NAVIGATING THE COVID-19 STORM: IMPACT OF THE PANDEMIC ON THE PHILIPPINE ECONOMY AND MACRO RESPONSES OF THE GOVERNMENT

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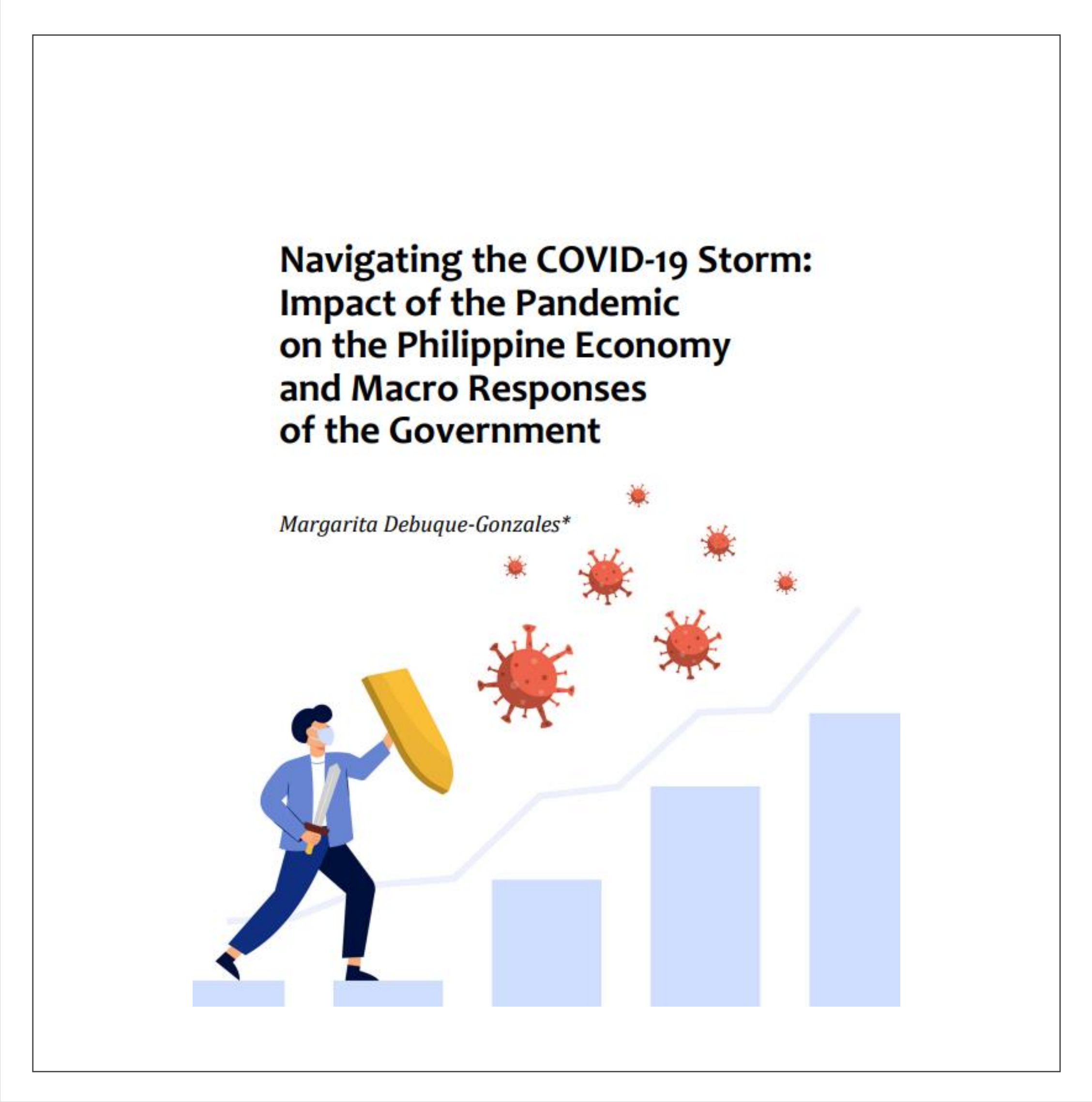

Navigating the COVID-19 Storm: Impact of the Pandemic on the Philippine Economy and Macro Responses of the Government

*Margarita Debuque-Gonzales**

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Economic impact of the COVID-19 pandemic in 2020

