

Reforming Thailand's Monetary Policy Operation Framework

Financial Markets Operations Group
25 September 2006

Outline

- 1) Need for reform
- 2) Goal of reform
- 3) Details of reform measures
- 4) Q&A

Need for reform

- 1) **Existence of BOT RP market adversely impacts money market development and transparency of monetary operation**
 - **Distorts market pricing of risk**
 - **Banks adjust liquidity directly with BOT rather than among themselves**
- 2) **Current operation framework has important shortcomings that will become much more severe if role of BOT RP diminishes**

Reform Goal

First Pillar: Closure of BOT RP market

- More active and efficient money market

Second Pillar: Operation framework that implements policy more effectively and is consistent with the closure of the BOT RP market

- More simple, coherent, and transparent market operation that relies more heavily on market incentives and mechanisms

Reform Details

1) Monetary Policy Instrument

- Switch policy rate to an overnight rate
 - Main operation goal will be to keep overnight market rates reasonably close to policy rate

2) Ensure Controllability of the Instrument

- Open market operations
- Standing facilities
- Reserve averaging

Open Market Operations

Current Framework: **RP 14-Day Policy Rate**

1) **Morning Bilateral Repo Session**

- Limited to Primary Dealers
- Fixed-rate operation at 14-day tenor

2) **Afternoon BOT Repo Session**

- Wider participation
- BOT acts as central counter-party and match-maker
- Also used by BOT to influence overall system liquidity

Open Market Operations

New Framework: Switch policy rate to an overnight rate

1) Morning Bilateral Repo Session

- Use 1-day RP as new policy rate
- Fixed-rate operation at 1-day tenor at this rate
- All other operations conducted as variable rate tender
- No 1-day RP operation on day of MPC

2) Afternoon BOT Repo Session

- Same as before

Standing Facilities

To limit volatility of overnight market interest rate, a corridor of ± 50 bps relative to policy rate will be established

- **Allow market participants to borrow or invest excess funds at predetermined rate**
- **Facility is there to be used, no stigma attached**
- **No incentive for market participants to engage in overnight transactions at rates away from the corridor**

Standing Facilities

Current Framework:

1) End-of-Day Liquidity Window

- Market participants can borrow funds from BOT overnight at policy rate + 150 bps subject to collateral
- Open between 17:00-17:30

