Box 1

ASSET PURCHASE PROGRAMMES OF LATIN AMERICAN CENTRAL BANKS

This box is part of the «Report on the Latin-American economy. Second half of 2020», which will be published on 8 October

To address the fallout of the COVID-19 pandemic on activity and employment, most emerging economies adopted highly expansionary monetary and fiscal policies, mainly between March and May, in line with those of advanced economies. As for monetary policies, central banks substantially cut their policy interest rates to what in many cases were record lows (see Chart 1.1), increased banking system liquidity (e.g. by reducing reserve ratios) and launched credit support programmes. In addition, macroprudential authorities adopted measures such as releasing capital buffers to sustain credit. However, the main change in these economies' policy responses was the announcement and implementation by their respective central banks of asset purchase programmes, in most cases for the first time ever.[1] This box describes the purchase programmes announced or adopted by the main emerging economies, focusing especially on Latin America. It points out the relevant differences between these programmes and those of the developed economies, and briefly analyses their effectiveness along with their main risks.

The main features of the asset purchase programmes of the relevant economies are shown in Table 1. In Latin America, the central bank of Chile started to repurchase own-debt issues and purchase bank bonds, and the Chilean government passed a constitutional reform and a bill giving the central bank the power to buy government bonds in the secondary market under exceptional and temporary circumstances.[2] In March, for the first time in its history, the central bank of Colombia began purchasing private as well as public debt securities in the secondary market. In the case of the latter instruments, the operation was renewed in April and reinforced with the possibility of intervening in forward markets. Meanwhile, the central banks of Mexico and Peru announced repo transactions with public debt securities with longer tenors than are customary in open market operations. In the case of Peru, its central bank included pension fund administrators among the institutions that can carry out these types of operations. Lastly, the Brazilian Congress passed a constitutional amendment in May authorising the central bank to purchase public and private debt securities in both the domestic and international secondary markets.

These Latin American and emerging-economy central bank asset purchase programmes generally differ from those of advanced economies in several respects. First, the scale of these programmes: those of the former are much smaller (see Chart 1.2), although the size of these countries' debt securities markets limits the universe of possible purchases. Second, central banks' balance sheets in emerging economies have a larger share of external assets (international reserves) (see Chart 1.3). This means that, where these programmes have been pursued at the same time as foreign exchange market interventions — to rein in currency depreciation by selling reserves — the central bank's balance sheet may not have increased.[3] Another significant difference is that, in some cases, financial asset purchases were announced or conducted before having reached the policy interest rates at which advanced economies' expansionary programmes were launched (see Chart 1.4).

However, the crucial difference between the asset purchase programmes of these two groups of economies has to do with their goals. In the case of the developed economies, they are unconventional monetary policy measures that are used regularly, especially in the wake of the crisis that broke in 2008, with the aim of loosening financial conditions by reducing longer-term interest rates once the policy interest rate has reached levels close to its effective lower bound. Only Croatia and Poland, among the emerging economies, have explicitly declared that this is their objective (see Table 1). With the exception of Indonesia, Guatemala and Ghana, who have also expressed their aim of financing the public deficit, the remaining emerging-economy central banks — particularly, those of Latin America — have adopted asset purchase programmes mainly to curb the rising volatility of longer-term interest rates, i.e. to avoid the potential adverse effects on financial stability and the deterioration of monetary policy transmission channels.[4] Purchases are

1 See D. Hofman and G. Kamber (2020), "Unconventional monetary policy in emerging market and developing economies", Special Series on Covid-19, IMF, for a more general discussion of unconventional monetary policies in the emerging economies.

