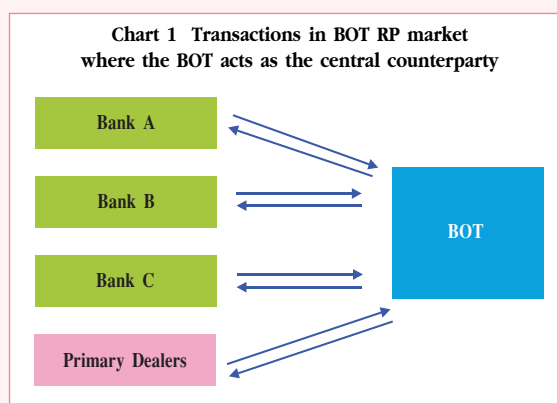


Closure of the BOT RP market

On 29 November 2007 the Bank of Thailand (BOT) officially announced that the last day of operation of the BOT-operated repurchase (BOT RP) market would be 12 February 2008. The closure of the BOT RP market constituted the second phase of the BOT monetary policy operation framework reform plan, the first phase of which had been implemented since 17 January 2007. The first phase involved (1) a switch in the monetary policy operating target (the policy rate) from the 14-day repurchase rate to the 1-day repurchase rate, (2) synchronizing reserve maintenance periods with MPC dates, and (3) establishing an interest rate corridor to limit interest rate volatility (further details on the reform of BOT monetary policy operation framework can be found in the January 2007 *Inflation Report*).

About the BOT RP Market

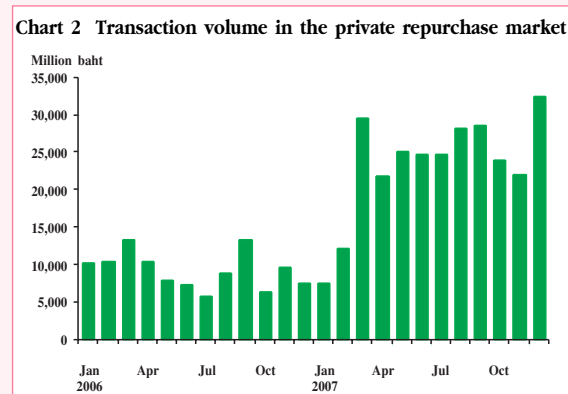
The BOT had played the role of a principal broker in the BOT RP market since it was first established in March 1979, acting as a matchmaker between financial institutions that were borrowers and lenders (Chart 1). Acting as the central counterparty to all transactions caused financial institutions to rely primarily on the BOT RP market as their main channel for short-term liquidity management, as the counterparty risk between borrowers and lenders was eliminated. However, changes in the financial environment and various standards and practices over the years had made certain practices in the BOT RP market inappropriate, as they failed to support proper functioning of the market mechanism and acted as obstacles to development of the money and bond markets. The BOT had therefore gradually phased out the role of the BOT RP market since June 2004, starting with a reduction in the frequency of BOT RP operating sessions from two to one per day. Moreover, to help market participants familiarize themselves with private repurchase (private repo) transactions and ensure that they were ready to transact privately instead of relying on the BOT RP market, the BOT had made some adjustment to be in line with internationally accepted standards, such as marking-to-market of collateral and taking an initial haircut.



Readiness for the closure of the BOT RP market

The BOT had prepared itself and market participants to ensure that the closure of the BOT RP market go smoothly and to facilitate money market development and proper functioning of the market mechanism. The important steps undertaken were:

1. Promotion of alternate liquidity management channels other than the BOT RP market to ensure that financial institutions would be able to manage their liquidity efficiently through other markets, such as (1) hosting educational seminars for market participants on the private repo market and the Global Master Repurchase Agreement (GMRA), and (2) coordinating with the ACI Thailand Club to set up a standard Annex to the GMRA, which would help individual companies save on legal fees. Chart 2 shows the significant increase in transaction volume of private repo operations, reflecting the market's readiness for the closure of the BOT RP market.



