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FEATURE

Monetary policy in Asia

Proactive so far, but faced with uncertainties

Akrur Barua and Monali Samaddar

Central banks are facing the unavoidable dilemma—short-term growth may come at the cost of soft long-term fundamentals, yet if they hold back now, the recovery may not sustain.

AS ASIA TRIES to find its way through the COVID-19 pandemic, policymakers have been quick to step in with much-needed economic support. While the fiscal side has focused on immediate health-related requirements and short-term economic support, monetary policy has taken up the twin roles of stimulating demand and stabilizing credit markets. Through interest rate cuts and liquidity measures, Asian central banks have tried to counter the declining economic activity in the first half of 2020.[1] Encouragingly, the tide seems to be turning with consumer spending and manufacturing showing signs of revival across the region. Yet central banks' worries are far from over given the course of the pandemic itself.[2] And while a proven vaccine is expected to be available by late 2020 or early 2021,[3] its deployment will take time given the large population in Asia and the logistics involved in vaccine deployment.[4] Evidence from Europe and the United States suggests that another wave of infections may have started,[5] serving as a grim reminder regarding the unpredictability of the pandemic. Monetary authorities in Asia's emerging markets may also have to contend with currency weakness given investors' preference for safe assets during this global uncertainty. And increased price pressures due to localized lockdowns may only add to central banks' woes.

Asian central banks have responded proactively to dent the downturn

As in previous economic crises, central banks in Asia have used policy rates[6] as a key tool to ease financial stress and stimulate growth. They have cut rates and lowered reserve requirements for commercial banks to support credit growth. That's just one part of the monetary response so far (figure 1). Monetary authorities have also indulged in unorthodox measures, such as nudging financial institutions to keep extending credit, encouraging credit flows to key sectors, establishing financing facilities, and ensuring adequate collateral for financial institutions. And like their counterparts in Europe and the Americas, central banks in Asia have been acting as a bridge between governments and financial institutions to provide additional lending support even as they ensure liquidity in fixed-income markets through government bond purchases.

FIGURE 1

Central banks have gone beyond policy rates to stem the economic upheaval due to COVID-19

Country	Monetary and macrofinancial measures
China	• Expansion of existing relending and rediscounting facilities to support micro-, small-, and medium-sized firms (MSMEs) involved in providing essential items and the medical and agricultural sectors • Reduction of reverse repo rates (RRR, 7-day and 14-day), one-year medium-term lending facility (MLF) rate, and the targeted MLF rate • Expansion of credit lines to support lending to businesses, and introduction of new lending instruments, including a zero-interest "funding-for-lending" scheme • Limit the tightening of financial conditions by encouraging lending to SMEs, delay of loan payments, higher tolerance for nonperforming loans, etc. • Reduction in one-year and five-year loan prime lending rates[a] • Temporary deferring of repayments of principal and interest on loans for SMEs[b] • Introduction of multiagency packages to support the financial system[c]
India	• Reduction of the repo and reverse repo rates and the cash reserve ratio; increase in the marginal standing facility and open market operations • Temporary relaxation of the norms involving debt default on rated instruments and export repatriation limits • Promotion of credit flows to the retail sector and MSMEs through various measures, such as a TLTRO-2.0 (funds to be invested in investment-grade bonds, commercial papers, special refinance facilities, a temporary reduction of the liquidity coverage ratio, etc.) • Regulatory easing, such as higher exposure limit, relaxation of some of the norms for state-government financing, credit support to exporters and importers, etc. • Purchase of long-tenor government bonds and sale of short ones to reduce pressure on longer-term yields[d]
Indonesia	• Reduction in the policy rate of 100 bps, lowering of RRR for banks, daily repo auctions, etc. • Introduction of a burden-sharing scheme worth US$40 billion in 2020 between Bank Indonesia and the government to support financing during the pandemic The scheme includes: – Purchases of government bonds at a maximum coupon rate to finance priority spending on public goods – Subsidization of the budgetary interest cost of spending support to firms, especially SMEs and large businesses[e]
Japan	• Targeted liquidity provision in the form of an increase in the size and frequency of Japanese government bond purchases without any upper limit on guidance • Increase in the special funds-supplying operations to provide loans to financial institutions • Temporary increase in annual purchases of exchange-traded funds, Japan-Real Estate Investment Trusts, commercial paper, and corporate bonds • Establishment of a new fund-provisioning measure to support financing to MSMEs[f]
Malaysia	• Reduction in the overnight policy rate and the statutory reserve requirement ratio • Increase in financing facilities, temporary easing of regulatory and supervisory compliance on banks, relief measures for insurance policyholders and takaful participants • Support to the real estate sector in the form of stamp duty exemption, lifting of loan-to-value requisite for certain mortgages, and real property gains tax exemption for disposal of residential homes until December 31, 2021 • Provision of targeted loan payment moratorium extension by the banking industry following the six-month blanket moratorium[g]

