impact of the pandemic was first felt in forward-looking financial markets. Global financial markets experienced sharp volatility when the World Health Organization officially declared the coronavirus outbreak a pandemic on 11 March 2020. Shortly thereafter, the Chicago Board Options Exchange Volatility Index (VIX), which is also known as the fear index, sharply increased to 82.7 on 16 March 2020 relative to its end-December 2019 value of 13.78 (Figure 14.1).

The pandemic and the lockdown measures implemented have dragged the global economy into a recession. In its latest World Economic Outlook (WEO) dated June 2020, the International Monetary Fund (IMF) revised its global growth

<sup>1</sup> Coronavirus Resource Center. Johns Hopkins University. <https://coronavirus.jhu.edu/map.html>

Figure 14.1. CBOE Volatility Index (VIX)



Source: CBOE

forecasts, projecting a contraction of 4.9 percent in 2020 compared with its projection of a 3 percent decline last April 2020. Recovery is expected to be very gradual and highly contingent on the successful containment of the coronavirus. Meanwhile, the World Bank (WB) envisions a 5.2 percent contraction in global GDP for 2020, the deepest global recession in decades.<sup>2</sup>

Second, the pandemic could potentially have more persistent and lingering effects on the economy. In the absence of a cure or vaccine, households and businesses will continue to face considerable uncertainty and downside macro risks. These include fear of further job losses or business failures, and the possibility of a renewed escalation of the outbreak that requires some lockdown measures to be reimposed. Moreover, the pandemic could trigger more permanent and structural changes in the labor market. According to Haldane (2020), the pandemic has shifted relative prices that incentivize firms to invest in machines instead of people, thereby potentially lowering employment and labor

<sup>2</sup> This is based on WB's latest Global Economic Prospectus released last June 2020.

productivity. Eventually, lower income for households and firms can be translated to a greater incidence of loan defaults and depressed consumption which could threaten financial stability and trigger a further economic recession. Likewise, the pandemic could have a more permanent impact on key sectors such as tourism, hospitality and retail. Concerns over COVID-19 transmission could force these sectors to restructure or completely change their business models.

The unprecedented nature of the pandemic has forced central banks all over the world to take sweeping measures to ensure sufficient liquidity, restore market confidence, alleviate financial market stress and support economic activity. This ability to marshal a series of forceful and timely responses makes central banks effective crisis managers (Rajan, 2020). For instance, during the GFC, central banks were at the forefront of lowering interest rates aggressively and resorting to non-conventional monetary tools such as quantitative easing to help contain systemic risks and successfully avert a global financial meltdown.

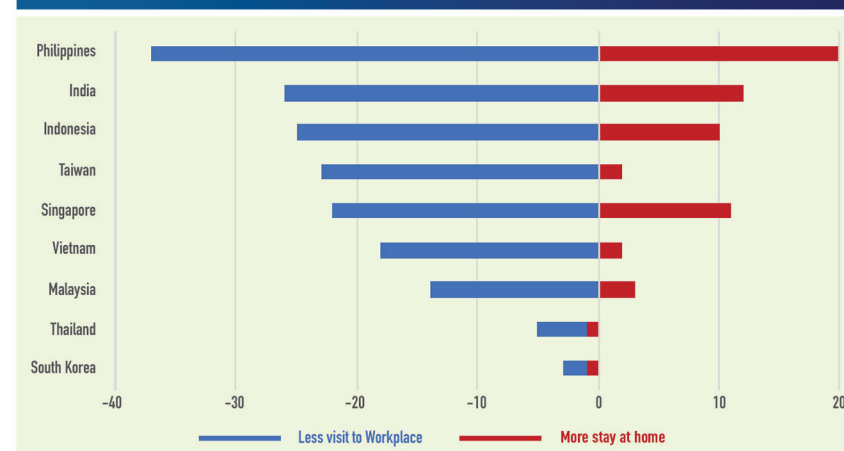
However, the unique character of the pandemic poses unfamiliar challenges for central banks and raises important issues about the conduct of monetary policy in these challenging times. These issues touch on economic, intellectual and institutional aspects of central banking which Borio (2019) refers to as a triple challenge.

It is therefore imperative that central banks bring these issues to the fore of policy agenda. Efforts to develop guidelines or frameworks on effective crisis response would not only enhance central banks' ability to manage economies during tail events but also enable them to successfully navigate this so-called "new normal," which the pandemic has ushered in. This book aims to contribute to this effort by sharing the Bangko Sentral ng Pilipinas' (BSP) experience in responding to the COVID-19 pandemic.

## 2. Impact on the Philippines

The Philippines was one of the first countries in Asia to impose lockdowns and restrictive containment measures. The national government (NG) quickly placed the major parts of the country under enhanced community quarantine (ECQ) on 16 March. Data on mobility trends as of 25 August 2020 indicate that the country had the largest decline in visits to the workplace and the most significant increase in the length of time that people stayed at home among other countries in ASEAN-4 (Figure 14.2).

Figure 14.2. Change in Visits to Workplace and Length of Stay at Home



Source: Google Mobility Data<sup>3</sup>.

