CB Plays Vital Role in Controlling Credit

'Bank of Banks'

Central Bank Encourages Growth of RP Banking

By DANIEL A. MONTILLA

It is indubitably clear that credit should be regulated since unrestrained credit expansion or contraction can lead to unprecedented booms or slumps, causing unhealthy or undesirable effects to the economy.

In the Philippines, as well as in other countries where central banking operates, the Central Bank plays a vital role in controlling credit and, if done properly and efficaciously, can contribute to economic stability.

Republic Act No. 265, the law which established the Central Bank of the Philippines, provides for various instruments of credit control and these serve not only as implementing monetary policies but to a great extent they underlie and shape them as well.

A significant instrument of credit control is the imposition of bank reserve requirements. Under the law, the Monetary Board may prescribe ratios from 10 per cent to 50 per cent against demand deposits and 5 per cent to 25 per cent against time and savings deposits. Within these ranges undue expansion of credit can very well be restricted.

100 Per Cent

However, in periods of inflation if such percentages are not sufficient to contain credit the law al-

(Continued on Page 9)

CB Plays

(Continued from Page 6)

lows the MB to prescribe ratios even as high as 100 per cent against any future increase in the deposits of each bank and a decrease in these reserve requirements in times of deflation.

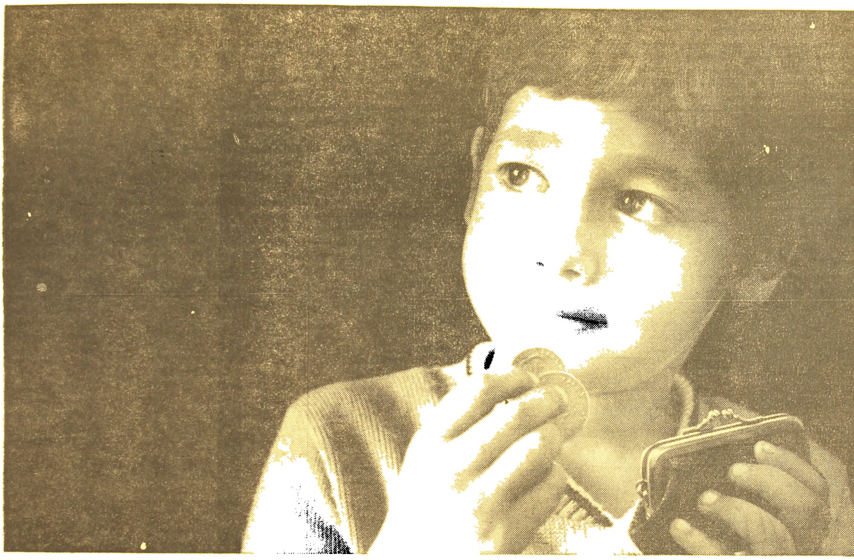
An equally important instrument designed for the same end is the fixing of interest or rediscount rates on Central Bank loans. Judging from the experiences of many countries, this instrument in the hands of the CB remains a most potent and lating inflationary and deflationary tendencies. However, in order not to cause harm, this instrument should be used only in accordance with the character and terms of credit operations, the credit needs of the market, composition of the Central Bank's portfolio and the general requirements of the national monetary policy.

Thus, in this connection, the law requires that the radiscounts, discounts, loans and advances which the CB is authorized to extend to banking institutions shall be used to regulate the volume, costs, availability and character of bank credit and to provide the banking system with liquid funds in times of need.

Circulars

A third type of credit control is direct action by the Central Bank. This kind of instrument regulating credit may assume direct dealings with banks on a bank-to-bank basis where the other means of control have failed or proved inadequate. The forms of direct action may consist of memoranda and circulars and these are necessarily coercive requiring compliance from individual banks and careffective weapon in regurying penalties in case of non-compliance.

However, short of employing the coercive measure of direct action or without resorting to the



other equally mandatory instruments of credit control, the CB can still attain the desired goal by means of moral suasion.

This tool may take the form of published announcements, holding of conferences, meetings with the Bankers Association of the Philippines (BAP) and the like wherein plans and courses of action are proposed and discussed. The object is to seek the cooperation of banks in the realization of the objectives of the Central Bank to stabilize the currency and promote overall economic progress.

That this approach has proven successful in many cases in the past, in that the banking community has heeded the call of support by the Central Bank, is due largely to the fact that appeals of this sort have instilled in the banks a sense of belonging and of being enthusiastic partners with the CB in the praiseworthy task of bringing about monetary stability and material welfare.

Open Market

Another important measure of credit control which is beginning to take roots in developing countries although still in its infancy in the Philippines is the traditional tool of open market operations. This instrument can very well serve as a brake to unwarranted expansion of credit in times of inflation and as an accelerator in granting more credit in periods of deflation.

The first situation can be effected when the Central Bank shall not make purchases of securities in the open market or at best minimize such purchases or even sell its security holdings. On the other hand, the second situation, i.e., in case of declining money supply and big doses are needed to be injected into the economy, is realized when the CB undertakes more purchases, withholds sales of its security holdings or repurchases its bonds or certificates of indebtedness.

