SUSTAINABLE ECONOMIC RECOVERY POLICIES FOR ASEAN CENTRAL BANKS IN THE POST-COVID-19 PANDEMIC ERA

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ABSTRACT:

This study highlights monetary and security tools which support central banks to perform their management tasks in order do minimize and prevent systemic risks in the financial system. The study also summarizes some cases of central banks that have well implemented monetary and security policies in a sustainable way. This study is expected to help ASEAN central banks gain lessons for the economic recovery in the post-COVID-19 pandemic era.

Keywords: central bank, recovery, COVID-19.

1. Introduction

From 2020, the COVID-19 pandemic devastated economies around the world. Governments were forced to take immediate and unprecedented steps to save lives and livelihoods. As the health crisis begins to stabilize and life-saving vaccines programs are rolled out, governments and central banks can now look forward to recovering sustainably, selectively boosting economic growth to increase resilience and ensure stability. There are growing calls for the public sector to provide society with transition pathways that bolster economic and social resilience against the many challenges we face in the 21st century, chief among which is climate change.

This policy brief aims to summary international central bank experiences in response to the economic recession resulting from the COVID-19 pandemic and identify opportunities to embed environmental sustainability into stimulus and recovery efforts. Our objective is to provide suggestions on how central banking tools can tackle and be informed by the financial stability risks associated with climate change.

ASEAN Central Banks have responded quickly to manage the economic fallout of COVID-19, utilizing their experience of the Asian Financial Crisis and the Global Financial Crisis (GFC) to help their economies withstand the economic impacts of the pandemic. Banks had built up capital and liquidity buffers, improved risk management practices and internalized the social cost of risk-taking, allowing them to weather the COVID-19 financial crisis better than those crises which came before them.

Central banks have played a major role in the wider public sector's effort to combat the economic fallout from the pandemic since March 2020. Their focus has been to ensure financial stability despite (temporary) double-digit falls in economic activity and to finance governments' expenditure programs. The economic disruption from COVID-19 has led to unprecedented innovation in how central banks use their policy toolkits to supply liquidity and ensure stressed businesses continue to access bank credit.

The paper explores the tools available to ASEAN central banks, examining those used in the pandemic response and how these might be used to foster a sustainable recovery. This section also considers whether any of the innovations recently used by central banks could be applied to climate risks. The conclusion draws upon this analysis to give suggestions for short- and medium-term action that can be taken by ASEAN Central Banks to recover after the COVID-19 pandemic.

2. Central banks' strategies to recover better

This section outlines the tools that are being used to respond to the pandemic by central banks and proceeds to suggest a method through which sustainability can be incorporated into specific policies and tools. This is positioned considering ASEAN Central Banks' mandates, which require them to: keep inflation below a target level, manage the exchange rate, ensure financial stability by monitoring systemic risks, and supervise individual banks and insurers to ensure they are operating within the prudential framework.

ASEAN Central Banks' broad mandates allow them to pursue development initiatives and shape broad national policy objectives, several have also developed sustainability strategies or frameworks, which enable mainstreaming of sustainability in wider operations. Furthermore, even central banks which do not have explicit or implicit sustainability objectives can still consider climate-related physical and mitigation risks when executing their roles in safeguarding the economy.

In the context of the COVID-19 pandemic, central banks' main roles have been to provide monetary stimulus to safeguard the stability of the financial system, support fiscal stimulus through purchasing government debt, and directly stimulate real-economy activity, for example, through corporate asset purchases. Most of the measures and instruments have been used in response to the pandemic to maintain liquidity and credit flows. The emphasis has been on enabling the continued functioning of the real economy. These measures are also designed to complement or support governments' fiscal policies.

3. Central banks' policies to rehabilitate

3.1. Prudential policy during COVID-19

Prudential regulation under the Basel Agreement ensures that banks have adequate Tier 1 capital (chiefly bank equity and retained earnings) to finance their exposure to loan losses and enough liquidity coverage (easily liquidated assets such as government bonds) to meet their borrowers' typical near-term funding needs. During the pandemic, there has been a loosening of prudential requirements by central banks to avoid the withdrawal of liquidity and a sharp reduction in interbank lending that occurred during the GFC.