Standing Facilities

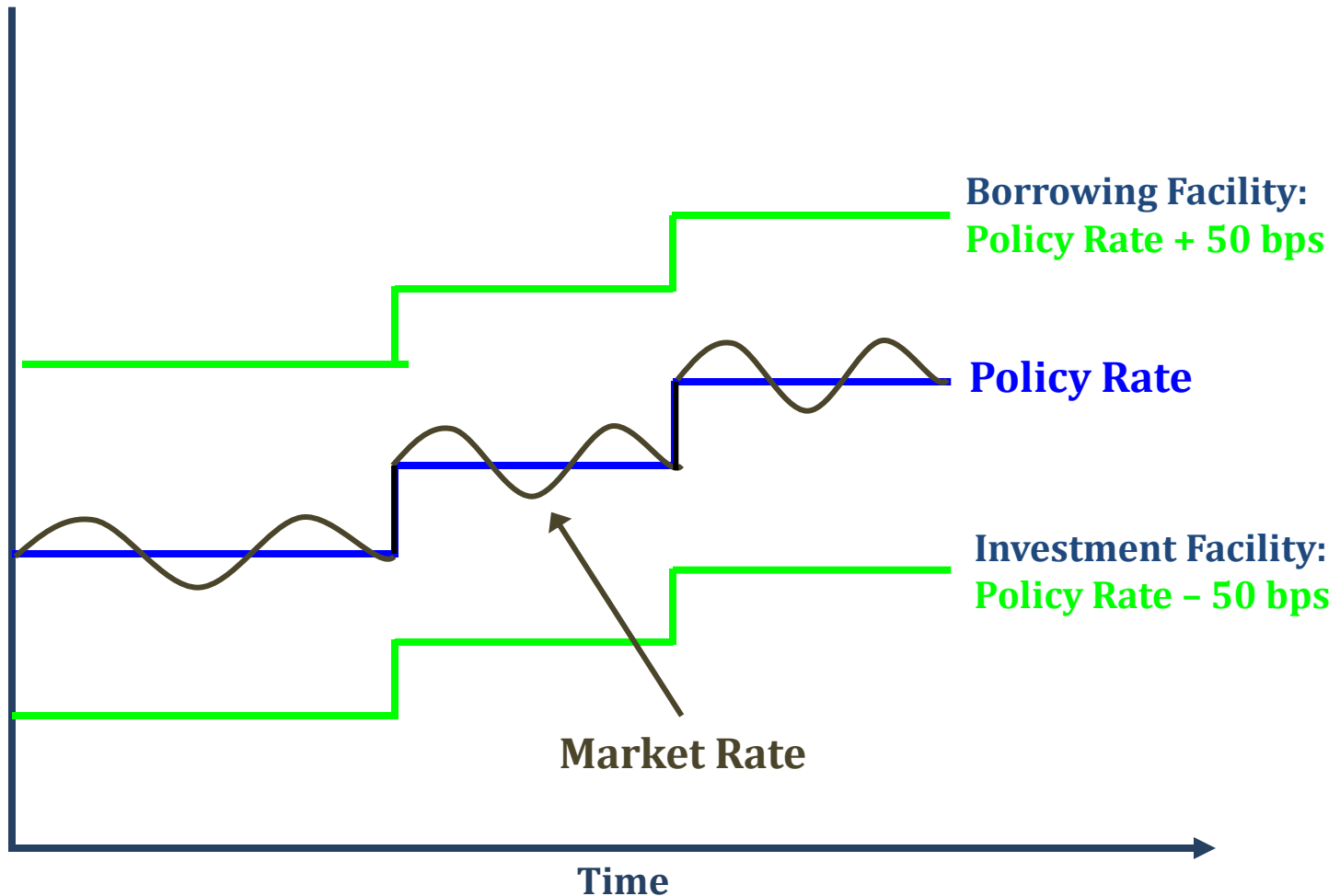
New Framework:

1) End-of-Day Liquidity Adjustment Window

- For Borrowing Facility use current collateralized lending at policy rate + 50 bps
- For Investment Facility use BOT Electronic P/N at policy rate - 50 bps (count towards fulfillment of liquid asset requirement)
- Overnight maturity, same-day settlement, and no quantity limit
- Accessible to all financial institutions that maintain CA deposits at BOT
- Available daily between 16.30-17.30