Country	Monetary and macrofinancial measures
Singapore	• The Monetary Authority of Singapore adopted a 0% annual rate of appreciation of the policy band and reduced the midpoint of the current SGD NEER level • The support package of 125 million Singapore dollar to upskill and strengthen financial services, and for digitalization and operational resilience • Establishment of a new MAS SGD term facility to enhance the banking system's access to SGD and US dollar funding • Temporary relaxation of loan payments and reduced installment payments by individuals and SMEs
Thailand[h]	• Reduction of the policy rate and contribution percentage of financial entities toward the Financial Institutions Development Fund • Provision of soft loans by the Bank of Thailand with government guarantees of up to 60% of the loan, temporary relaxation of loan repayment conditions, and reduction of interest on debts to selected financial institutions • Support measures for financial sector stability include establishment of a Corporate Bond Stabilization Fund, purchase of government bonds, and a reduction in BOT bond issuances.

Source: International Monetary Fund, accessed October 29, 2020.
a. The People's Bank of China press statement, accessed October 29, 2020.
b. The People's Bank of China press statement, accessed October 29, 2020.
c. The People's Bank of China press statement, accessed October 29, 2020.
d. Anandadeep Mandal and Neelam Rani, "Decoding Operation Twist—the act of RBI during COVID-19," *Mint*, accessed September 13, 2020.
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Economic activity is recovering, but uncertainty remains

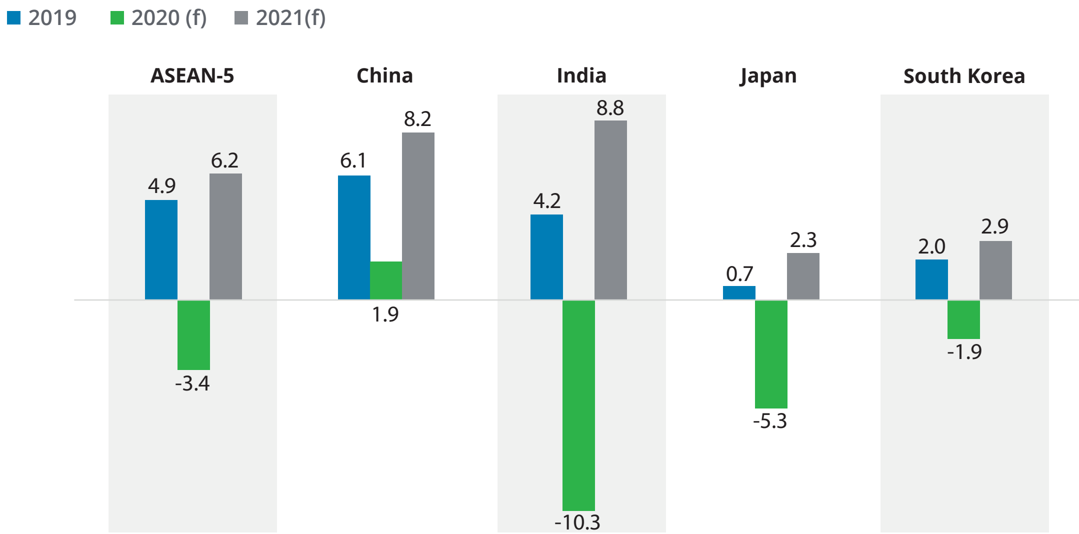
As countries learn the ropes of the pandemic, and with fiscal and monetary measures playing their part, economic activity is slowly reviving. China has been leading the way with healthy GDP growth in the second and third quarters of the year. While Vietnam and Taiwan had relatively steady growth in Q3 2020, the pace of contraction has lessened in South Korea. High-frequency data on consumer spending and manufacturing also points to improvement across the region. In India, manufacturing activity as indicated by the purchasing managers' index swung back into growth since August while in the Association of Southeast Asian Nations (ASEAN) bloc, activity has been slowly picking up since March.[7] Consumer spending also seems to be bouncing back with the value of retail sales rebounding from lows between March and May. In China, for example, retail sales in September were 13.3% higher than in March; while in Vietnam, sales in October were up by nearly half compared to April.