Macro and (more) micro view

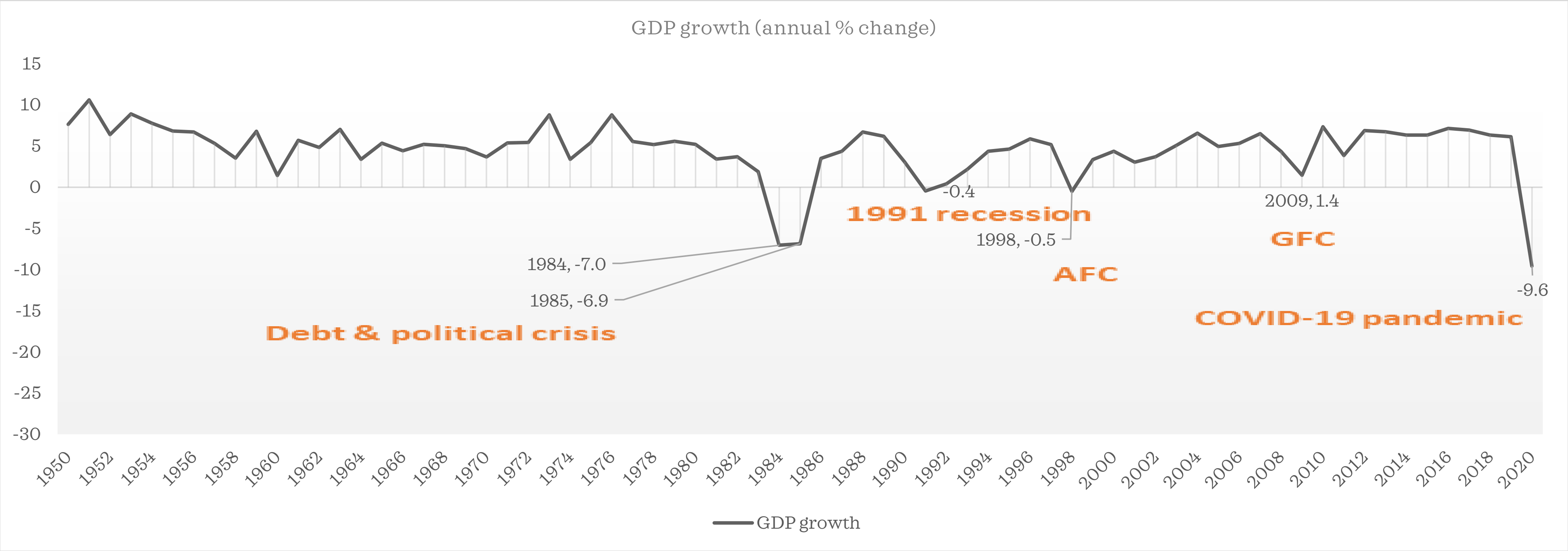
Deepest crisis in post-war history ("pandemic standstill")