Microprudential Regulation: 39% of CBs have loosened microprudential regulations in response to the pandemic, according to Dikau et al.'s 'Toolbox of Sustainable Crisis Response Measures for Central Banks and Supervisors' (2020). This can be enacted quickly, increasing commercial banks' liquidity allowing them to continue providing credit to their customers. The Banco Central do Brasil relaxed the capital requirements for smaller financial institutions (FIs); their modelling suggested this potentially releases BRL1.3bn of liquidity that may allow up to BRL16.5bn in credit provision. The Banco

Central de Chile made liquidity regulations more flexible by expanding the eligible currencies for meeting foreign currency reserve requirements and relaxing the liquidity coverage requirement (LCR) on a case-by-case basis. The capital conservation buffer (CCB), which stands at 2.5% of risk-weighted assets, has been reduced by nine CBs. Whilst facilitating liquidity flows and ease of lending, this can increase risk exposures – many banks have set expectations for the use of the additional capital from these buffers; to support the economy and not for capital distributions (dividends and share buybacks). This follows Basel standards which dictate that banks that do not maintain their CCB standard will face automatic constraints on income and dividend distributions.

Applicability for recovering: To direct liquidity flows to the most sustainable activities, central banks can vary capital requirements according to financial institutions' climate risk exposure. Capital buffers would be set higher for those with greater exposure to unsustainable activities because these financial institutions (FIs) would be at greater risk of default. Conversely, capital requirements could be discounted according to an FI's green lending. In 2019 the Hungarian central bank, Magyar Nemzeti Bank (MNB), did so, announcing a preferential capital requirement against balance sheet exposure to energy-efficient housing loans. The discount reflected the reduced risk of default on green mortgages.

Macroprudential Regulation: Loosening macroprudential regulation has been used by 21% of CBs during the crisis, according to Dikau et al. (2020). Commercial banks and other FIs are required to hold capital buffers directly proportional to the size and riskiness of their lending activities – the Countercyclical Capital Buffer (CCyB) aims to protect the banking sector from periods of excess aggregate credit growth that have often been associated with the build-up of system-wide risk. Its countercyclical nature makes the CCyB the easiest to deploy in a crisis; CBs can decrease the level of the CCyB immediately to maintain the flow of credit in the economy.

Dikau et al. (2020) warn that such countercyclical release can be potentially environmentally damaging since the new bank lending engendered by the increase in available capital is not necessarily directed at sectors most in need. This can be countered by excluding or penalizing lending to sectors with the highest transition risk. This raises the wider issue of climate risks not being adequately priced into economic risk management - an issue that is beginning to be addressed by climate disclosures and stress testing.

Applicability for recovering: Regulators wishing to safeguard macroprudential stability should calibrate regulatory instruments to account for systemic financial risks like climate-related risks. This can be informed by using climate scenarios in improved stress testing and disclosure requirements. FIs, and their counterparties, will need time to collect information needed to measure and manage such risks. When developing these datasets, priority should be given to sectors and organizations that are most material. New macroprudential instruments can be leveraged to reduce risks identified by stress tests, such as the implementation of a countercyclical carbon capital buffer, acting similarly to the CCyB to give climate-sensitive resilience to banks or setting exposure restrictions for certain assets or sectors. Risk weighting of assets can be made more sensitive to climate risk by giving higher risk weightings to exposed sectors or by reducing the risk weighting of green assets, as done by the People's Bank of China (PBOC).

3.2. Monetary Policy during COVID-19

To increase the real economy's access to finance and also reduce the cost of finance, central banks have used monetary policy instruments to expand liquidity and credit supply in the economy. Central banks can implement monetary policy directly through their regulatory powers or indirectly by influencing money market conditions as the issuer of central bank money (currency in circulation and balances with the central bank). Whilst direct policy is more frequently used in emerging market economies, both types can be used concurrently.