A corridor on the overnight rate

Overnight Interest Rate



Reserve Maintenance Period

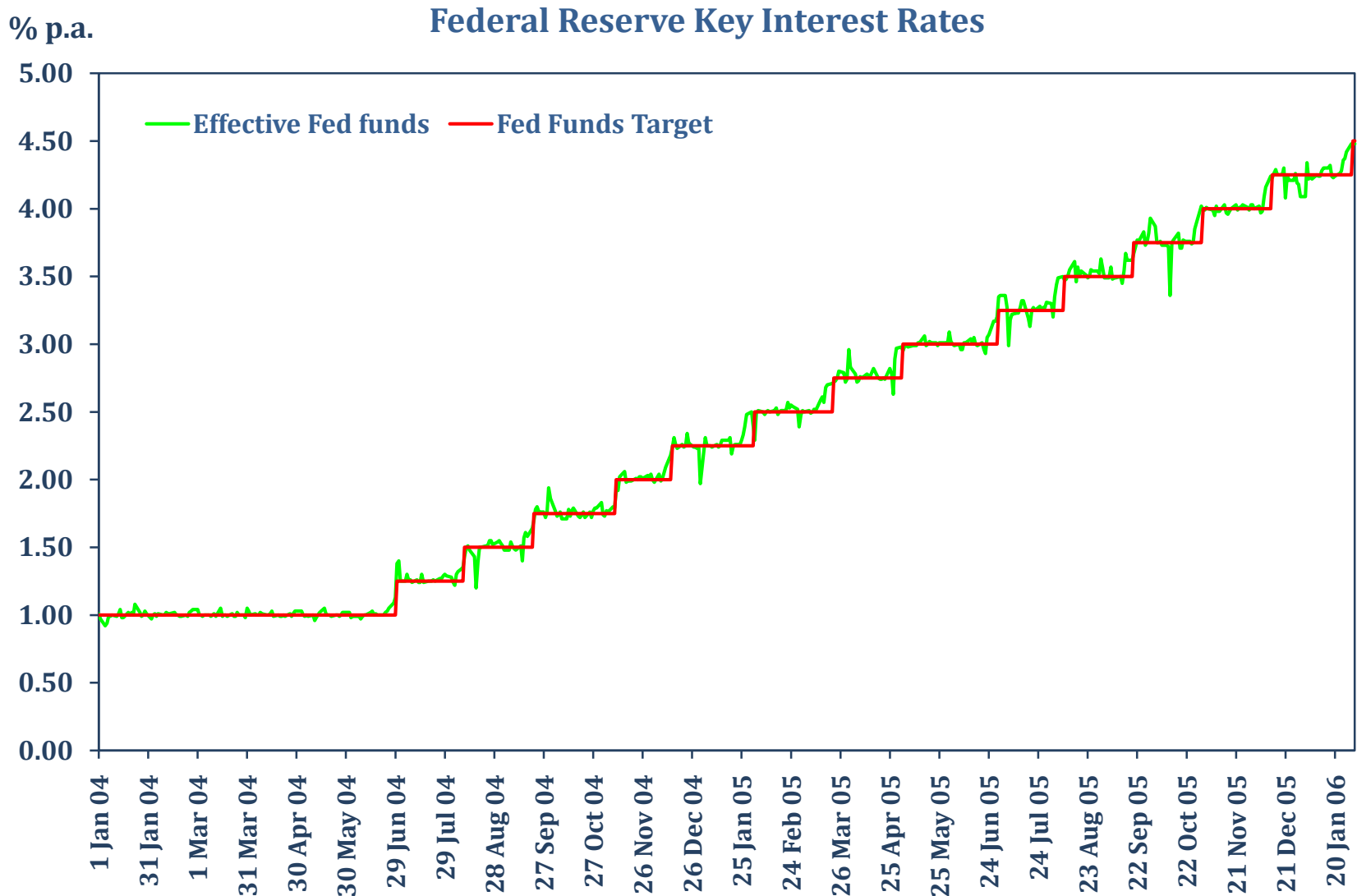
Why need to synchronize reserve maintenance period with MPC dates?

- If MPC expected to change rates then CA on each day of maintenance period no longer perfect substitutes
- When banks use reserve averaging to speculate on rate changes within a maintenance period, it is harder for BOT to provide the 'right' amount of liquidity to ensure rate stability



This reduces effectiveness of averaging mechanism and leads to greater interest rate volatility