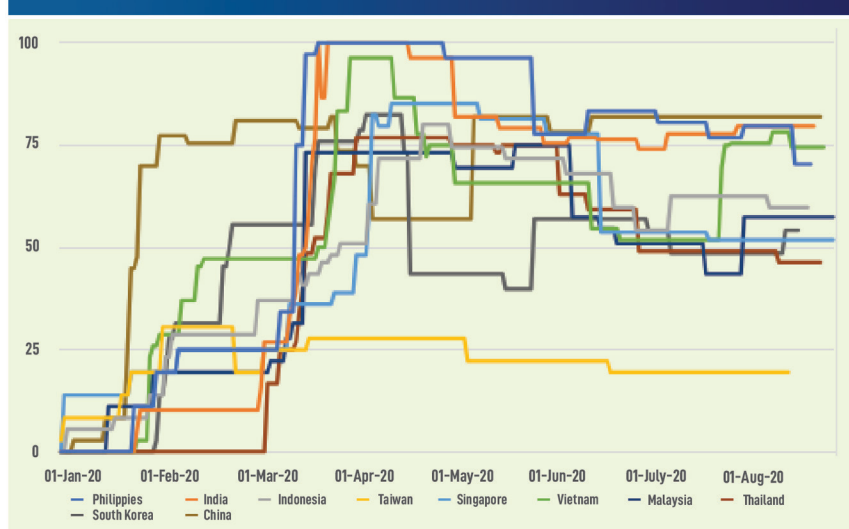
Likewise, based on the COVID-19 government response stringency index, the Philippine's national government (NG) implemented the strictest lockdown response compared to other Asian countries.<sup>4</sup> The index for the Philippines peaked at 100 index points from 22 March to end-April 2020 and remain elevated at 70.4 index points as of 25 August 2020 (Figure 14.3).

<sup>3</sup> Note: Figure 14.2 shows the percent change in visits to the workplace and length of stay at homes compared to the baseline period since the declaration of a pandemic outbreak by WHO on 11 March 2020. The baseline is the median value from the 5-week period 03 Jan – 06 Feb 2020.

<sup>4</sup> This index is a composite measure of different metrics, each taking a value between 0 and 100. A higher score indicates a stricter government response (i.e., 100 = strictest response).



Figure 14.3. Covid-19 Government Response Stringency Index



Source: Thomas Hale, Sam Webster, Anna Petherick, Toby Phillips and Beatriz Kira (2020).  
Oxford COVID-19 Government Response Tracker, Blavatnik School of Government.

## 2.1 Impact on the real economy

The pandemic and lockdown measures imposed by the NG adversely affected domestic economic activity. The country technically entered a recession as GDP contracted by 16.5 percent in the second quarter of 2020 from the same period the previous year. This is the largest decline ever recorded since the 10.7-percent drop in 1984.

Domestic demand, which has been the main driver of the country's growth, sharply declined due to the historic drop in consumption (-15.5 percent), capital formation (-54.6 percent) and total exports (-37.0 percent). These were partly offset by higher government spending (+22.1 percent) and lower imports (-40.0 percent). On the production side, industry (-22.9 percent) and services (-15.8 percent) registered their biggest drops in history. Meanwhile, agriculture (+1.6%) recovered slightly after declining in the first quarter of 2020.

Most ASEAN countries are seeing their growth forecasts this year revised downward. A synchronized deep downturn in 2020 is taking place, in both advanced economies, emerging market and developing economies. Among the

Asian economies, India (-23.9 percent) suffered the largest decline, followed by Malaysia (-17.1 percent) and the Philippines (Figure 14.4). The pandemic has so far brought immediate disruptions in economic activities across the region, as evident in the decline in tourism flows, disruption in air travels and weakening consumer and business confidence. Several countries imposed lockdowns, community quarantines, stay-at-home orders, temporary business closures and travel restrictions or prohibitions to contain the virus. Beyond the direct disruptions caused by travel and mobility restrictions, interruptions in normal business operations, contraction in demand as well as breaks in supply chain connectivity may also be caused by measures introduced by governments. These measures aim either to mitigate the spread of the pandemic or to avert supply shortages of medical and food supplies for the domestic market.

Figure 14.4. Real GDP of Selected Asian Countries (% Year-on-Year Change)



Sources: Various Statistical Agencies and Bloomberg

## 2.2 Impact on domestic financial markets

Concerns over the pandemic and ECQ were quickly reflected in key domestic financial markets. The Philippine Stock Exchange Index (PSEi) sharply declined to an eight-year low of 4,623.42 points on 19 March from 7,815.26 points on 31 December 2019 (Figure 14.5).

Figure 14.5. Philippine Stock Exchange Index (PSEi)



Source: Bloomberg

A temporary increase in risk premium in the local debt markets was also observed. The Philippines' 10-year bond yield slightly increased to 5 percent on 2 April. While the yield eased to 4.5 percent on 8 April, it remained slightly elevated relative to the 4.4 percent yield last 31 December 2019. Credit spreads in the dollar funding markets also followed a similar trend. The Emerging Market Bond Index or EMBI for Philippine (debt) spreads rose sharply from 69 basis points (bps) on 31 December 2019 to 302 bps on 23 March before moderating to around 200 shortly thereafter. (Figures 14.6 and 14.7).

Figure 14.6. Philippine 10-Year Bond Yields (%)



Source: Bloomberg

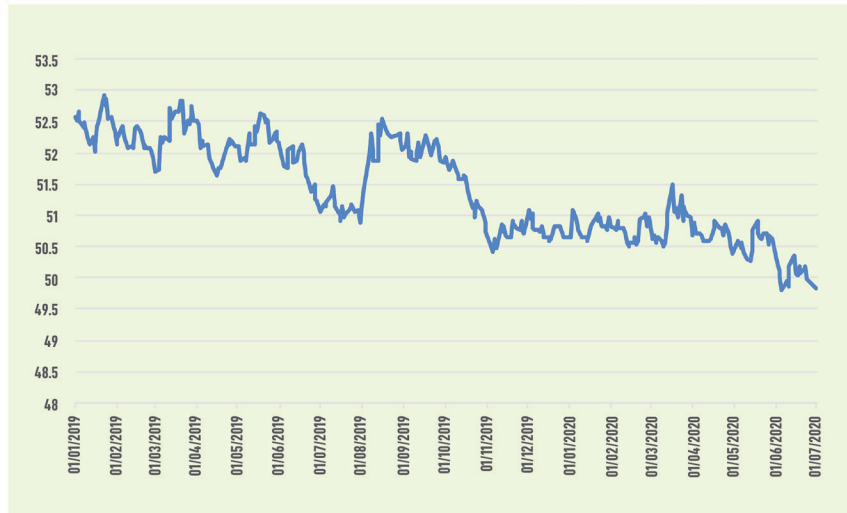
Figure 14.7. EMBI + Philippine Spread (bp)