Source: Thai Bond Market Association

In addition, the BOT had been coordinating with the Financial Institutions Development Fund (FIDF), the largest borrower in the BOT RP market, to find other sources of financing. And as a result of long-term bond issuance to investors including the issuance of the 2- and 4-year saving bonds in November 2007, the FIDF's reliance on the BOT RP market had been reduced substantially. Furthermore, it was expected that the FIDF would be able to end its need to seek financing through the BOT RP market prior to the closure of the BOT RP market in February 2008.

2. Phasing out the BOT RP market by increasing the principal brokerage fee in the BOT RP market from 3 to 6 basis points per annum and increasing the minimum amount per transaction from 10 to 300 million baht in order to discourage financial institutions from entering the BOT RP market and encourage them to seek financing through alternative channels.

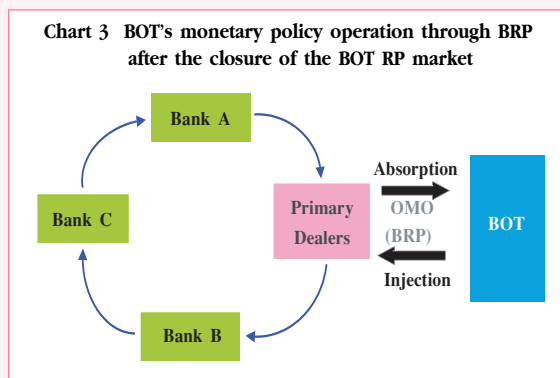
3. Enhancing the BOT's effectiveness in managing liquidity through other channels in order to maintain the policy interest rate as determined by the MPC. The reform of the monetary policy operation framework undertaken since 17 January 2007 had resulted in more efficient open market operations. Moreover, since 2007 the BOT had gradually increased its operations through bilateral repurchase (BRP)^{1/} transactions, as reflected in the increase in the ratio of BRP transactions to the BOT's total repurchase transactions (BRP + BOT RP) from just 40 per cent in 2006 to around 85 per cent towards the end of 2007. Part of this achievement could be explained by the addition of 5 primary dealers, resulting in a total of 14 members since October 2007. In other words, the BOT's transactions through the BRP almost replaced BOT RP transactions. This would help facilitate the BOT's liquidity management both in normal and emergency situations, and especially in the period immediately following the closure of the BOT RP market.

Effects of the closure of the BOT RP market on monetary policy operations

1. Monetary policy signaling instrument (policy interest rate). The closure of the BOT RP market would result in a change of the reference rate from the 1-day (BOT) repurchase rate to 1-day BRP rate. Should the BOT wish to borrow or lend in the 1-day BRP tenor, the BOT would do so only at the policy rate (fixed-rate tender).

2. Liquidity management in the money market.

The aforementioned preparations for the closure of the BOT RP market would enhance the effectiveness of the BOT in managing liquidity to maintain the policy rate. Financial institutions would need to find ways to manage liquidity among themselves while the BOT would oversee and manage liquidity in the financial system as a whole by increasing transactions with PDs through Open Market Operations (Chart 3). This would support more in-depth money market development and a better functioning of market mechanism as well as indirectly enhance the monetary policy transmission mechanism.



To conclude, preparations undertaken to support the closure of the BOT RP market in the previous periods^{2/} and going forward should facilitate market participants in the smooth transition after the closure of the BOT RP market, although financial institutions could be affected somewhat in the period immediately following the closure. Nevertheless, according to the plan, the reform of the monetary policy operation framework should be completed by February 2008. The reform would lay a strong foundation for a transparent monetary policy operation framework in accordance with well functioning market mechanism while promoting further development of the Thai financial market in the future.

^{1/} The BRP operation, which began in 2000, was only transacted with Primary Dealers (PDs) who were responsible for transferring liquidity on behalf of the BOT to the financial system. The BOT's objective for conducting dual operations, the BRP and the BOT RP was to stimulate and develop the private repurchase market.

^{2/} Recent market survey showed that all financial institutions had found alternative channels to manage liquidity in place of the BOT RP market but the effectiveness in liquidity transfers could be limited, especially when the Special Business Tax was still at 3 percent and the tax was imposed each time liquidity was transferred.