

## **BOT now has much more freedom in monetary operations**

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One of the most crucial amendments in the new Bank of Thailand Act that came into effect earlier this month is the fact that the BOT now has operational independence. In other words, the central bank has the authority to utilize monetary policy instruments to achieve its policy objectives. This is in the spirit of the code of best practice for monetary policy implementation.

The new Act bestows a higher degree of freedom in conducting monetary operations in terms of greater availability of instruments as well as increased flexibility in using those instruments. Degrees of freedom in choosing instruments can be put to many good uses. Recent sub-prime-related liquidity problems confirm that central banks' operations play an important role in maintaining stability in money markets.

The BOT's overriding principle in conducting monetary operations is to keep the operations market-oriented to ensure that market mechanisms function well. This will, in turn, strengthen the policy transmission mechanism.

Naturally, from an operational vantage point, more tools allow more choices. A good combination of these choices of monetary instruments will enable the BOT to manage liquidity to maintain the policy interest rate more efficiently, which will enhance effectiveness of monetary policy implementation.

Under the new Act, the BOT will be able to pay interest on its uncollateralized deposits and will no longer require prior approval from the Finance Ministry to issue its own securities. This, of course, does not mean the BOT will stop coordinating with the government debt managers - the Public Debt Management Office (PDMO). It is in both the PDMO's and the central bank's interests to collaborate closely on debt-securities issuance to ensure the good functioning of the bond market.

The BOT's operational reform plan, which included the closure of the BOT RP (repurchase) market, was part of the continued efforts to improve our monetary operations procedures. With the cessation of the BOT RP market last month, the central bank introduced a new facility called "The BOT Debt Security Repurchase Window", designed to mop up any residual excess liquidity in the system.

With a large amount of excess liquidity, this new facility helps relieve pressure from other instruments, thus preventing undue distortions in other markets. This facility is being transformed into the "Deposit Facility", where financial institutions can voluntarily deposit their excess money with the BOT at market-determined rates.

The interest-paying Deposit Facility effectively means, in theory, that the central bank has unlimited capacity to sterilize surplus liquidity.

In practice, the BOT will use a combination of instruments, since the choice of monetary instruments tends to have positive externalities on the liquidity of the market of the chosen instrument, increasing its breadth and depth. For example, central-bank RP operations in many countries have significantly contributed to their RP market liquidity. The systematic issuance of BOT bills and bonds has also facilitated increased trading in secondary market.

The BOT can and will purposely leverage on its degree of freedom in conducting monetary operations to also further financial market development.