The term “direct” refers to the one-to-one correspondence between the instrument (such as a credit ceiling to a sector) and the policy objective (such as restricting domestic credit into the sector). Direct instruments set or limit either prices or quantities through regulations and may also be used to allocate credit, and can include: Direct controls on interest rates (e.g., minimum and maximum interest rates, preferential rates for certain loan categories); Credit ceilings (at an aggregate level or on individual banks); Directed lending policies (e.g., preferential central bank refinance facilities to direct credit to priority sectors); Window guidance/moral suasion to promote priority sectors.

On the other hand, indirect monetary policy tools such as open market operations (OMOs) and standing facilities operate through the money market and can be described as market-based instruments. These are explained in more detail below. Nonstandard policies of asset purchase and quantitative easing have also swelled central bank balance sheets across the world.

Indirect Monetary Policy Instruments: Open market operations are an active method of liquidity supply, initiated by the central bank and offered to a wide range of counterparties but settled through open auction mechanisms. In contrast, standing facilities provide passive liquidity supply in a bilateral arrangement agreed between the central and commercial banks. Dikau et al. (2020) found 48% of central banks have used indirect monetary policy instruments such as OMOs and standing facilities in their COVID-19 response.

- Open Market Operations: During open market operations, the CB lends short-term to FIs to change the commercial banks’ offered interest rates. OMO responses include PBOC injecting RMB3.33 trillion (gross) liquidity into the banking system via OMOs (reverse repos and medium-term lending facilities) and the Bank of Korea’s (BoK) provision of unlimited OMO liquidity via a weekly repo facility at set interest rates.

Longer-term refinancing operations (LTROs) are used to support liquidity requirements and reduce sovereign debt yields. The European Central Bank (ECB) has introduced additional LTROs to meet liquidity needs and support euro market operating, followed by pandemic emergency longer-term refinancing operations (PELTROs) with an interest rate 25 basis points below the average refinancing rate, providing additional longer-term financing to banks. These have been continued into 2022 due to the resurgence of the pandemic.

- Standing Facilities: have been widely used to target financial support to specific sectors, specifying how money from the facility should be lent on. BoK established a Corporate Bond-Backed Lending Facility, a standing lending facility that allows ready access to credit using eligible corporate bonds as collateral. The Bank of Japan’s (BoJ) Special Funds-Supplying Operation facilitates SME financing. Further incentivization was provided by expanding eligible collateral to include ‘private debt’ and applying a favorable interest rate to FIs’ current account balances corresponding to loans provided. The BoE introduced the “Term Funding Scheme with additional incentives for SMEs” (TFSME) in which lending to SMEs generated greater borrowing allowances, reinforcing transmission of low-interest rates to the real economy. The increasing numbers of CBs introducing term funding schemes show they are widening their toolkits and turning their attention to the longer term.

Applicability for recovering: If these instruments for stimulating the real economy are calibrated without sustainability considerations, they could potentially lead to a build-up of more assets with high carbon bias, further increasing FI's exposure to transition risks on their balance sheets. Indirect monetary policies could support the reduction of climate-related risks through the exclusion or tilt against climate/transition risk exposed assets from the schemes.

- Collateral Frameworks: Changes to the collateral frameworks were used in 29% of responses analyzed by Dikau et al. (2020). This entails reducing the haircut so that more can be borrowed for the same collateral or expanding the range of assets that are eligible to be used as collateral. For example, the Banco Central de Chile expanded its framework to include corporate securities as collateral for its liquidity operations and high-rated commercial loans as collateral for funding facility operations. The ECB temporarily reduced its haircut by 20% in its LTRO facility, increasing its risk tolerance to aid the Eurozone economy. Other CBs have made similar adjustments – the Bank of Korea's collateral ratio has been lowered from 70% to 50%, alongside a broadening of eligibility.