In this country open market operations has been resorted to not only to control credit but also to make more people bank conscious since commercial banks serve as agents in the encashment of bonds, to encourage forced savings habits and, most importantly, to finance economic development of the country.

In addition, when open market operations expand or restrict credit, bank reserves are either increased or decreased. When the Central Bank purchases securities in the open market the proceeds of the sale are credited to the member bank's deposit accounts at the Central Bank. This will increase the reserves of the banks because of an increase of the money available for circulation.

Conversely, when the CB sells securities in the open market, the deposit accounts of the member bank will be debited, resulting in the shrinkage of money supply and thereby in the bank reserves. Thus if the bank reserves are expanded member banks can provide more credit to the public and if bank reserves are reduced less credit is available.

Other Reasons

Besides the fact that open market operations as a device in controlling credit is comparatively of recent vintage in the Philippines; there are other reasons why it cannot be used extensively as yet in this country. For one thing, the market for securities is small and the country is still largely agricultural where it is difficult to develop among the people the consciousness of investing their money in bonds and securities.

For another thing, the people are not accustomed to buying and selling them and it is believed it would take some time to reorient their minds toward investment in securities. Nevertheless, education and moral suasion can be very useful measures that can bring about changes in this direction.

There are still other instruments that can control credit and which are better known as selective credit control measures such as the placing of ceilings on rediscounts of commercial banks and the requirement that commercial banks should maintain a one-to-one ratio between their actual foreign exchange assets and foreign exchange liabilities.

There are authorities, however, such as Dr. Gregorio S. Miranda, who claim that the former measure did not entirely curb lendings made by commercial banks and therefore not very effective in controlling credit. But the one-to-one ratio which was designed to check unnecessary imports has been more effective in regulating credit with the added advantage of reducing the amount of the foreign exchange liabilities of commercial banks with the corresponding increase in their foreign exchange assets.

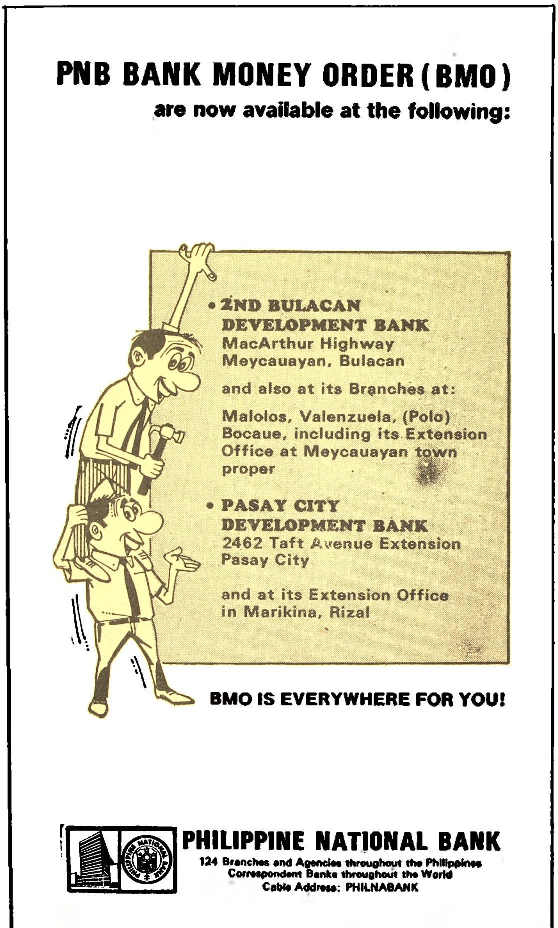
Other Measures

Still in certain instances these traditional instruments of credit control may not be effective enough to cope with the situation, say a rapid skyrocketting in money supply or an unchecked decrease in the quantity of money in circulation, bringing about a serious case of deflation. To be sure, many central banks in the world, including ours, have invariably employed other measures, singly or collectively in conjunction with the traditional instruments.

These measures are the rationing of credit (i.e., placing a limit on discounts), prescribing minimum cash margins for opening letters of credit and the imposition of minimum ratios which capital and surplus of banks must bear to the volume of their assets.

By and large, however, all these credit control measures, despite their limitations imposed by circumstances, lack of fiscal restraint, the law and the usual untrammelled spending on developmental projects and public works, have contributed in one form or another toward the expansion of credit and the curbing of unwarranted expansion and consequently that too of the money supply.

***His work on this matter, Business and Government, has been used as reference for this article.**



The Corner Bank

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tively account for 53 per cent of Provident's total number of depositors and 42 per cent of its total deposits.

To keep pace with the bank's growth, Provident has expanded its lending operations. At present, its total outstanding loans amount to over ₱41 million. A majority of these loans were granted for real estate development and housing construction as a response to the present need for housing facilities.

Provident today enjoys the trust and confidence of over 110,000 depositors who avail of the 12-hour service of the bank from Monday to Saturday. Such trust it has continuously nurtured through improved and better services and relentless efforts in looking for means to bring higher returns for the funds entrusted to it by these depositors.