Rare collapse in services

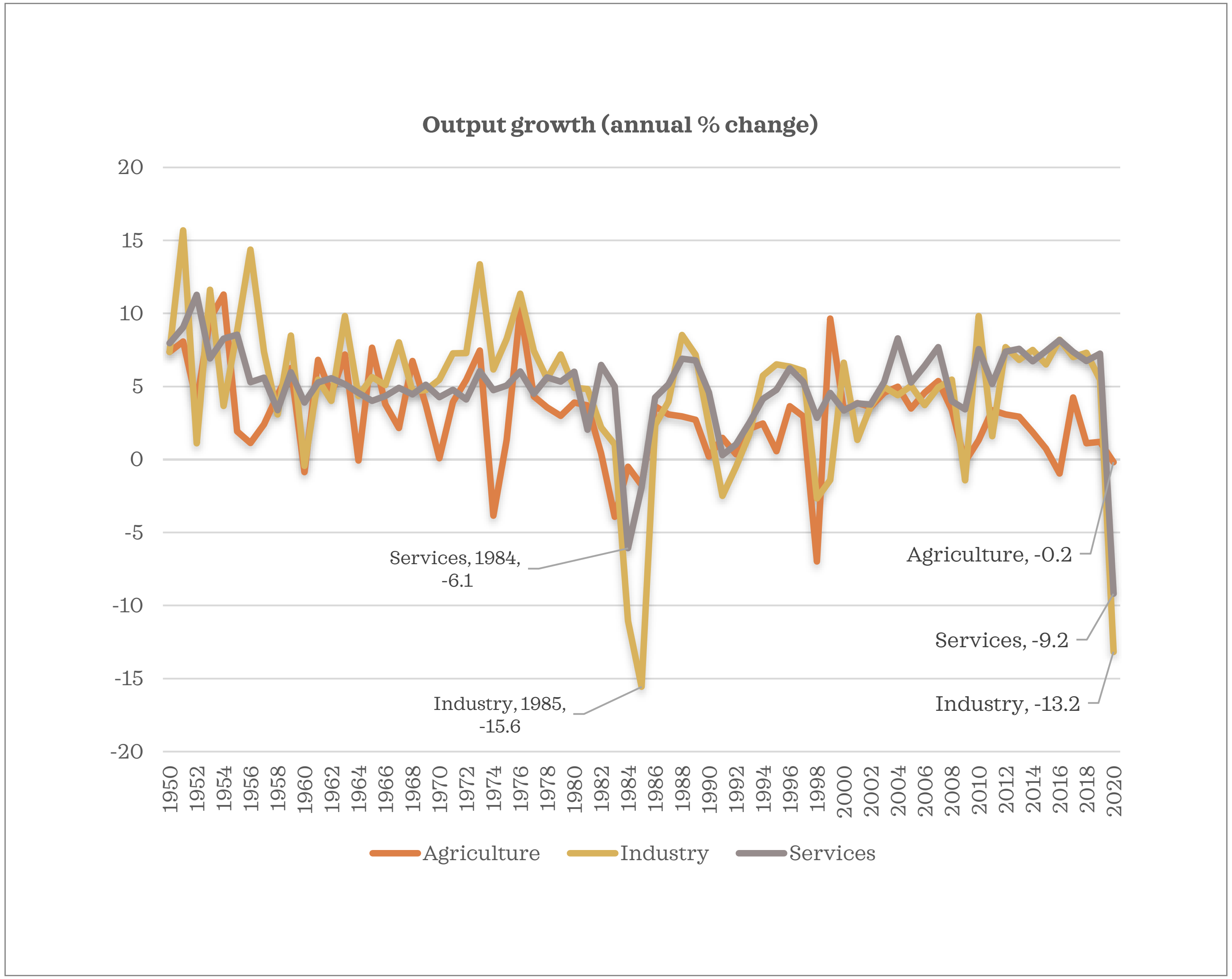
Breakdown in household spending

Mixed impact on inflation

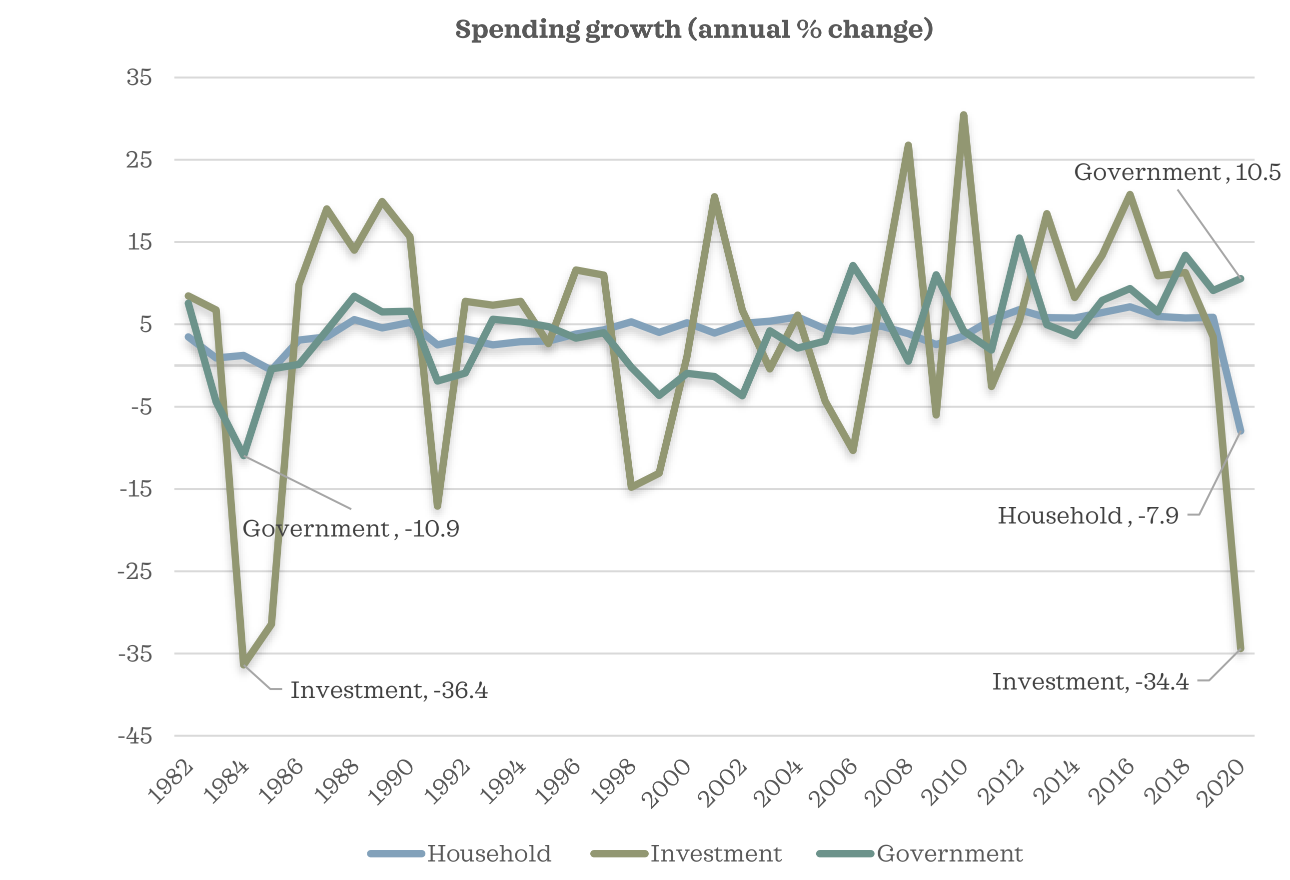
Severe job and income insecurity



Deepest crisis in recent history



Rare collapse in services



Breakdown in household spending

Mixed impact of the COVID-19 pandemic on inflation

“Not your regular crisis”