2 The exercise of this power calls for the favourable vote of four of the five directors of the central bank.

3 Assuming reserve sales have not been sterilised.

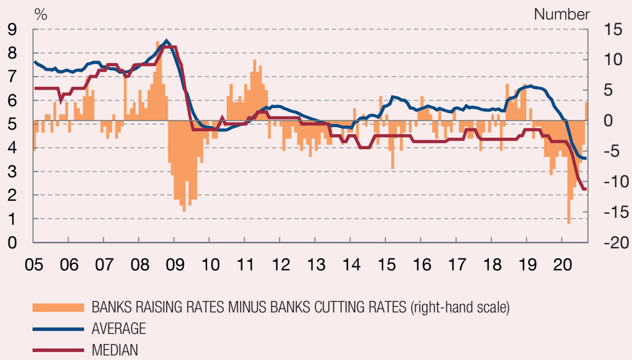
4 The Report submitted by the Board of Directors of the central bank of Colombia to the Congress of the Republic in July 2020 stated the following: "[…] Purchases of public and private sector securities. The aim was to stabilise key markets for the transmission of monetary policy and to provide ample and stable liquidity which would contribute to the preservation of the payment system and credit supply". The minutes of the monetary policy meeting of the central bank of Chile held on June 2020 state that: "[…] the financial asset purchase programme would allow, in principle, to reduce certain risk premiums in the capital market, facilitate portfolio rebalancing towards riskier assets, and directly provide liquidity to non-banking institutions, which nevertheless are important mobilizers of private savings".

Box 1
ASSET PURCHASE PROGRAMMES OF LATIN AMERICAN CENTRAL BANKS (cont'd)

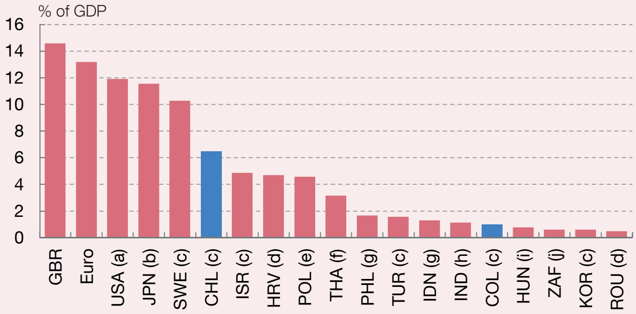
Chart 1
POLICY INTEREST RATES AND CENTRAL BANKS' BALANCE SHEETS, ASSET PURCHASE PROGRAMMES, MARKET REACTIONS TO THE ANNOUNCEMENTS OF THE PROGRAMMES

In addition to further policy interest rate cuts, the central banks of some emerging economies announced asset purchase programmes to address the fallout from the pandemic. These programmes are, for the time being, smaller than those of the advanced economies, in a context where central banks' balance sheets have a high proportion of reserves, and were launched without exhausting the room for manoeuvre afforded by conventional policies. Market reactions were generally favourable.

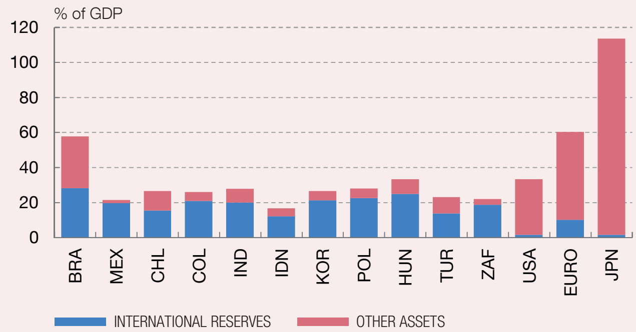
1 POLICY INTEREST RATES IN EMERGING ECONOMIES



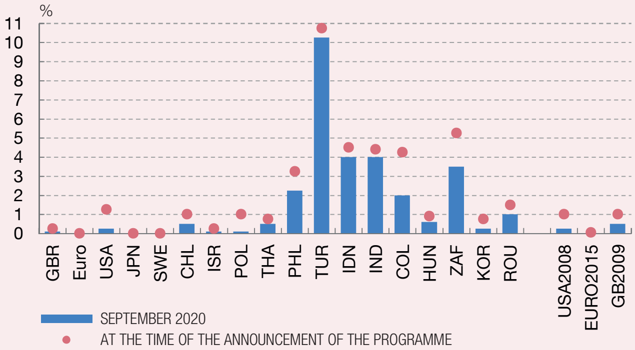
2 SIZE OF THE FINANCIAL ASSET PURCHASE PROGRAMMES SINCE THE ONSET OF THE PANDEMIC



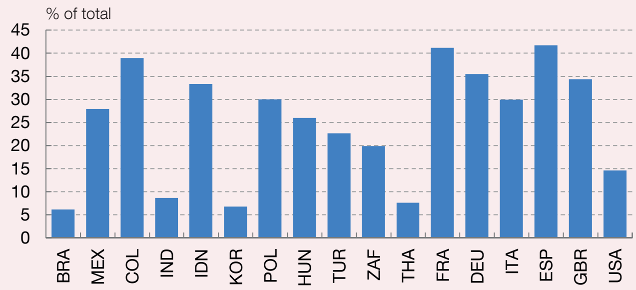
3 CENTRAL BANK ASSETS (% OF GDP) (2020)



