

Philippines: BSP's extraordinary measures

The Philippines' central bank conducts daily purchases of government securities in the secondary market to “shore up market confidence”



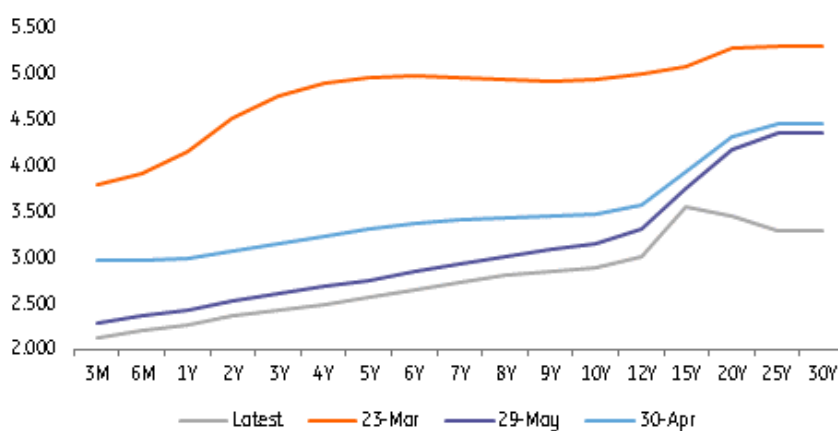
BSP uncorks extraordinary measures to combat Covid-19 fallout

The Bangko Sentral ng Pilipinas (BSP) has carried out “extraordinary” measures to shore up confidence and ensure that local financial markets remain functioning in response to the fallout associated with Covid-19 and the lockdowns that it brought. Financial markets were in disarray in March with global new infections surging and with the national government implementing strict lockdown measures to shut down the economy and slow the pace of infection. To support financial markets, on 24 March, the BSP announced it would be doing the following: a) reducing the policy rate window volume offering from Php320 billion to Php100 billion, b) a Php300 billion 3-month repurchase agreement with the Treasury and c) purchasing local government securities from the secondary market via a daily purchase 1-hour window.

Philippines' version of quantitative easing

The outright purchase of government securities from the secondary market is the Philippines' first attempt at carrying out quantitative easing to deal with the crisis the economy is facing. The BSP implemented the purchase window to reassure market participants of demand for government securities and to encourage participation in the bond market. And for the most part, the policy has worked, alongside recent aggressive policy rate cuts, to calm market nerves, resulting in lower borrowing costs. Bond yields hit a peak on 23 March before falling quickly in the weeks thereafter, due in large part to aggressive BSP rate cuts and liquidity infusions. On top of slashing policy rates and flooding the financial market with liquidity, the BSP began purchasing bonds in the secondary market, amplifying the transmission of the BSP's conventional monetary policy by preventing bond yields from drifting higher during any daily bouts of risk aversion.

Philippines local bond yield curve (various dates in 2020)



Source: PDEX

Local bond market on training wheels

BSP's bond purchase window was originally slated for operation from April to June or "until market conditions return to normal". With risks related to the Covid-19 pandemic and the impending economic recession remaining high, market conditions appear to be far from normal despite the recent improvement in sentiment from the lows seen in March. Thus we expect BSP to extend the operations of its bond purchase window possibly for at least another quarter as sentiment will likely remain fragile as the economy slowly reopens from its almost three month lockdown. With BSP implementing its bond purchase programme, the local bond market is in effect moving on "training wheels" with bond yields capped and any heavy sell-off averted.

BSP's bond purchase programme extended for now but for how much longer?

The presence of BSP in the secondary market caps any rise in yields for the time being, but it may also limit the ability of monetary authorities to gauge true market sentiment and the shape of the "true" yield curve. This predicament complicates the timing of the eventual removal of the "training wheels" with the central bank at some point having to remove this support from the market. BSP has indicated that the size of total purchases through the BSP's special window amounts to roughly 20% of total trading volume from March to June, with ING estimating roughly

Php400 to Php480 billion has been purchased so far. This shows that although BSP's purchases may not dominate trading, they constitute a sizable portion of trading volume and the Bank may eventually take quite a sizable amount of bonds onto its balance sheet. For now, however, BSP will be content to keep its purchase window open, helping guide market rates lower to aid the recovery. A careful look at an eventual exit strategy of the purchase programme may be warranted to ensure a full transition to normalcy.

Exit strategy?

BSP indicated that the bond purchase programme would remain in place until "market conditions return to normal" as this move helps complement its other traditional tools to keep monetary policy extremely accommodative during the economy's recovery. We can expect the central bank to retain this accommodative stance until the broader economy shows some signs of recovery and thus we can expect the bond purchase programme to remain in place likely until early next year. Given that the total amount amassed by BSP through its purchases may be significant, it may be difficult for the BSP to avoid some form of market sell-off in the future should they decide to actively wind down the balance sheet. Thus the best exit strategy for the central bank may simply be one where BSP holds on to them for the long haul.