The extent and duration of the revival in economic activity, however, is uncertain given the current course of the pandemic and that a proven vaccine will likely come in only by late 2020 or early 2021.[8] And even when a vaccine is made available, it will take time before the vaccine can be administered to most of the population.[9] So, sectors such as aviation, tourism, and hospitality will continue to face pressures, especially with highly restricted international travel. In Thailand, a key tourist destination, foreign tourist arrivals are down to zero from 3.8 million in January. A similar trend—albeit with some variability—is also evident in countries like Malaysia and Hong Kong. The economic recovery, therefore, is unlikely to be uniform across sectors and economies. According

FIGURE 2

Key Asian economies, barring China, are set for economic contraction this year

Annual real GDP growth (%)



Notes: ASEAN-5 includes Indonesia, Malaysia, Thailand, the Philippines, and Singapore. (f) denotes IMF forecasts.
Sources: IMF (sourced through Haver Analytics); Deloitte Services LP economic analysis.

to the International Monetary Fund (IMF), emerging and developing Asia[10] is expected to contract by 1.7% in 2020 despite a 1.9% rise forecasted for China; growth in India is set to fall the most among notable economies in this bloc.[11] Advanced economies like Japan and South Korea are also expected to contract this year (figure 2).[12] Such a scenario points to continued involvement of central banks in reviving growth into 2021.

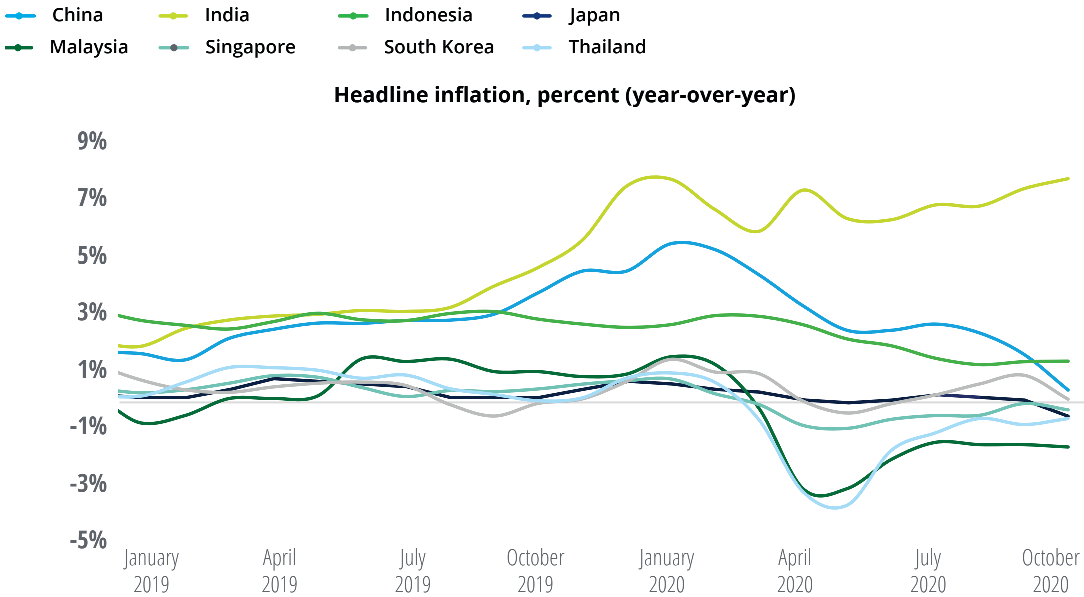
Moderation in inflation pressures in most economies will aid monetary policy

The strong dent in economic activity has led to an overall moderation in inflation across major economies in Asia (figure 3). A hit to demand for certain consumer goods has impacted goods prices, while services inflation, especially in recreation and transportation, has dropped. Consequently, core inflation has moderated in key Asian economies, barring India. In Malaysia, for example, low core inflation is attributed to the softening of prices of clothing and footwear, and transportation. Weak energy prices have also weighed on overall inflation since the start of the year. In Singapore, for example, prices of fuel and utilities fell by 9.6% year over year in Q3 2020; while in Thailand, energy prices fell by 10.5%.