Source: Bloomberg

Meanwhile, the domestic currency remained broadly stable amid the COVID-19 pandemic. From its 31 December 2019 level of ₱50.64 per US dollar, the peso appreciated to ₱48.85 in late June. This is in stark contrast to a depreciation of most Asian currencies against the US dollar during the height of the pandemic (Figures 14.8 and 14.9).

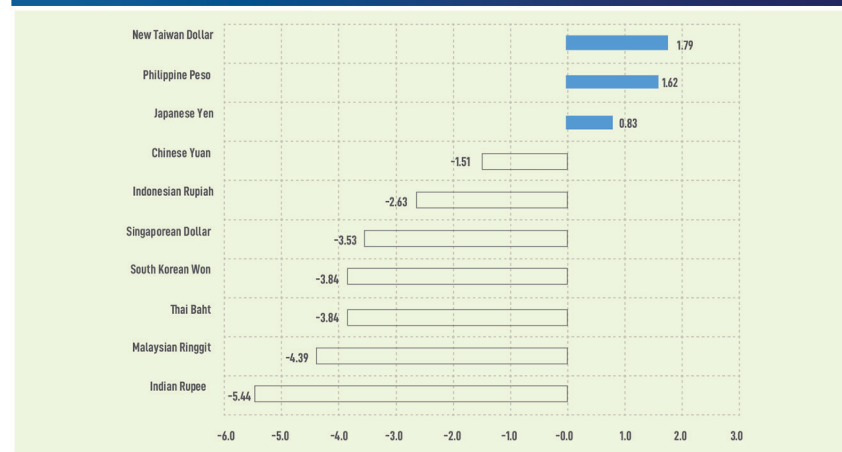
Figure 14.8. Peso per US Dollar



Source: Bloomberg

The sharp increase in financial market volatility was felt across all countries in the region, particularly from March to April 2020. Foreign exchange volatility increased sharply for ASEAN-4 economies (consisting of the Philippines, Indonesia, Malaysia and Thailand), with the Indonesian rupiah exhibiting the

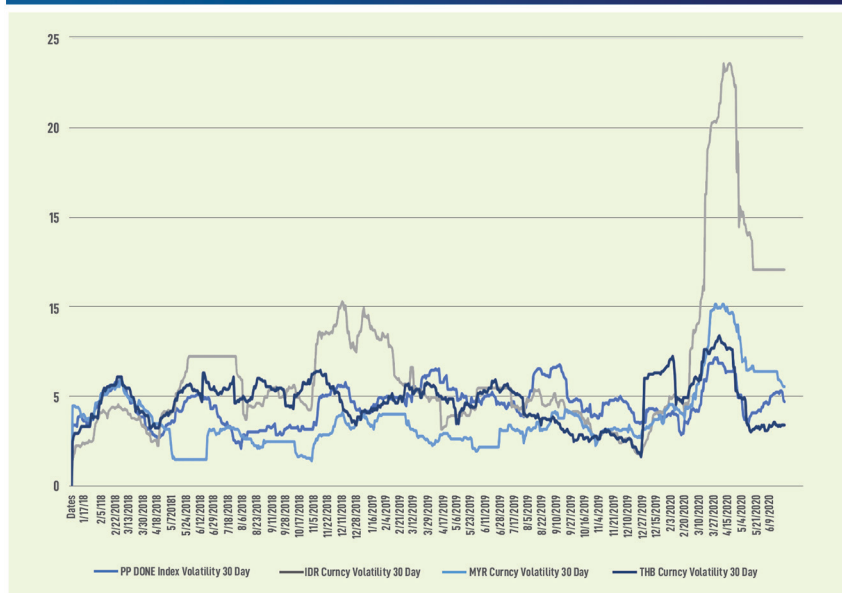
Figure 14.9. Asian Currencies vs. the US Dollar, as of 30 June 2020



Source: Bloomberg

largest volatility. It is worth noting that the Philippine peso was the least volatile among the four currencies. A similar trend was observed in the equities market, as volatility in equities increased sharply for all ASEAN-4 economies during the same period (Figures 14.10 & 14.11).

Figure 14.10. FX Volatility of the ASEAN-4



Source: Bloomberg

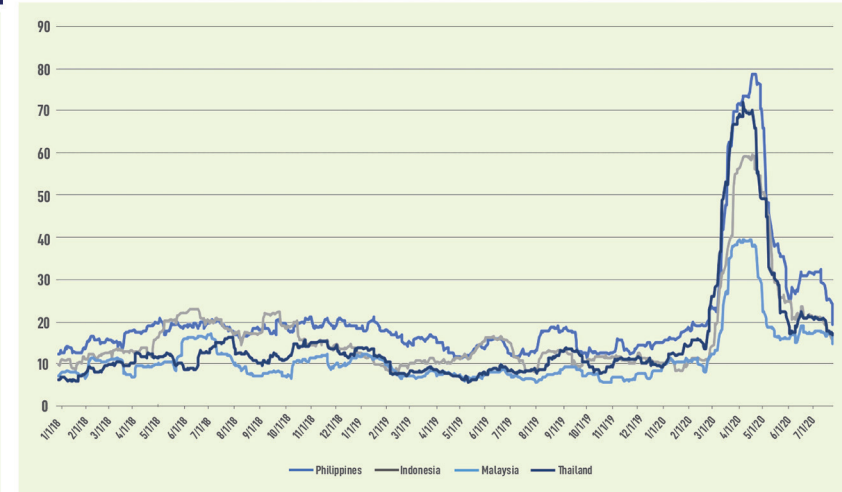
### 3. The impact of the BSP's COVID-19 response