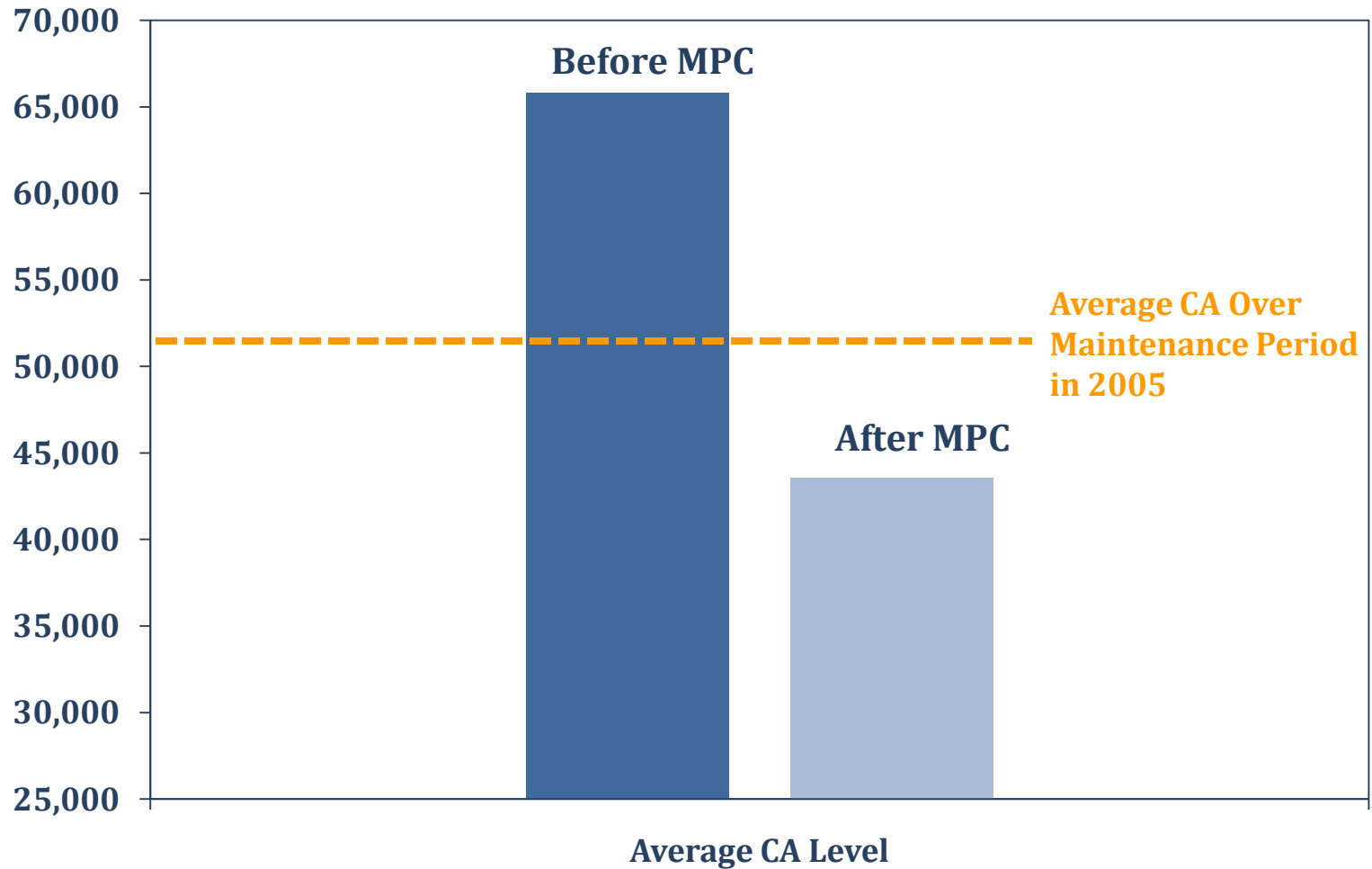
Interest rate speculation in the US



Average CA Outstanding Before and After MPC Meetings 2005 Within Same Maintenance Period

(For Expected Upward Cycle: June, July, Sep, Oct, Dec)