- Not due to financial excess
- Mix of supply and demand shocks

Supply shocks

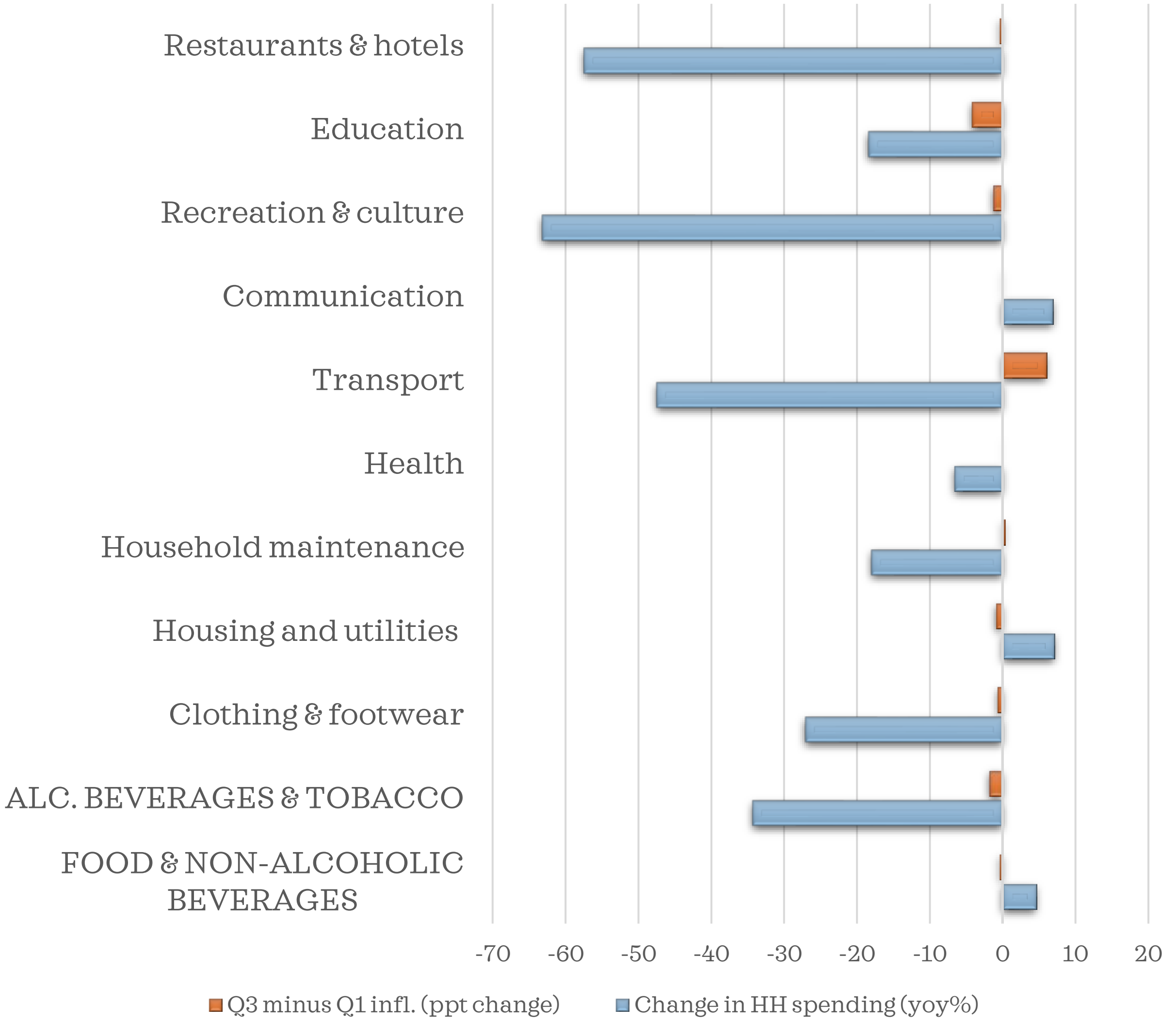
- Supply bottlenecks, price acceleration
- Example: transport service

Demand shocks

- Consumption decline, price deceleration
- Examples: restaurants and hotels, recreation and culture, clothing and footwear, and education

Other factors

Change in household spending and consumer prices during the COVID-19 pandemic



Dark legacy – Income and job insecurity

Only agriculture saw a sizable gain in number of workers in 2020

Jobs lost in construction and services (especially domestic trade and vehicle repair, transport and storage, accommodation and food)

Sustained employment growth only for own-account workers (without family farm or business or any paid employee)

Sustained decline in the number of wage and salary workers, particularly those employed in private establishments (5.5M jobs lost)