Recognizing the unprecedented nature of the pandemic's economic and financial shocks, the BSP undertook timely and decisive measures to ensure adequate domestic liquidity, shore up market confidence and sustain the flow of credit to support growth. These measures include a mix of monetary policy tools and regulatory relief and forbearance.

In particular, the BSP has reduced the policy rate four times in 2020, bringing the cumulative rate reduction to a total of 175 bps. Likewise, the reserve requirement ratio (RRR) of universal and commercial banks (UKBs), as well as non-bank financial institutions with quasi-banking functions, was reduced by 200 basis points from 14 percent to 12 percent in April 2020.<sup>5</sup> In accordance with its charter, the BSP also provided bridge financing to the national government and participated in the secondary market for government securities. However, the ample monetary policy space meant that the BSP has not had to resort to

<sup>5</sup> The RRR was already previously cut by 600 bps in 2018-2019.

Figure 14.11. Equities Volatility of the ASEAN-4



Source: Bloomberg

non-conventional measures to combat the dire economic implications of the COVID-19 pandemic. The bridge financing is subject to limits as stipulated in the BSP charter while the purchase of government securities is provided for under the BSP's powers under open market operations.

As mentioned in the earlier chapters, the BSP has also introduced regulatory relief and forbearance in the form of relaxation of regulations for BSP-supervised financial institutions (BSFIs). This aims to ease the impact of the pandemic on banks and other financial institutions and ensure they can maintain their financial health.

While the full impact of the BSP's response on the real economy remains to be seen, initial assessments indicate that its quick and forceful monetary response resulted in an observed easing and improvement in domestic liquidity conditions.

Table 14.1 presents an analysis of variance (ANOVA) on key financial market variables to assess the impact of the BSP's asset purchases on domestic financial markets. This exercise tests for the equality of means of selected financial market variables between the pre-asset-purchase period (13-23 March) and the post-asset-purchase period (24 March-8 April).<sup>6</sup>

**Table 14.1. Analysis of Variance Pre- and Post-BSP Asset Purchases<sup>7</sup>**

	Philippine Stock Exchange (PSEi)		Philippine Stock Exchange Volatility		USD/Php Exchange Rate		USD/Php Exchange Rate Volatility	
	Level	Growth	Level	Growth	Level	Growth	Level	Growth
Difference in Means	306.28	0.302	21.21	-0.09	-0.70	-0.00214	-1.49	-0.08
F-Statistic	4.37**	8.80***	93.11***	10.78***	65.10***	1.29	13.72***	17.83***
	5 Year Credit Default Swap		Interbank Call Loan Rate (IBCL)		Emerging Market Bond Index (Philippines)		Philippine 10 Year Bond Yield	
	Level	Growth	Level	Growth	Level	Growth	Level	Growth
Difference in Means	-40.76	-0.096	-0.575	-0.022	-36.72	-0.1166	-0.512	0.016
F-Statistic	50.08***	5.09**	16.71***	1.39	9.81***	23.32***	5.37**	16.43***

Source: BSP Staff Estimates

The results indicate the following:

- **PSEi and PSEi volatility.** After the BSP's asset purchases, the PSEi tended upwards, increasing by roughly 306.28 points compared with the start of the quarantine. This translates to a recovery of about 30.2 percent, and shows the PSEi quickly recouping its losses during the start of the quarantine period. While the volatility of the PSEi may have increased, the index has stabilized at a much a higher level than the 8-year low experienced before the asset purchases.<sup>8</sup>
- **Peso exchange rate and peso volatility.** The Philippine peso strengthened vis-à-vis the US dollar, appreciating by roughly 0.70 pesos post asset purchase. The volatility likewise decreased by around 8 percent since the start of quarantine.

- **Interbank call loan rate (IBCL).** The IBCL declined by roughly 0.575 percent and contracted by around 2 percent since the asset purchases. This suggests that the lending rates between banks have eased which may have potentially encouraged greater lending among banks.
- **5-Year credit default swap (CDS).** The credit default swap decreased by 40.76 suggesting an improvement in market conditions as investors are less wary of investments defaulting vis-à-vis before the BSP's asset purchases. As such, it appears that the BSP's measure was able to quell the increasing risk aversion before the asset purchases at the beginning of quarantine.
- **Emerging market bond index (EMBI-PH) and Philippine 10-year bond yield.** The EMBI for the Philippines decreased by 36.72 while the 10-year bond yield also declined by 0.512, indicating an easing of liquidity conditions.

<sup>6</sup> The government announced the lockdown on 13 March while the announcement of BSP's asset purchase was made on 24 March.

<sup>7</sup> An ANOVA was conducted to compare a difference in means in key financial market variables before and after the announcement of the BSP's asset purchases on 23 March 2020. The sample period started on 12 March 2020, when quarantine measures were imposed.

<sup>8</sup> The PSEi fell by almost 18 percent to 4,373 points a day after it halted trading momentarily, an 8-year low relative to the present index which is at 5,700 points.