Applicability for recovering: Expansion of collateral frameworks to include green assets can be used to incentivize sustainable investment. Monetary Authority of Singapore's (MAS) new Term Facility accepts residential property loans as collateral from certain banks. This facilitates increased lending to households and corporates, demonstrating how targeted action on collateral frameworks can change finance markets. The ECB recently expanded its framework to accept sustainability-linked bonds as collateral for Euro system credit operations and asset purchases.

Direct Monetary Policy Instruments: Direct instruments have seen widespread expansion during the pandemic as CBs maintain liquidity flows to the real economy.

- Reserve requirements: can be reduced, thereby increasing the funds available to banks for lending. Normally these are set in a market-neutral approach with a percentage of all customer deposits being placed with the central bank. But lower reserve requirements could be applied to the desired form of lending. To increase Micro Small and Mid-size Enterprise's (MSME) access to credit during the pandemic, the Banco Central do Brasil allowed FIs to deduct up to 30% of their reserve requirements on deposits used to provide credit to MSMEs, which they project expands lending to MSMEs by BRL 55.8 billion.

Applicability for recovering: Differentiated reserve requirements, as applied to MSMEs in the initial response, could be used to direct recovery spending towards more sustainable lending. For example, Lebanon's CB, Banque du Liban, differentiates reserve requirement ratios according to the amount of bank lending flowing to renewable energy and energy efficiency projects.

- Corporate financing facilities: provide businesses with money on a short-term basis without any need for collateral. These provide liquidity directly to the real economy and can be targeted to specific industries, making them well suited to a crisis that has disproportionately impacted Small and Medium Enterprises (SMEs) and industries such as the hospitality and transport sectors.

Corporate financing facilities and commercial paper (CP) purchase increase the debt holdings of the central bank. As commercial paper markets froze across the world, many CBs established emergency commercial paper purchase progras (or revived GFC programs) to supply short term funding. BoJ doubled its CP and corporate bonds purchases relative to the GFC, while BoE established a purchase program ten times larger than that of the GFC. They have also been used in a targeted fashion to assist priority sectors. The Central Bank of Nigeria provided N150bn of targeted credit facilities for households and

SMEs; priority was given to lend to businesses in the health sector.

Applicability for recovering: Despite the low uptake of the Canada's Large Employer Emergency Financing Facility, attaching disclosure requirements to facilities should not be discounted as a way to stimulate sustainable investment. If such requirements are attached consistently to all financing facilities (rather than lenders of last resort) offered by the CB and government with enough flexibility to ease the burden of reporting, there is potential for the CB to influence risk awareness and management in the real economy.

- Non-Standard Instruments: During the pandemic, central banks (and other investors) have been asked to greatly expand purchases of government and corporate bond issuances into their quantitative easing (QE) or asset purchase programs (APPs). At least 18 central banks have carried out asset purchases in their responses. Such action provides immediate liquidity, indirectly funds fiscal policy and restores investor confidence. These non-standard instruments expand the central bank's balance sheet by increasing the money supply to buy up high-quality financial assets (government and some commercial bonds) from the secondary market. QE is used to boost the economy through credit creation when the bank rate cannot be further reduced. Because of the near-zero interest rates in many OECD countries, QE programs have been expanded. Primary market purchasing (monetary financing) is not permitted in many central banks as it increases the risk of heightened inflation – secondary market purchase is more widely used.

Applicability for recovering: There is the potential for a sustainability focus in the types of bonds purchased in QE programs. As part of its COVID-19 Embedding sustainability into the COVID recovery - Climate Bonds Initiative 15 response, Sweden's Riksbank expanded its SEK700bn (USD82bn) QE program to include sovereign and municipal green bonds. Separately, it made inclusion in its corporate bond QE program conditional on issuers complying with sustainability standards. QE is a less common CB practice in ASEAN. But these considerations could be used by Indonesia and the Philippines that engage in QE or Singapore that holds foreign corporate bonds.