COVID-19 pandemic crisis in perspective

Economic and financial vulnerability across periods

Rare public health shock came during a time of uninterrupted growth and relatively good macro fundamentals

Mid-1980s debt and political crisis: lesson was need for disciplined public sector (keep deficits and debt at sustainable levels)

Asian financial crisis 1997/1998: lesson was importance of a disciplined financial sector (regulatory reforms, greater exchange rate flexibility but also accumulated FX reserves)

The Philippines entered the COVID-19 crisis with a healthy financial sector: low bank NPLs, high FX reserves, controlled deficits, low public and external debt

Unlike past crises, the country did not have to deal with a peso freefall and high inflation rates (instead, external surpluses, peso appreciation, mild inflation up to end-2020)

COVID-19 pandemic crisis in perspective

Bright areas during the pandemic in 2020

- External surplus
- Currency stability
- Moderate inflation
- Alternative forms of financing (acceptance of)

COVID-19 pandemic crisis in perspective

A DIFFERENT KIND OF CRISIS

- Not a financial crisis
- Complex combination of AS and AD shocks
- Sectoral shutdowns
- “Keynesian supply shock” (Guerrieri et al. 2020)
- Fiscal multipliers not working while on lockdown

Pandemic Policy Primer 1.0

Swift and strong policy action is critical in any crisis.

Since they are analytically the same, the response to a pandemic should be the same as to a natural disaster—i.e., with ample relief spending (e.g., Krugman 2020).

Risk of negative financial market spillovers remains. Can use standard monetary policy (e.g., policy rate cuts) to offset the decline in market risk tolerance or even nonstandard policy (e.g., large-scale asset purchases) to transfer some of the risk.

Optimal policy would combine monetary loosening with abundant social insurance/protection for workers in closed (contact-intensive) sectors (relief stage).

Less emphasis on traditional fiscal policies for the time being, to be used more widely when fiscal multipliers start to function again (recovery stage).

Pandemic Policy Primer 2.0 (for developing countries)

Not all policy prescriptions may be feasible for developing countries which have weaker systems for healthcare and social protection services, and more constrained fiscal space.

Tradeoff between "flattening the infection curve" and "flattening the recession curve" is harsher because of limited institutional capacity and greater vulnerability (dependence on remittances and tourism, informality).

Ideal solution: soften the tradeoff early on through prompt containment efforts and widespread testing and tracing.

Alternative to blanket lockdowns (when infection risk is not at its peak): targeted policies (Acemoglu 2020).

Alon et al. (2020) suggest a similar approach—on account of developing countries having younger populations, more hand-to-mouth households, larger informal sector, and lower fiscal capacity.

Targeted relief in the 1st phase

- Spending for public healthcare capacity
- Support for affected workers (unemployment or leave benefits for those in the formal sector)
- Support for poor households (targeted cash transfers)
- Support for affected businesses (wage subsidies, temporary tax cuts, moratorium on debt payments, credit lines)
- Relieve stress in the financial system (liquidity support through policy rate cuts, reduction of reserve requirements, longer maturities on the discount window)

Recovery in the 2nd phase

- Switch from crisis management to macro stimulus to help the economy regain its pre-crisis growth path
- Caveats on monetary and fiscal policies in developing countries: weak monetary transmission and low fiscal multipliers (from 0 to 1) particularly in low-income countries
- Alternative goals:
  - avoidance of procyclicality in the economy
  - continued provision of public goods and services, including healthcare
  - macroeconomic stability

Pandemic Policy Primer: policies for developing economies (Loayza and Pennings 2020)

Pandemic Policy Primer (for developing countries)

No clear line between relief and recovery for as long as there's uncertainty about COVID-19

Sensible economic goal in the meantime would be to alleviate the harsh effects of the pandemic while preventing amplification of shocks across different sectors (Chang 2020)

Pandemic Policy Primer (preventing amplification of shocks)

Brunnermeier and Krishnamurthy (2020)	Didier et al. (2021 J Fin Stab)
• Goal: To “evergreen” SME until the pandemic is over • Shock amplification in the COVID-19 crisis will most likely be through corporate sector balance sheets, triggered by sharp cash flow reductions • Policy should therefore focus on the survival of viable firms • A “pause” for SMEs, which are less able to weather a liquidity shortfall, is advocated • This entails ample provision of low-cost refinancing by the central bank (for rolled over loans) to stabilize existing businesses	• Goal: To prevent inefficient bankruptcies (preserve firm-worker relationships and supply chain networks, maintain productivity/ potential until reopening) • Government can work with the financial sector to keep firms afloat, while the economy enters “hibernation” • This entails policy interventions to sustain financing (e.g., adjusting the institutional framework by allowing forbearance for borrowers and avoiding unwarranted increases in borrowing cost) and loosen credit to firms (e.g., through standard monetary policy)

PANDEMIC POLICY PRIMER (PREVENTING AMPLIFICATION OF SHOCKS)

Alternative approaches

- Some of these policies might have **limited success** given **continued public health restrictions**, **high uncertainty**, and **heightened credit risk of firms**
- Alternatively, some governments have absorbed the risk in credit provision to ensure resources for firms
  - Capitalization of state-owned banks
  - Scale-up of credit guarantee programs
  - Large-scale purchases of portfolios of loans
- Emphasis on SMEs, which have fewer funding sources apart from retained earnings and bank financing (and which have less bargaining power with creditors)
- Since these measures transfer credit risk to government, the recommendation is to design them so that they minimize the cost to public resources e.g., through risk diversification across industries and firms and by setting up the right incentives for both lenders and borrowers (Didier et al. 2020)

COVID-19 crisis still essentially a public health crisis—it demanded a strong public health response for a robust economic recovery.