Moderation in inflation augurs well for monetary policy as it leaves central banks more room to revive growth. For the Bank of Japan (BOJ), however, the fall in aggregate demand and energy prices will be a cause for concern as it may complicate the long fight against deflationary pressures through strong quantitative easing. Other central banks will likely remain wary of any supply-side push on inflation as happened during the early stages of the pandemic when disruptions in supply chains pushed up prices of certain consumer goods. In India, supply-related issues have aided food and beverage inflation, which in turn has pushed headline inflation above the Reserve Bank of India's upper level of the target range[13] for six straight months. In China, too, food inflation averaged 18.3% year over year between

FIGURE 3

Barring India, inflation has moderated for key Asian economies



Note: The data is nonseasonally adjusted.
Sources: Haver Analytics; Deloitte Services LP economic analysis.

February and April. It is likely, however, that food-related inflation will slow as economies open further and supply chains function more smoothly than in the initial months of the pandemic. While that hasn't happened in India yet, the latest data suggests that food inflation has slowed in countries such as Indonesia and, to a lesser extent, China.

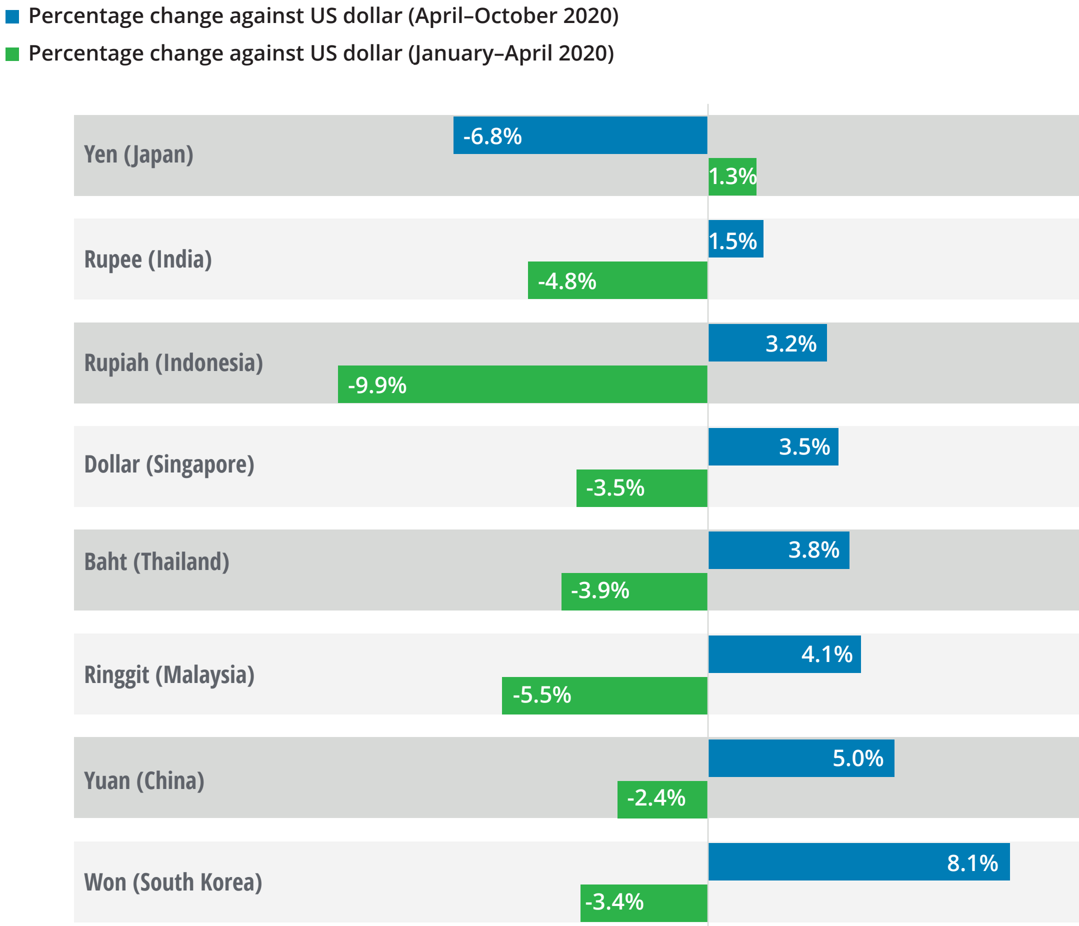
Don't forget them currencies

The start of the pandemic and its initial economic impact predictably put pressure on key Asian currencies due to a global rush toward safe assets such as the US dollar. Apart from the Japanese yen, again a safe asset, the plunge in most Asian currencies started in February, reflecting investors' concerns at that time about deteriorating economic and financial fundamentals as COVID-19 spread globally (figure 4).

While cutting interest rates may have posed a worry for Asian central banks due to depreciating currencies, what has worked well is that advanced economies have also eased policy. That has lessened the impact of interest rate differential between Asian currencies and, say, US currencies. And with central banks in advanced economies expanding their balance sheets sharply, a revival in economic activity in Asia means that global liquidity is likely to flow back to the region, thereby aiding currencies. Indeed, since May, Asian currencies have recovered (figure 4), buoyed by a

FIGURE 4

Key Asian currencies, barring the "safe" Japanese yen, fell in the early days of the pandemic, but are rebounding from their lows



Note: The calculations are based on end-of-month values.
Sources: Haver Analytics; Deloitte Services LP economic analysis.

nascent economic recovery and uptick in financial markets.

However, it is too early to say that the phase of currency depreciation is over. A surge in infections in Europe and the United States in late October has impacted global financial markets, reinforcing the uncertainty about the pandemic. Any rise in global uncertainty may topple the currency apple cart, thereby making further monetary easing difficult for Asian central banks other than the BOJ.