Overall, the results appear to suggest that the BSP's interventions were able to calm the market and ease domestic liquidity conditions. This is seen in the lowering of the loan rates between banks, the strengthening of the PSEi, decreasing of the CDS and the recent appreciation of the Philippine peso.

#### 4. Lessons

The initial success of the BSP's timely and aggressive policy actions affirms its crucial role as a crisis manager. Nonetheless, the country continues to grapple with the pandemic and its associated risks. Thus, from a policy perspective it would be useful to take stock of the potential implications of the BSP's recent actions and highlight key lessons from this experience that could be useful going forward.

##### *Lesson 1: Act fast*

First, the severity of the pandemic's potential impact on the economy provided a clear case for swift, timely and decisive policy responses. A study by Correia et. al. (2020) using data from the 1918 flu pandemic in the United States, found that cities that acted first with quick and unprecedented policy actions such as lockdowns and contact tracing, among others, eventually had higher potential outcomes relative to those cities that did not respond immediately.

In terms of central banking, monetary policy can help mitigate the socioeconomic fallout from the pandemic and prevent them from developing into a long-term economic slump, by playing three key essential roles, namely: 1) to ensure that the overall monetary stance is sufficiently accommodative; 2) to stabilize market function and ensure the smooth transmission of monetary policy to the economy; and 3) to maintain ample central bank liquidity is required, especially to maintain credit provision (Lane, 2020).

The idea that temporary downturns can permanently damage an economy's productive capacity, also known as hysteresis effect, recently gained widespread support in the aftermath of the GFC (Yellen, 2016). Hysteresis can operate through several channels. Unemployment can cause human capital or skills to deteriorate. In the presence of nominal rigidities and constraints on monetary policy, a temporary shock can create conditions for slow recoveries or even permanent stagnation (Acharya et al., 2016; Pissarides, 1992). Moreover, Wee

(2016) showed that recessions can permanently change skilled young workers' search behavior, causing them to stay in careers in which they have a comparative disadvantage. This mismatch eventually causes a permanent misallocation. Likewise, Bianchi et al. (2014) find that declines in research and development during recessions can explain the persistent effects of cyclical shocks on growth.

Accordingly, the timing of monetary policy matters significantly for long-term outcomes. In particular, accommodative policy early in a recession can prevent hysteresis from occurring, thereby enabling swift economic recovery. In contrast, delayed interventions may lead to the existence of multiple steady states that would prevent an economy from reverting to full employment.

In line with these principles, the BSP's intervention was geared at restoring confidence in the markets, ensuring sufficient liquidity and preventing liquidity strains that could potentially lead to bankruptcies, defaults and lay-offs, which in turn could leave long-lasting scars on the country's growth potential.

##### *Lesson 2: Strengthen defense*

Second, sound macroeconomic fundamentals are always the best line of defense against economic shocks. The Philippines entered this crisis with a solid macroeconomic footing. In 2019, real GDP grew at 5.9 percent, making the country one of the fastest-growing economies in Asia. This also extended the Philippine economy's streak to over 20 years of uninterrupted broad-based growth.

Growth was accompanied by a manageable inflation environment. Year-to-date inflation for 2019 averaged 2.5 percent. More recently, inflation settled at 2.3 percent in the second quarter of 2020 which is within the NG's inflation target range of 3 percent  $\pm$  1 percentage point (ppt) for the year.

The sound and stable condition of Philippine banks has also been one of the anchors of the domestic economy. The reforms put in place by the BSP along with the banks' commitment to improve their ability to manage operational risks have resulted in significant improvements in the quality of domestic banks' assets and loan portfolios as well as strong capitalization.

The country also enjoyed a manageable external payments position before the pandemic started. The Philippines' international reserves rose from US\$18.5 billion in 2005 to US\$87.8 billion in 2019. Likewise, the country's external debt



metrics steadily improved, with the significant decline in the external debt-to-GDP ratio from 57.3 percent in 2005 to 21.4 percent as of end-March 2020

All of these provided the economy resilience to soften the economic and financial impact of the COVID-19 pandemic. This also puts the economy in a strategic position to revert to its growth trajectory once the pandemic is successfully contained.

More importantly, the country's sound macroeconomic fundamentals provided the BSP with ample policy space to aggressively respond to the pandemic without losing its focus on its core mandates of safeguarding price and financial stability.

### ***Lesson 3: Stay focused***

Third, keeping prices low and stable is still the heart of monetary policy. Pursuing price stability remains the primary and fundamental objective of monetary policy and should be a key consideration when undertaking market interventions during crisis periods (Noyer, 2011; IMF, 2020).

Placing primacy on price stability allowed central banks to resolve the time inconsistency problem associated with the monetary policy process and gain credibility as independent institutions. These key elements allowed central banks to contribute towards greater overall stability and effective crisis management. Successful anchoring of inflation expectations enhanced central banks' flexibility to respond aggressively when needed during crisis situations.

While the economic landscape is gradually evolving, along with central banks' functions, the consensus remains among policymakers that monetary policy contributes best to desirable socioeconomic outcomes by promoting low and stable inflation.

### ***Lesson 4: Act together***

While central banks' recent actions have put them at the forefront of crisis management, the current pandemic requires a well-coordinated mix of policy responses. Fiscal policy and monetary policy need to go hand in hand.

First, the pandemic is primarily a public sector crisis. This means that the problems associated with the crisis can be tackled more directly by fiscal policy while monetary policy can only address the secondary shocks or the financial

repercussions of the pandemic. For instance, massive fiscal stimulus and structural reforms are needed to improve healthcare systems and improve research on finding a cure for the coronavirus (Roach, 2020). Moreover, targeted fiscal responses such as cash handouts and expanded unemployment benefits can help improve the welfare of affected workers and households by ensuring that they have continued means to purchase goods and services (Frydman & Phelps, 2020). Over time, sustainability will require some long-term measures to be in place such as improved healthcare, education and training, and capacity building.