Macro fundamentals remain important even if powerless to prevent a pandemic recession.

Asset purchase programs of EMEs surprisingly considered "a game changer" by lowering financial-sector risk and providing leaders much-needed breathing space (GFSR 2020).

So far, the country has been able to maintain image of fiscal responsibility and fundamental strength (negative outlook by just one rater during the pandemic).

But a protracted struggle to contain the pandemic makes it increasingly harder to continue the difficult policy balance of protecting the vulnerable and shoring up the economy, given limited fiscal resources.

Reviewing the monetary and fiscal policy responses

Some important notes

Government's monetary response to the crisis

Liquidity support

- **Policy rate cuts**
  - ❖Key policy rate lowered 5 times in 2020, by 200 bps total (to overnight RRP rate = 2%)
  - ❖On Feb 6 (25 bps), Mar 19 (50 bps), Apr 16 (50 bps, off-cycle), Jun 25 (50 bps), Nov 19 (25 bps)
- **Reserve requirement ratio cuts**
  - ❖BSP Governor authorized by MB to cut the RRR by up to 400 bps in 2020 (Mar 23)
  - ❖RRR lowered by 200 bps to 12% for U/KBs (Mar 24, effective Apr 3)
  - ❖RRR lowered by 100 bps for thrift and rural/cooperative banks to 3% and 2%, respectively (Jul 21, effective Jul 31)
- **Other measures**
  - ❖Temporarily suspended TDF auctions for certain tenors (Mar 17)
  - ❖Temporarily reduced the term spread on peso rediscounting loans relative to the overnight lending rate to zero (Mar 19)
  - ❖Opened daily 1-hour window for purchases of highly traded and liquid government securities in the secondary market (Mar 24)
  - ❖Expanded range of eligible GS for purchase to cover all peso-denominated GS in the secondary market and reduced the daily overnight RRP volume offering (Apr 8)
  - ❖Reduction in minimum liquidity ratio for stand-alone thrift banks, rural banks, and cooperative banks from 20% to 16% (April 7)

Regulatory relief

- Regulatory relief granted to banks whose clients were affected by the Asian Swine flu and COVID-19 (Feb 26)
- Temporary relaxation of BSP rules on compliance reporting by banks, calculation of penalties on required reserves, and SBLs (Mar 19)
- Relaxation of documentary and reporting rules for FX operations of banks (Mar 27)
- Prudential accounting relief measures to reduce the impact of mark-to-market losses on the financial condition of BSP-supervised financial institutions (Apr 8)
- Temporary relaxation of the borrowing limit of pawnshops from 50% to 70% until December 2021 (Jun 18)
- Further easing of regulatory requirements on bank operations until Mar 2021, including temporarily easing the SBL from 25% to 30% (Jul 21)
- Exemption of debt securities acquired as a result of market-making activities of BSP-supervised financial institutions from the SBL (Jul 22) Increase in the limit on U/KBs' real estate loans, from 20% to 25% (Aug 20)
- Regulatory relief granted to branches of foreign banks by suspending sanctions for breach of SBL (Dec 29)

MSME-related lending support

- **Loans to MSMEs permitted to be counted as part of banks' compliance with reserve requirements (Apr 16)**
- **Relaxation of regulatory capital treatment of banks' exposures to MSMEs (May 5):**
  - ❖Temporary reduction in the credit risk weights of loans granted to MSMEs that are current in status from 75% (diversified MSME portfolio with at least 500 borrowers) and 100% (non-diversified MSMES portfolio) to 50% (subject to review by end-December 2021)
  - ❖Assignment of a zero-percent risk weight for MSME loans that are covered by guarantees (by the Philippine Guarantee Corp. and by the Agricultural Guarantee Fund Pool and the Agricultural Credit Policy Council) as complement to NG programs that support financing to small businesses and small farmers and fisherfolk
  - ❖Deferred implementation of the revised risk--based capital framework for thrift banks and rural/cooperative banks which cater to MSMEs and clients in rural communities (to take effect in January 2023 instead of January 2022)

