

## **How central bank expands money supply**

Central bank usually adopts monetary policy to control money supply at the appropriate level according to the ongoing economic situation. To expand the money supply central bank uses expansionary monetary policy, which is mainly used during recession, like COVID 19 situation. BOT of Bank of Thailand decides to use three monetary instruments to keep the headline inflation remaining the range of 1-3%, which are Reserve Requirements, Open Market Operations (OMOs) and Standing Facilities.

The first tool is Reserve Requirements. The reserve ratio is the percentage of deposits that commercial banks must keep as reserve. To increase money supply the central bank reduces the reserve ratio so that the excess ratio (  $ER = \text{total reserve} - \text{required reserve}$ ) or the money for lending from the commercial banks is higher. Currently, the percentage required is at 6%.

The second tool is Open Market Operations (OMO). Central bank uses the tool to keep or adjust interest rate to be at the announced level and to have an appropriate level of money liquidity in our economy. There are four transactions taking place under OMO :

### 1) Bilateral Repurchase Operations

This transaction occurs when a cash borrower sells a security with a specified price and maturity to a cash lender. Once the maturity date arrives, the cash borrower will return the money with interest to the cash lender.

### 2) Issuance of BOT Bonds

There is a high volatility in bonds market caused by COVID 19 which greatly reduced the confidence of investors, along with the increasing financial needs of governments to launch COVID 19-oriented measures. BOT, thus, expands the size per auction to 10,000-60,000 million baht for all maturities of BOT bills. This provides flexibility for BOT bill issuance sizes adjustment in accommodating government plans and to stimulate investors' demand.

### 3) FX Swap

It is the same concept as Bilateral Repurchase Operations but in two different currencies with an equivalent amount of money being borrowed and lent in the hope to reduce volatility in money market interest rates. The eligible securities are government bonds and bills, BOT bonds and bills, State-Owned Enterprise bonds guaranteed by the government or with AAA rating, Japanese Government Bonds (JGBs), bonds issued by Malaysian government and Malaysian central bank.

#### 4) Outright purchase/sale of securities

These transactions permanently increase or drain money available to the banking system. The Bank usually increases rather than drains reserves through this transaction to accommodate the permanent increase in money currency as the economy grows.

The third tool is Standing Facilities. Financial institutions with insufficient liquidity are allowed to borrow funds from the BOT on an overnight basis by using collateral assets as specified by the BOT as collateral. The interest rate is the policy rate plus 0.5%.

The three monetary tools that Bank of Thailand uses to influence the money supply affect the economy through five channels which are interest rates, credit, asset prices, exchange rate, and expectation channels and it will further affect economic activities.

Since interest rate is cut, consumers and investors will have lower cost of borrowing so they are likely to borrow more (interest channel) which also induce demand for other assets such as stock, bond and property. (asset channel) This might further improve their confidence if they anticipate an improvement in economic conditions. (expectation channel)

Commercial banks are more willing to lend more to businesses as low lending rate reduces burden on businesses helping to strengthen their balance sheet and financial position. (credit channel)

Low interest rate leads to capital outflow and results in depreciation of Thai baht as supply of dollars fall, which makes our export becomes relative cheaper to foreigners so the increase in export can be expected.

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