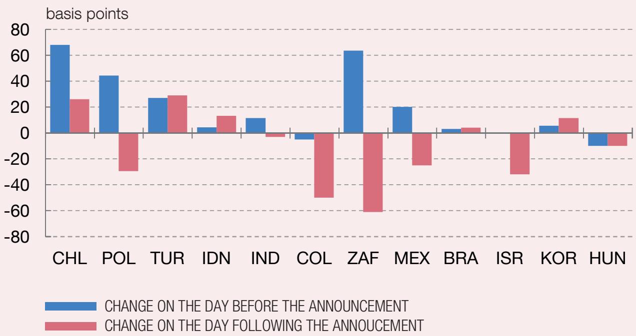
4 OFFICIAL INTEREST RATES



5 PARTICIPATION OF NON-RESIDENTS IN DEBT MARKETS (k)



6 CHANGES IN LONG-TERM INTEREST RATES IN LOCAL CURRENCY



SOURCES: Banco de España, national central banks, IIF, Refinitiv.

a MBS and Treasury bond purchases from 16 May to 20 August 2020.
b Sum of the increase in government bond holdings and the JPY 20 trillion announced for corporate bonds.
c Amounts announced.
d Interventions until 30 July.
e Purchases until 19 August.
f Increase in government bond holdings in central bank balance sheet since March and announced of corporate bond purchase programme.
g Public debt purchases.
h Debt purchases in open market operations plus announced sovereign bond purchases.
i Public debt and MBS purchases until 23 August.
j Increase in public debt holdings in the central bank's balance sheet.
k Debt liability holdings of non-residents (International Monetary Fund's Coordinated Portfolio Investment Survey) divided by the size of the debt securities markets (Bank for International Settlements).

Box 1

ASSET PURCHASE PROGRAMMES OF LATIN AMERICAN CENTRAL BANKS (cont'd)

Table 1
MAIN CHARACTERISTICS OF EMERGING ECONOMIES' ASSET PURCHASE PROGRAMMES (a)

Country	Announcement	Objective	Size (% of GDP) (b)	Purpose	Targeted assets	Market
Croatia	13 March	Not specified	4.7	Maintaining stability in the public debt market	Public debt	Secondary
Poland	17 March	Not specified	4.6	Changing the long-term liquidity structure of the banking sector, guaranteeing liquidity in the secondary securities market and strengthening the monetary policy transmission mechanism	Public debt	Secondary
Chile	19 March	Quantified	6.5	Containing the effects of high-volatility-generating events in the debt securities market	Repurchases of own-debt issues, bank debt (and subsequently, corporate debt)	Secondary
Korea	19 March	Quantified	0.6	Stabilising the bond market and supporting public debt supply and demand to increase banks' purchasing power	Public debt (extended on 22 April to commercial paper and corporate bonds)	Secondary
Thailand	19 March	Quantified	3.1	Providing liquidity and ensuring the normal functioning of debt securities markets	Public / private debt	Secondary
India	20 March	Not specified	1.1	Ensuring all market segments have sufficient liquidity and remain stable, with an appropriate trading volume	Public debt	Secondary
Romania	20 March	Not specified	0.5	Consolidating the structural liquidity of the banking system to contribute to the financing of the real and the public sectors	Public debt	Secondary
Colombia	23 March	Quantified	1.0	Providing permanent liquidity to ensure the smooth operation of financial markets	Public debt, bank debt	Secondary
Israel	23 March	Quantified	4.8	Loosening credit conditions and supporting economic activity	Public debt	Secondary
Philippines	24 March	Quantified	1.6	Providing support to government bond market participants in the event they need to liquidate their holdings, thereby promoting participation in bond auctions	Public debt	Primary / Secondary
South Africa	25 March	Not specified	0.6	Increasing market liquidity, promoting the smooth operation of local bond markets and improving its own balance sheet composition	Public debt	Secondary
Turkey	31 March	Quantified	1.6	Reinforcing the monetary policy transmission mechanism by increasing government bond market liquidity	Public debt	Secondary
Indonesia	1 April	Not specified	1.3	Helping the government finance actions for offsetting the impact of COVID-19 in the event the market is unable to absorb all the government debt issues	Public debt	Primary / Secondary
Hungary	7 April	Not specified	0.8	Restoring the stability of government bond market liquidity and improving the supply of long-term funding by the banking sector	Public debt / bank MBS	Primary / Secondary (public debt) Only primary (MBS)
Guatemala	24 April	Quantified	Up to 2.5	Congress used the derogation provided for in Article 133 of the Constitution, which exempts the Banco de Guatemala from the ban on lending money to the State in the event of a catastrophe or public disaster	Public debt	Primary
Ghana	15 May	Quantified	1.8	Financing the public deficit increase in response to the rise in market financing costs	Public debt	Primary