In other words, while central bank interventions can provide support during times of crisis, these must be accompanied by fiscal and structural reforms to enhance their effectiveness in helping the economy get back on track (Lagarde, 2020).

Second, allowing central banks to take on broader public policy goals could potentially overburden monetary policy (Orphanides, 2013). Overburdening of monetary policy may eventually diminish and compromise the independence of central banks, which in turn could reduce the effectiveness of central banks to maintain price stability and limit their ability to contribute to crisis management going forward.

This is important because it recognizes the limits and the potential trade-offs of monetary policy. Carstens (2020) argues that while the measures implemented by the central bank have been necessary and have shown initial success, these bring major challenges going forward in the form of a significant overlap between fiscal and monetary policy. Central bank balance sheets are bound to grow considerably this year, in tandem with a massive increase in public debt. This puts central banks at risk of losing their independence.

Moreover, central bank support can potentially lead to moral hazard. Central bank actions can be taken as implicit bailout which incentivizes market agents to take excessive risks. The excessive reliance on central bank policies could likewise exacerbate underlying systemic problems and hinder needed structural adjustments (Group of Thirty, 2015).

All these lessons need to be taken into account to ensure that the efficacy of monetary measures, particularly during crisis periods, are maximized while the associated costs are minimized.

## 5. Conclusion

The current pandemic has underscored the BSP's central role as an agent of macroeconomic stability during periods of crisis. In response to the pandemic, the BSP undertook unprecedented measures to ensure liquidity in the financial markets and provide support to the real economy.

While these measures are necessary and appear to have had initial success, the full extent of the pandemic and its implications on the economic landscape remain unknown. Given this uncertainty, it is important to be aware of the limits and trade-offs associated with central bank policies to ensure that the BSP's long-term objectives are not compromised.

Towards this end, the BSP has been circumspect in ensuring stability in this challenging time without losing focus on its primary mandates of safeguarding price and financial stability and preserving its hard-earned credibility and independence.

Moving forward, the BSP remains attentive to challenges of the "new normal" and the rapidly evolving economic and financial landscape. It stands ready to deploy necessary policy measures as warranted by evidence-based assessment of overall economic conditions.

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## AFTERWORD

When planning for this book began in June 2020, the intention was to chronicle the BSP's policy decisions during the COVID-19 pandemic. The unprecedented crisis called for an unprecedented response, and the entire government, including the BSP, acted promptly and decisively.

More than year since, the BSP's actions proved to be in the right direction. The economy is gradually recovering as the mass vaccination program quickened and widened its scope. Mobility restrictions are being relaxed.

Bolstered by years of resolute reforms, the whole-of-government response helped the domestic economy remain resilient against the adverse effects of the global pandemic.

The country's macroeconomic situation remains generally intact as evidenced by the improvement in gross domestic product (GDP), within-target inflation projection over the policy horizon, ample financial-system liquidity, and robust external payments position. At the same time, the banking system continues to be sound and stable amid the pandemic.

### *The numbers speak*

The country's strong macroeconomic fundamentals before the pandemic shielded the economy against the onslaught of COVID-19.

As expected, the Philippines was not spared from the global economic slowdown. The country's real or inflation-adjusted output contracted by 17 percent in the second quarter of 2020, the lowest since 1981.

The strict lockdown and mobility measures imposed to curb the spread of the virus in March 2020 crimped productive activity. The unemployment rate rose to 17.6 percent in April 2020.

Nonetheless, BSP was able to keep inflation low and stable, averaging only 2.6 percent throughout 2020 despite severe typhoons and supply distribution bottlenecks. Thanks to the benign inflation environment and well-anchored inflation expectations, the BSP managed to take decisive and prompt monetary policy actions that kept financial markets functioning and the system liquid.

On the external front, the overall balance of payment position (BOP) in 2020 reflected the effects of the disruptions in global demand and supply chains. The country posted a BOP surplus of US\$16.0 billion in 2020, driven by net inflows in the current account amounting to US\$11.1 billion as imports significantly dropped.

Despite the crisis, the government continued to build up the gross international reserves, capping 2020 with US\$110.1 billion in reserves, equivalent to 12.3 months of imports.

More than a year later, the country is now gradually seeing positive results of the implementation of data-driven policies. After five quarters of economic contractions, GDP grew by 12.0 percent in the second quarter of 2021. The momentum continued the following quarter when output rose 7.1 percent, despite the reimposition of stricter quarantine measures in August and September. For the first three quarters of 2021, the country's economic expansion averaged 4.9 percent, within the government's target GDP growth of 4-5 percent for the year.

The unemployment rate declined to 8.1 percent in the first three quarters of the year, from 10.4 percent in 2020. The employment level for the said period has already exceeded the average employment level in 2019, before the onset of the pandemic.

Meanwhile, inflation averaged 4.5 percent in the first ten months of 2021, mainly caused by supply-side factors, including the rise in world oil prices and supply disruptions brought about by weather disturbances and African Swine Fever.

While the inflation path is seen to remain above the target range of two percent to four percent up to October 2021, it is projected to settle within the inflation target range before the end of the year as the non-monetary measures of the government will help moderate the impact of supply bottlenecks. Inflation expectations remain firmly aligned with the baseline projection path for 2022-2023.

As domestic activity gradually resumed, the country's current account and the balance of payments for January to June 2021 reverted to a deficit amid strong

imports of raw materials and capital goods for productive purposes, indicating a pickup in economic activity ahead.