4. Conclusion

This paper aims to identify the tools used during the COVID-19 pandemic, which are the most suitable for climate risk mitigation and can be most easily repurposed. CBs' response to the COVID-19 pandemic has showcased their capacity for fast, innovative action. Policies used by CBs during the pandemic - to protect businesses, maintain economic stability and stimulate recovery - could protect AMS from future systemic risks - particularly climate risks.

While sustainability considerations can be applied to almost all of a central bank's toolkit, specific policies will likely be more impactful and easier to implement over the next few years. This paper identifies our assessment of the policies and tools used by central banks which could be repurposed to mitigate climate risks over the near term. Individual CB's responsibilities will vary depending on the exact remit. Instruments in green have a high potential for incorporating sustainability factors.

* Short-term: As referred to above, introducing disclosure requirements is an immediate priority for central banks looking to develop their understanding of climate-related risks. These can be developed in collaboration with governments to ensure alignment with corporate disclosure requirements. Other ASEAN CBs could follow the example of Bank Negara Malaysia, Monetary Authority of Singapore and Bangko Sentral ng Pilipinas for their introduction.

There is also a risk that fiscal stimulus packages introduced by the government and supported by central banks (through their purchase of government debt) to rescue businesses could worsen physical climate or transition risks. CBs should examine the climate-related risk of the assets they buy for policy purposes like exchange rate management or accept as collateral and ensure these assets, and the currency/economic system they support, are resilient to and not worsening future climate and transition risks. Some countries (like France) have tied rescue package in high emissions sectors, like aviation, to help long-distance domestic transport make modal shift from aviation to rail to help transition to a lower emissions economy. This Just transition policy balances the socioeconomic need to retain employment in important sectors to their reform.

We suggest ASEAN Central Banks investigate whether:

- Open market operations are tailored to support bank lending (both short and medium-term) targeted specifically to businesses that reduce climate risk exposure;

- Haircuts and asset eligibility for collateral could be reviewed through a climate-related risk lens;

- Corporate financing facilities, where the CB buys equity or bonds directly from issuers, could also be tilted to encourage green investment.

Adjustments to collateral frameworks may reduce the volume of central bank lending to banks, and so must be individually assessed. However, the NGFS suggests the implications for monetary policy effectiveness of the options suggested above may be negligible compared to more stringent exclusionary policies and therefore easier to implement.

* Medium-term: In the medium-term (the next 2-5 years), many central banks and regulators plan to require greater disclosure of climate risks in their countries' financial systems. This will be both for individual banks and the entire financial system's exposure using forward-looking risk assessments.

Climate-risk scenarios and climate-related stress tests (already being taken forward in Singapore) are an important medium-term policy in the prudential regulation toolkit. They are a departure from risk managers' usual analysis based on historical data and instead model future risks using a range of plausible climate-risk scenarios in anticipation of these events. The data and models are still being developed. Still, the stress tests can be iterated and improved over time as the evidence base and tools become more available and more sophisticated. The results will provide central banks with quantitative insights into the comparative risks faced by different financial institutions within an economy and can be used to set prudential guidelines ■

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CÁC CHÍNH SÁCH PHỤC HỒI KINH TẾ BỀN VỮNG HẬU ĐẠI DỊCH COVID-19 CHO CÁC NGÂN HÀNG TRUNG ƯƠNG TẠI KHU VỰC ASEAN

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TÓM TẮT:

Nghiên cứu này trình bày các công cụ bảo vệ và tiền tệ nhằm hỗ trợ các nhiệm vụ của ngân hàng trung ương, qua đó giảm thiểu rủi ro đối với hệ thống tài chính. Bên cạnh đó, nghiên cứu cũng tổng hợp một số trường hợp đã thực hiện tốt các chính sách tiền tệ và bảo vệt một cách bền vững tại các quốc gia trên thế giới. Qua đó, các ngân hàng trung ương khu vực ASEAN có thể rút ra các bài học về phục hồi nền kinh tế sau đại dịch COVID-19.

Từ khóa: ngân hàng trung ương, phục hồi, COVID-19.