SOURCES: IMF, IIF, national central banks, BIS.

a In addition to the countries included in the table, the Brazilian Congress passed a constitutional amendment on 7 May to address a national emergency, giving the central bank the power to purchase public and private debt in national or international secondary markets. In the Czech Republic, an amendment to the Central Bank Law expands the types of securities and counterparties with which it can participate in secondary markets, in the event of disorderly market conditions. In both cases, the new powers have not yet been used. In Malaysia, the central bank announced an extension of open market operations, including those with public debt. The Central Bank of Mexico announced a 100-billion-peso increase in open market operations with public debt (0.4% of GDP).

b In the case of non-quantified programmes, purchases to date (see chart notes).

made mostly in secondary markets (only those explicitly aiming to finance deficits make purchases in primary markets). In addition, these asset purchases may have consequences for exchange rates. Purchasing debt securities with longer-dated maturities increases their price and reduces their volatility, thereby reducing incentives for non-residents to exit. That in turn lowers selling pressures on the national currency, especially in economies with a significant share of non-residents in the debt market (see Chart 1.5).

As for the effectiveness of these programmes in emerging economies, their announcement generally coincided with a reduction in long-term local-currency-denominated government bond yields (see Chart 1.6). Arslan et al. (2020)[5] show that bond purchases by the central banks of emerging economies had a significant negative effect, on average, on the yields of these bonds for a number of countries, but that its effect on exchange rates was much more limited. Meanwhile, Hartley and Rebucci (2020)[6] show that the local-currency-related effect on long-term interest rates is greater for programmes announced by emerging as opposed to advanced economies. In any case, the bulk of the purchases was made in March and April, before the ensuing recovery of financial markets as from May.

The main risk of implementing asset purchase programmes in emerging economies is a possible rise in inflation and inflation expectations. That would be a particular concern in Latin America, considering the past bouts of high inflation and hyperinflation arising from the monetary financing of public deficits.[7] For now, however, COVID-19 has had net disinflationary effects, chiefly owing to the opening of wide negative output gaps. In Mexico and Brazil, inflation expectations over the medium term hovered around pre-announcement levels across the entire maturity spectrum (with declines of 0.1 percentage points for 2023 and 2024 in the case of Brazil); in Colombia they fell nearly half a percentage point; and in Chile they remained anchored at 3%, which is the inflation target of its central bank.

Another potentially relevant risk of these programmes could arise were agents to perceive that the central bank has become a major player in these markets. That could undermine the correct functioning of these markets along with that of the derivatives markets and lead to a sub-optimal allocation of financial resources. Taking communication actions which emphasise the temporary nature of the asset purchase programmes — and thereby limiting their contingency to the current exceptional circumstances, in line with the approach of the central banks of some advanced economies — could contribute to averting the materialisation of this risk. This is reflected in the bill approved by the Chilean Congress in August, conferring power on the Chilean central bank to purchase debt securities on the secondary market.[8]

5 Yavuz Arslan, Mathias Drehmann and Boris Hofmann (2020), "Central bank bond purchases in emerging market economies", *BIS Bulletin,* no. 20 (June 2020).

6 Jonathan S. Hartley and Alessandro Rebucci (2020), *An Event Study of COVID-19 Central Bank Quantitative Easing in advanced and emerging economies,* NBER Working Paper, no. 27339 (June 2020).

7 The future continuity of these programmes might ultimately limit the independence of central banks in these countries.

8 In accordance with this bill, once these extraordinary circumstances abate, the securities will be sold by the central bank on the secondary market at the time and under the terms and conditions set by its Board.