Nonetheless, the gross international reserves as of October 2021 remain ample at US\$107.9 billion, equivalent to 10.8 months' worth of imports of goods and payments for services. The GIR is supported by improving inflows of cash remittances from overseas workers and business process outsourcing.

However, business sentiment remained cautious due to the highly transmissible delta variant of the coronavirus, reimposition of lockdowns, and rising inflation rate due to supply constraints.

By contrast, consumer confidence is gradually improving based on the third quarter 2021 Consumer Expectations Survey. The optimism stemmed from expectations of improvements in job creation, additional income sources, speedier vaccine rollout, and provision of financial assistance.

In the first semester of 2021, the banking system displayed solid footing. Banks continued to grow their assets, deposits, and capital while posting sufficient capital and liquidity buffers, net profit, and ample loan loss reserves.

The total assets of the banking system rose by 6.9 percent year-on-year to ₱19.9 trillion as of August 2021. The asset expansion, which was largely funded by deposits, enabled the banking system to support the country's financing needs and to deliver relevant financial products and services during the pandemic.

As expected, the gross non-performing loans (NPL) ratio of the banking system increased, reaching 4.5 percent as of August 2021 from 2.8 percent a year ago. However, loan-loss provisioning remained adequate as banks reported an NPL coverage ratio of 83.5 percent for the period.

The banking system remains well-capitalized, with capital adequacy ratio at 17.2 percent as of second quarter of 2021. This is well above the 10-percent minimum threshold set by the BSP and the 8-percent international standard. Based on the results of BSP's regular and ad hoc simulations, the banking system is reasonably well-capitalized and well-provisioned. Hence, banks will be able to continue lending to support the economy.

Credit activity has also started improving as it posted an increase of 2.7 percent in September 2021, the second month of growth after more than a semester of

declines that started in December 2020. The improvement in outstanding loans of the banking system reflects the modest recovery in banks' overall lending attitudes along with improved economic prospects owing to the gradual lifting of pandemic containment measures.

Lending activity is projected to improve further in the coming months in view of the accelerated vaccination program and calibrated reimposition of granular quarantine restrictions only where absolutely necessary. According to the Philippine Banking Sector Outlook Survey for the first semester of 2021, majority of respondent banks expected double-digit growth in their loans over the next two years. Banks continued to lend or grant financial relief to their borrowers based on the latest data on new loans granted and restructured loans for the semester ending June 2021.

### ***Digital transformation***

The health crisis has presented unique opportunities for financial institutions to hasten digital transformation. Households and businesses are now finding it easier and more convenient to use cashless transactions particularly in making payments.

About a fifth of the country's retail payments already takes place digitally as of end-2020, up from ten percent in 2018 and only one percent in 2013. The key drivers include the greater digitalization of payments to merchants (up 47.8 percent) and person-to-person fund transfers (up 18.1 percent), as well as the full digitalization of the disbursement of government salaries as of the end-2020. Meanwhile, digital transactions made up 26.8 percent of total transaction value in 2020, higher than the 20-percent share in 2018.

Basic deposit accounts (BDAs) and e-money accounts grew significantly. From four million accounts in 2019, the number of BDAs opened almost doubled to 7.4 million accounts as of the second quarter of 2021.<sup>1</sup> The amount of deposits in the basic accounts stood at ₱4.9 billion held in 137 banks. From 2019 to 2020, the number of active e-money accounts grew by 93 percent from 17.9 million to 34.7 million accounts, or an increase of 16.8 million. E-money accounts are offered by 61 electronic money issuers (EMI). It is estimated that around 19 million new accounts were opened from 2019 to 2020, based on the increase in BDA and e-money accounts.

<sup>1</sup> BDA data as of Q2 2021 is preliminary.

Last year, the BSP launched the Digital Payments Transformation Roadmap (DPTR) for 2020-2023. It aims to transform the country into a cash-lite society through digitalization of payments and increase the number of Filipinos with access to financial services. At the same time, BSP intends to make available more innovative and responsive digital financial products and services. Recent data suggest increased utilization of electronic platforms.

Cashless transactions and contactless payments are an integral part of the DPTR and BSP's financial inclusion agenda. They are also key planks of the new economy because they make possible safer banking and financial transactions for consumers and enterprises amid the health crisis.

Use of digital payment channels has grown. PESONet transaction volume and value which grew by 31 percent and 41 percent, respectively, compared to levels in October 2020. From the 4.9 million transactions amounting to ₱293 billion last year, PESONet transactions reached 6.5 million worth ₱412.4 billion in October 2021.

Like PESONet, InstaPay transactions also saw a notable boost over the past year. From 29.8 million transactions in October 2020, InstaPay volume grew by 41 percent and reached 41.9 million transactions in October 2021. In terms of value, InstaPay transactions recorded an increase of 79 percent from ₱142.6 billion to ₱254.7 billion for the same reference month.

The significant year-on-year rise in the volume and value of digital payments suggests a growing shift towards digital payment channels from the traditional payment instruments such as ATM cash withdrawals and checks. While digital payments are on the rise, the volumes of both "off-us"<sup>2</sup> ATM cash withdrawals and check transactions decreased by two percent during the past year.

The introduction of QR code-enabled payments was a big step toward onboarding even the small players because it requires less expensive infrastructure—only a smartphone and internet access are needed.

The use of QR code payments was bolstered with the development of the National QR Code Standard, dubbed as "QR Ph." The move accords with the BSP's drive to transform the fragmented QR-driven payment services into interoperable payment solutions, making digital payments more accessible, affordable, and ubiquitous throughout the country.