There's a limit to monetary firepower

While central banks have been proactive in countering the downturn and have acted in tandem with fiscal authorities, there is a limit to how much they can do. Central banks will also be wary about the impact on debt from strong monetary support. For example, household debt in some Asian economies surged after 2008 due to a credit-driven expansion.[14] Similarly, in China, the overall debt-to-GDP ratio is expected to reach 335% in the upcoming months.[15] That's not all. Central banks will also be wary about deteriorating fiscal balances as governments provide desperate support to their economies. In India, for example, the general government debt-to-GDP ratio has risen by 17% so far this year compared to 2019.[16]

Business bankruptcies will also likely worsen if the economy doesn't rebound fast, thereby putting strain on banks' asset quality. According to Moody's, by 2022, nonperforming assets in banking will likely double on average across 14 Asia-Pacific economies.[17] In this scenario, a low-interest-rate ecosystem will only add to banks' woes due to lower profitability.

There are difficult choices ahead for monetary policy in Asia: Focus too much on short-term growth and see long-term fundamentals deteriorate, or hold back now and risk jeopardizing the current recovery. Clearly, it's an unenviable task to be a central banker in these times.

Endnotes

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About the authors

Akrur Barua | abarua@deloitte.com

Akrur Barua is an economist with the Research Insights team. As a regular contributor to several Deloitte Insights publications, he often writes on emerging economies and macroeconomic trends that have global implications like monetary policy, real estate cycles, household leverage, and trade. He also studies the US economy, especially demographics, labor market, and consumers.

Monali Samaddar | msamaddar@deloitte.com

Monali Samaddar, of Deloitte Services India Pvt. Ltd., is an economist and senior analyst in the Research & Insights team. She contributes to periodic macroeconomic briefings and research focused on the United States and the global economy. Earlier in her career, she covered the ASEAN 5 economies. She holds a postgraduate degree in economics from the Mumbai School of Economics and Public Policy.

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Practice leadership

Patricia Buckley
Director | Deloitte Services LP
+1 571 814 6508 | pabuckley@deloitte.com

Patricia Buckley, Deloitte Services LP, is the managing director for Economics responsible for contributing to Deloitte's Eminence practice with a focus on economic policy.

Akrur Barua
US economics | Deloitte Insights
Manager | Deloitte Services India Pvt. Ltd
+1 678 299 9766 | abarua@deloitte.com

Akrur Barua is an economist with the Research & Insights team.

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