

## **Unconventional Measures to Cope with Financial Tsunami**

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History has demonstrated time and again that dealing with unprecedented problems requires inventive problem-solving approaches. Today, in economies where financial markets are facing potentially rising systemic risks, coping with the ongoing global financial tsunami has witnessed numerous measures that have been continually employed to help mitigate liquidity and especially credit problems. The Federal Reserve Bank (Fed) took the toolkit of "unconventional measures" by bailing out Bear Stearns in March of last year. Soon after, a number of measures, including the liquidity provision to primary dealers and foreign central banks, capital infusion to troubled banks, and an assets-guarantee programme, were deployed by the Fed and other US authorities to augment the conventional policy rate cut. Indeed, the Fed liquidity facilities have been increasingly utilised by market players following the collapse of Lehman Brothers in September last year.

So far those measures have helped alleviate liquidity strains quite significantly. Though they have also brought down credit spreads somewhat, the credit problems still stay notably elevated.

The Fed will have to continue providing liquidity directly to key credit markets and purchasing securities until the US financial markets stabilise. This operation is known as "credit easing", which is conceptually different from the Japanese "quantitative easing". In the US case, credit easing aims to help credit conditions of households, businesses and financial institutions. These activities contribute to expanding the assets side of the Fed's balance sheet. In contrast, the Japanese quantitative easing focused on expanding the bank reserves on the liability side of the balance sheet, which did not seem to be effective in fighting economic slump and deflation.

Not only the US central bank but also other major central banks have implemented various unconventional measures. For example, the Bank of Japan announced a programme to purchase corporate bonds to facilitate corporate financing. The Bank of England has also established an asset - purchase facility, while the European Central Bank has already injected enormous liquidity into the system, through formerly unconventional channels.

Ironically, implementing unconventional measures has become conventional practice in this financial turmoil. Market participants not only get used to it but seem to believe that more will be created. Apparently it has also become more and more acceptable among economists to believe that preventing further falls in financial markets and overall economies has a higher priority than avoiding the moral hazard problem associated with helping and bailing out banks in troubled during this severe crisis.

To date, we have not seen any clear signs of recovery in the US economy - the epicenter of the problem. In addition, contraction in the real sector will likely adversely affect the banking sector further in the feedback loop of the crisis. Fiscal measures will need to take the lead in averting snowballing declines and ensuring economic recovery further down the road.

Nevertheless, the unconventional help by authorities from the monetary side will also remain essential to support the fiscal stimulus in mitigating the problems that could lead to further rounds of the financial tsunami.

Views expressed are the author's own.

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