<sup>2</sup> "off-us" withdrawals refer to transactions using ATMs are operated by a different bank; distinct from "on-us" withdrawals when ATMs used belong to the same bank that issued ATM card

The BSP launched the QR Ph for person-to-person payments or "QR Ph P2P," which primarily catered to remittances and payments within the informal sector, in November 2019. Less than two years later, in October 2021, it rolled out QR Ph for person-to-merchant payments or "QR Ph P2M" to expand the coverage of the system.

The latest move enables merchants, such as department stores, pharmacies, supermarkets, hardware stores, and restaurants, to accept e-payments. QR Ph P2M also makes bills payments faster and more convenient.

Since the P2M use-case covers a large end-user base—both individuals and businesses—the benefits gained when merchant payments are digitalized could have far-reaching societal impacts. Through this platform, the BSP expects to extend the reach of digital payments to micro and small enterprises which comprise over 98 percent of registered businesses in the country and employ about two thirds of the labor force. Hence, QR Ph P2M will not only drive greater use of digital payments but will also advance the BSP's goal of financial inclusion by providing more opportunities for micro and small businesses to grow.

Last June, the BSP issued the open finance framework, a key enabler for digital transformation and financial inclusion by promoting consent-driven data portability, interoperability, and collaborative partnerships between financial institutions and fintech players. The move implements a key element of the BSP's digital banking framework, introduced in November 2020, to hasten payments digitalization and financial inclusion. The digital banking category will include banks that offer financial products and services that are processed end-to-end through a digital platform and/or electronic channels with no physical branches.

### ***Economic recovery through policy coordination and legislative support***

All these gains were achieved with the whole-of-government approach in addressing the crisis. For its part, the BSP implemented temporary and time-bound policy measures to support the economy. The BSP's policy and liquidity-easing measures have injected into the financial system the equivalent of 12.8 percent of the country's full-year nominal GDP for 2020 as of October 2021.

First were measures to boost market confidence on availability of low-cost credit resources, such as cuts in the policy rate and the reserve requirement.

The lower policy rates were meant to nudge banks to reduce their own lending rates, thereby promoting credit-taking activities. Meanwhile, the lower reserve requirement is intended to increase the volume of loanable funds.

Second were extraordinary liquidity measures to the national government (NG) to help fund the pandemic-response measures. These included provisional advances to the Bureau of Treasury (Btr), purchases of government securities in the secondary market, and remittance of advance dividends to the government.

Third were regulatory and operational relief measures to maintain the stability of the financial system and ensure public access to financial services. These included: (1) counting loans to micro, small, and medium enterprises as compliance to the reserve requirement; (2) increasing the single borrower's limit; and (3) raising the ceiling for real-estate loans to promote bank lending.

On the legislative front, the government passed bills that would foster a stronger and faster economic rebound while limiting the scarring effects of the pandemic on the economy. Among these are the passage of the Financial Institutions Strategic Transfer (FIST) Act and the Corporate Recovery and Tax Incentives for Enterprises (CREATE) Act.

Meanwhile, the proposed Government Financial Institutions Unified Initiatives to Distressed Enterprises for Economic Recovery (GUIDE) bill aims to strengthen the capacity of government financial institutions, such as the Philippine Guarantee Corporation, Land Bank of the Philippines, and the Development Bank of the Philippines, to assist micro, small, and medium enterprises cope with the effects of COVID-19.

### Recognition

For actions to mitigate the impact of COVID-19, BSP received the "Best Systemic and Prudential Regulator in Asia Pacific" award from the Asian Banker in October 2020.

BSP also received the 2020 Gold Standard Award for Country and Trade Promotion for its efforts to ensure that the international investment community sees a truthful and transparent picture of the Philippine economy. The award was

given by industry body Public Affairs Asia on 8 December 2020.

The research arm of The Economist Group, the Economic Intelligence Unit, which focused on financial inclusion in the COVID-19 response, likewise recognized the country's initiatives to mitigate the adverse economic impact of the current global health emergency.

Moreover, despite the challenges caused by the pandemic, market analysts remain confident in the Philippine economy. They continue to expect the country faces favorable medium-term growth prospects based on the stable outlook affirmed by majority of major credit rating agencies.<sup>3</sup>

To be fair, credit for these achievements belongs not only to the BSP but to the entire government, to reiterate what was said earlier: solid fundamentals allowed the country to weather this pandemic while evidence-based policies and measures paved the way for gradual recovery a year after.

Looking ahead, the BSP will continue to support the economy for as long as necessary to ensure the country's strong and sustainable economic recovery. It will also remain vigilant against any emerging risks to the outlook for inflation and growth and will adjust its policy settings as needed.

The BSP remains steadfast in achieving its mandate of maintaining low and stable inflation to safeguard the Filipinos' purchasing power, ensuring an efficient payments and settlements system, and safeguarding the country's financial system.

It is imperative that everyone works together as one nation with the shared objective of sustaining the economic recovery.

<sup>3</sup> Standard & Poor's Global affirmed BBB+ rating with stable outlook on 27 May 2021, Rating and Investment Information, Inc. affirmed BBB+ rating with stable outlook on 22 April 2021, Moody's affirmed Baa2 with stable outlook on 16 July 2020, and Japan Credit Rating Agency, Ltd affirmed the Philippines' credit rating of "A-" with a "stable" outlook on 6 September 2021. Assessment by Fitch Rating on 12 July 2021 indicates a slight decline in the country's credit rating outlook from BBB stable to BBB negative. According to Fitch, this was due to downside risks to the country's medium-term growth prospects and possible challenges associated with unwinding the exceptional policy response to the health crisis and restoring sound public finances as the pandemic recedes.



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