NG support / Others

- **NG support:**
  - ❖BSP's P20B remittance of advanced dividend to the National Government even though it was no longer required to make dividend payments to the government under the newly amended BSP charter (Mar 2, Mar 26)
  - ❖MB approval of PHP 300 billion 6-month repurchase agreement with the National Treasury (Mar 23)
  - ❖Short-term (3-month) provisional advances to NG amounting to PHP 540 billion after the repurchase agreement was fully settled in September (Oct 1)
  - ❖Extension of PHP 540 billion provisional advances to NG for another 3 months (Dec 28)
- **Others:**
  - ❖Relaxation of KYC requirements to facilitate access to financial services (Apr 1)
  - ❖Suspension of fees related to digital financial services (such as through online banking facilities and electronic money platforms) as added relief to BSP-supervised financial institutions affected by COVID-19 (Apr 28)
  - ❖Ceiling set on credit card charges (Sep 25, effective Nov 3)

Government's fiscal response to the crisis

Relief

Bayanihan I signed March 24, 2020; 3-month effectivity (expired June 24, 2020)

Bayanihan I total budget releases reported end-December 2020, PHP 386.142 bn (1.99% of GDP)

- **COVID-related on-budget expenditures from Bayanihan I include:**
  - ❖ Social Amelioration Program & related measures, PHP 211.4 bn (1.1% of GDP)
  - ❖ Small business wage subsidy & support measures for vulnerable workers (including OFWs and health workers), PHP 64.6 bn (0.3% of GDP)
  - ❖ COVID-related medical responses, >PHP 50 bn
  - ❖ Bayanihan grants to LGUs to fund emergency responses to COVID-19, PHP 37.0 bn
  - ❖ Education spending for learning continuity, PHP 10.9 bn
  - ❖ Various agri-related measures
- **COVID-related off-budget measures include:**
  - ❖ Credit guarantees for small businesses and support to agri sector, PHP 120 bn (0.62% of GDP)

Relief + Recovery

Bayanihan II signed September 11, 2020; availability of funds extended from December 19, 2020 to June 30, 2021

Bayanihan II budget releases as of end-December 2020, PHP 109.2 bn (0.56% of GDP)

- **Budget appropriations in Bayanihan II, total of PHP 140 bn (0.72% of GDP) includes:**
  - ❖ Capital infusion to GFIs, PHP 39.5 bn
  - ❖ Health-related responses, PHP 30.5 bn
    - –Includes hiring of 50,000 contract tracers, PHP 5 bn
  - ❖ Support to agriculture and fishery, PHP 24 bn
  - ❖ Cash-for-work programs & unemployment assistance for displaced workers, PHP 13 bn
  - ❖ Transport sector support, PHP 9.5 bn
  - ❖ Education support, PHP 8.9 bn
  - ❖ Financing of social protection programs, PHP 6 bn
  - ❖ Tourism sector support, PHP 4.1 bn
    - –Includes cash-for-work programs, PHP 3 bn
  - ❖ LGU assistance, PHP 3.5 bn
- **Standby fund in Bayanihan II, PHP 25.5 bn (0.13% of GDP)**
  - ❖ Covid-19 testing & procurement of medicines & vaccine, PHP 10 bn
  - ❖ Capital infusion to LBP, PHP 9 bn
  - ❖ Capital infusion to DBP, PHP 6.5 bn
- **Tax change in Bayanihan II**
  - ❖ NOLCO extension from 3 to 5 years (for net operating loss during 2020 and 2021), PHP 16.262 bn

"Reset" + "Rebound" + "Recover"

FY 2021 National Budget

PHP 4.506 tr (21.8% of GDP, up 9.9% from FY 2020 budget)

- **"Reset": Responding to the COVID-19 pandemic**
  - ❖ Health sector budget, PHP 210.2 bn (up 19.6% annually)
  - ❖ Regular health programs include:
    - —Health insurance premiums, PHP 71.4 bn
    - —Medical assistance to indigent patients , PHP 17 bn
    - —Deployment of doctors, nurses and other health workers to disadvantaged communities and national hospitals, PHP 16.6 bn
    - —Infrastructure upgrade, PHP 14.7 bn (includes PHP 5.52 bn in unprogrammed funds and PHP 1.4 bn from ADB and World Bank funded projects)
  - ❖ New health programs/projects include:
    - —Equipment and materials, PHP 5.7 bn
    - —COVID-19 vaccines, PHP 2.5 bn (plus PHP 70 bn in unprogrammed appropriations for vaccine procurement and logistics)
    - —Foreign-assisted projects addressing pandemic needs, PHP 5.3 bn
    - —R&D, PHP 334.56 mn
- **"Rebound": Reviving infrastructure development**
  - ❖ DPWH core programs, PHP 317.7 bn
  - ❖ DOTR projects, including:
    - —Rail transport, PHP 47.7 bn
    - —Land transport, PHP 12.6 bn
- **"Recover": adapting to post-pandemic life**
  - ❖ Food security, PHP 57.2 bn
  - ❖ Industry and livelihood, PHP 27.9 bn
  - ❖ Education, PHP 22.9 bn
  - ❖ Social protection, PHP 134.6 bn
  - ❖ National ID and community-monitoring system, PHP 4.4 bn