Million Baht



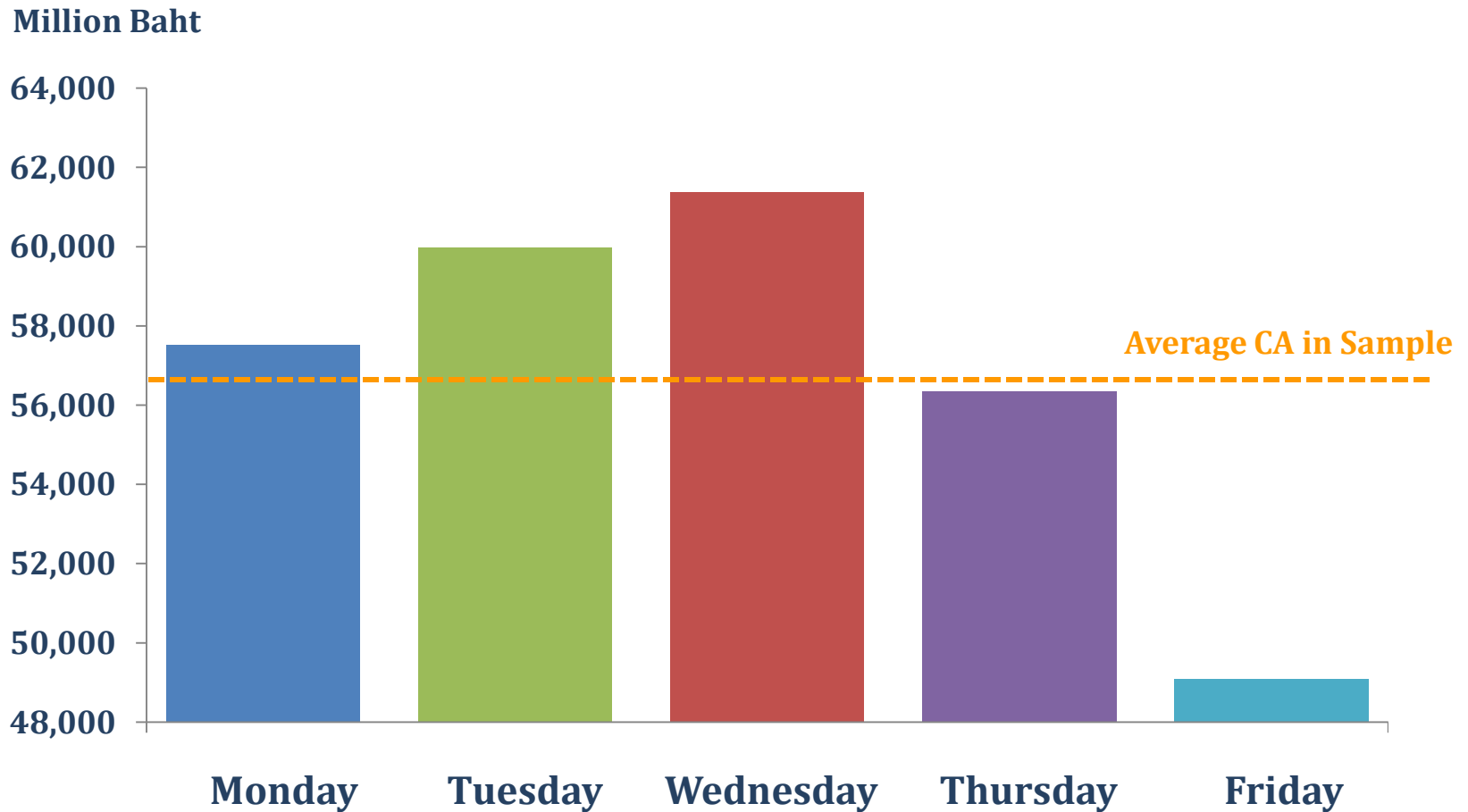
Reserve Maintenance Period

Why choose to fix day of the week?

- Under current setup, end of maintenance period may fall on a weekend or a Monday which reduces flexibility of liquidity management and may exacerbate flow uncertainty on this day (imbalances are accumulated)
- Under current setup, number of days in each maintenance period may be affected by number of days in the month

CA level displays strong day of the week pattern

Average Daily CA Balances: Day of the Week (Jan 2005-Aug 2006)



Reserve Maintenance Period

New Framework: Synchronize reserve maintenance period with MPC dates

- **Maintain 2-week maintenance period**
- **Fixed-day instead of fixed-dates**
- **Period starts on Wednesday and ends on the second Tuesday thereafter**
- **Uniform averaging period across all financial institutions (ie. including finance companies)**
- **Retain carry-forward/backward provision**

Summary

Operation Framework

- Switch policy rate to 1-day RP
- Establish corridor of ± 50 bps relative to policy rate
- Revision of reserve maintenance period

Closure of BOT RP Market

- BOT enters market only once per day through bilateral RP operations

What Markets Need to Prepare For

- **Revised reserve maintenance period**
- **More intra-market transactions**
- **Money market rates that better reflect market conditions, expectations, and risks**

Further Information, Questions, and Feedback

Monetary Operations Strategy Team

E-mail: Most@bot.or.th

Phone: 02 356 7530-1