Publication: The Business Times, pg 17
Date: 01 April 2020
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The role of Asia's central banks is being challenged by Covid-19

By Dave Fernandez

AS THE coronavirus pandemic, which started in Asia, spreads around the world, it is worth reflecting on the region's central bank responses so far and thinking about what may happen in the near future. Monetary policy actions in Asia and globally have received much attention, and justifiably so. But as the fiscal responses to the potential global recession grow, harder questions about central bank limits are coming soon.

Where are we now? So far, it is "follow the Fed" – a maxim that still applies – including in Asia. The Federal Reserve's extensive actions, which consist of a series of inter-meeting announcements since March 15 to before the opening bell on March 23, undoubtedly set the bar for other central banks.

In the Asia-Pacific, March has seen policy rates drop in Australia (to 0.25 per cent), Indonesia (4.50 per cent), South Korea (0.75 per cent), Malaysia (2.50 per cent), New Zealand (0.25 per cent), the Philippines (3.25 per cent), Thailand (0.75 per cent), and Taiwan (1.125 per cent), with Hong Kong (0.86 per cent) following its pre-set formula based on the Fed funds rate.

In terms of asset purchases, Korea announced it would buy government bonds to stabilise markets, while Japan increased its buying programme for both equities and corporate debt. The Fed's move to expand its central bank swap lines, though notably not with China, underlines the risk posed by a potential global dollar shortage.

In the future, the Fed may follow Asia, at least a bit, in terms of expanding its tool kit. Former Fed chair Ben Bernanke gave a nod to Asia in his January American Economic Association presidential address, citing a version of Japan's yield curve control (YCC) as a policy worth considering, possibly for capping the two-year Treasury rate (Governor Lael Brainard also floated following Japan in this way).

Notably, Australia adopted its version of YCC, modified by targeting the yield on its three-year sovereign. In contrast, venturing into negative rates – as has been done in Europe and later, unfortunately, in Japan – is unlikely for the region's other central banks, let alone the Fed, given the risk-reward consideration.

Stepping back, it should go without saying that central banks should not be the focus of policy responses to the coronavirus pandemic and its devastating consequences. In that respect, Singapore and China – places where virus-containment protocols of first-order importance are quickly becoming global models – bear some attention. Singapore this week joined the global trend and eased its monetary policy settings, but the Monetary Authority of Singapore statement clearly states that its stance "reflects the primary role of fiscal policy in mitigating the economic impact of Covid-19". In mainland China, cuts in lending reference rates have defied market forecasts and instead have been very measured, with the focus again more on fiscal policy.

The emphasis on fiscal policy will likely get even more pronounced, with Singapore taking the lead globally by adding another close to 10 per cent of GDP to its package. Returning to monetary policy, eventually those Asian central banks not yet at their effective floor may get there. At some point, perhaps soon, thornier questions about politicising monetary policy, central bank independence and monetising government spending will be heard more frequently.

In Asia, the line between the central bank and the government was never as bright as it became in the US in the post-Volcker world. Unless Asia sees green shoots of recovery in the coming months, full-blown, internally-coordinated national responses will be demanded, including the deployment of sovereign wealth funds that countries like the US lack. In that situation, do not be surprised to find more Asian central banks more integrated into their national teams.

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