Restructuring

Supply-side stimulus

- **CREATE Act includes the following:**
  - ❖ Permanent CIT rate cut from 30% to 25% (effective July 1, 2020)
  - ❖ Lower CIT rate of 20% for corporations with net taxable income of not more than PHP 5 mn and total assets (not including land) of not more than PHP 100 mn
  - ❖ Temporary tax cuts (between July 2020 & June 2023):
    - –For proprietary educational institutions and hospitals (from 10% income tax rate to 1%)
    - –Minimum CIT (from 2% to 1%,)
    - –For taxpayers whose gross sales or receipts do not exceed the VAT threshold of PHP 3 mn (from 3% percentage tax rate to 1 %)
  - ❖ VAT exemptions on housing, e-books, drugs & medicine
  - ❖ Strengthening of FIRB
- **Tax change in Bayanihan II**
  - ❖ Repeal of IPO tax, PHP 1.16 bn

Review of monetary response (positives)

Overall, the country has been able to put together an appropriate set of monetary responses, based on the conceptual framework provided.

Ample liquidity has helped relieve market stress and avert financial instability.

Regulatory relief has lessened the pressure on financial institutions.

Policy has focused on MSMEs and households.

Review of fiscal response (positives)

Except for the permanent tax cuts, the country's fiscal response has pretty much followed the accepted playbook, with proper sequencing of relief and recovery measures.

Initial aim was to provide relief to workers, households, and businesses at the height of the pandemic in 2020 (through Bayanihan 1).

Shifted to a more targeted approach (under Bayanihan II) and incorporated more stimulus elements in the national budget (e.g., infrastructure spending).

Focus on households and firms: through cash transfers/grants, payments relief (from taxes, loans, rents, and utilities) and tax exemptions/deductions.

Financial conditions (liquidity, stress and risk) collapsed during the pandemic. Credit standards expectedly tightened. Credit demand expectedly weakened.

The BSP estimated a total of PHP 1.9 trillion (9.6% of GDP) injected into the financial system by mid-October 2020. But around PHP 1.5 trillion or greater had been lodged in its liquidity management facilities (as of time of writing) despite efforts to support domestic liquidity.

Banks worried about balance sheets and bottom lines sought haven in BSP's risk-free instruments. They also set aside substantial amounts as loan-loss provisions to protect themselves in a weak economy.

Policy observers saw such procyclical behavior of banks as evidence that the central bank was already "pushing on a string." This highlighted the need for a better balance between fiscal and monetary responses.

"Pushing on a string"

Reviewing the monetary-fiscal policy combination

While its COVID-19 spending may seem unremarkable in the Asian region, the Philippines embarked on an ambitious program in terms of proportion of population covered (Cho 2021).

Expected glitches: incomplete list of beneficiaries, absence of national ID system and unified database, physical handling of cash, which made distribution unsafe (in terms of infection) and prone to corruption and leakage. 4Ps-related performance invites some optimism (World Bank 2020).

Traditional forms of public spending proved even harder. Following Bayanihan I, public works postponed/cancelled while limited operating capacity due to quarantines led to implementation delays of remaining projects. Public infra program was revised down (infra spending fell in 2020).

Tax cuts in the fiscal package may not a be a major source of fiscal stimulus in the near term, if faced with continued weakness of aggregate demand. Full benefits of CREATE would be more likely in the longer term.

“A hard fiscal push”

Reviewing the monetary-fiscal policy combination

Key lessons

Remember the past lessons (maintain economic fundamentals)

Follow a playbook (this will help plan and coordinate macro responses)

Get lessons from the literature (they help)

- Countries with larger first-year responses in government spending, especially on healthcare, exhibited faster recovery (Ma et al. 2020).
- Social insurance/protection for affected workers in closed sectors (or where social distancing is required) is the best way to prevent (Keynesian) supply shocks triggering demand shortages (Guerrieri et al. 2020).
- In a pandemic crisis, shock amplification will likely be through corporate balance sheets (due to sharp cash flow reductions), especially of small firms, and the goal should be to prevent inefficient bankruptcies (Brunnermeier and Krishnamurthy 2020, Didier et al. 2021).
- A growing body of research support what we already know about the quicker way out of a pandemic (Keynesian) slump—by raising consumer/investor confidence (e.g., by successful containment and vaccination), and direct injection of demand (e.g., cash grants for the poor, cheap credit/grants for small firms with sustainable businesses).

Policy challenges moving forward

Though COVID-19 may eventually be considered endemic, developing countries including the Philippines would still need to prepare for a resurgence of the disease and possible emergence of another pandemic.

Policymakers will need to optimally time the country's exit strategy for COVID-19 support measures to minimize macroeconomic risk.

The government will have to act to avert the risk of economic scarring due to a protracted pandemic crisis, but it will also need to have a sound fiscal strategy to maintain macroeconomic stability.

Philippine recovery - the 2 key elements

Nurse the economy back to health.

Maintain investor and business confidence while doing so.

Thank you!

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