

FN 211: Central Bank and Monetary Policy

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November 30, 2013

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- Introduction
- **Getting to know BOT**
- Monetary Policy

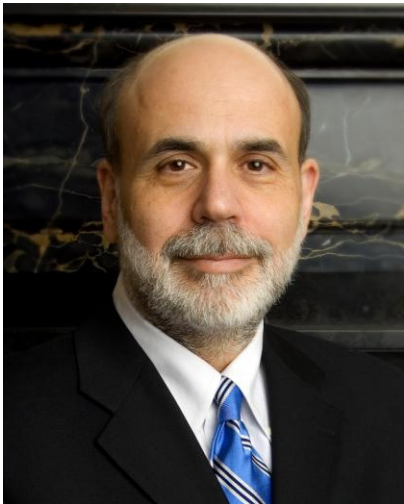
What is functions of a central bank?

Functions of FED

- Oversee and regulate banks to make sure that financial system is healthy
- Banker's bank: settlement checks and financial transaction
- Government's Bank: process checks written by the government holding government deposit
- Facilitate the government when it want to raise cash; FED will issue T bill, bond, note
- Lender of Last Resort: provide loan to banks directly through a discount window.
- Formulate monetary policy

They are quite the same as functions of BOT.

Who is who?



BOT: Monetary Policy Committee

The Bank of Thailand Board Members



Monetary Policy Committee

- | | |
|-------------------------------|---------------|
| 1. Mr. Prasam Trairatvorakul | Chairman |
| 2. Mrs. Pongpen Ruengvirayudh | Vice Chairman |
| 3. Mrs. Tongurai Limpiti | Member |
| 4. Mr. Ampon Kittiampon | Member |
| 5. Mr. Narongchai Akrasanee | Member |
| 6. Mr. Siri Ganjarendee | Member |
| 7. Mr. Aswin Kongsiri | Member |

Getting to know MPC

- One of the main committees of the Bank of Thailand
- Meets regularly (approximately every 6 weeks)

Function & Mechanism of MPC

- Setting the monetary policy stance.
- Monitoring internal and external economic conditions and formulating the monetary policy direction
- Assess economic and monetary conditions, as well as other risk factors which effect inflation and economic growth
- Consider data about the global economy, and domestic production, as well as other factors that are likely to affect the price level.

Source: BOT website

MPC Calendar

MPC No.	MPC Meeting Date
1/2014	Wed 22 January
2/2014	Wed 12 March
3/2014	Wed 23 April
4/2014	Wed 18 June
5/2014	Wed 6 August
6/2014	Wed 17 September
7/2014	Wed 5 November
8/2014	Wed 17 December

Why this calendar matter?

Source: BOT website

Investors estimated a policy rate before these dates in MPC calendar



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Monetary Policy-Outline

1 **Objective of Monetary Policy**- Price stability in the economy ~ low and stable inflation

2 **Monetary policy target:** Inflation Targeting 0.5%-3%

3 **Monetary policy mechanism**

4 **Monetary policy instrument**



Monetary Policy

1 **Objective of Monetary Policy**- Price stability in the economy ~ low and stable inflation

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Objective of Monetary Policy: why price stability matters?

Price stability in the economy (low and stable inflation)

- Preserve the **purchasing power of consumers and savers**
- Maintain **price competitiveness** of businesses in both domestic and international markets
- Reduce volatility of the **real interest rate**
- Promote a good overall economic environment through **reduced uncertainty**, which could otherwise negatively affect private-sector consumption and investment planning and decision-making

Source: BOT website

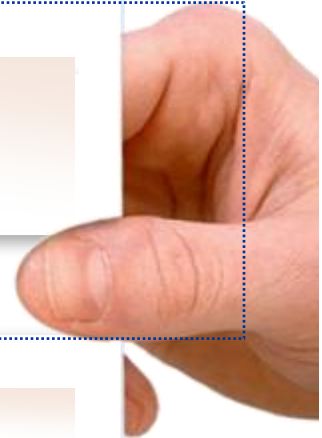
Monetary Policy

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Policy Targeting Setting- Inflation Targeting

- The use of core inflation as the policy target
 - Core inflation is year-on-year percentage change of the Consumer Price Index (CPI) the excluded fresh food and energy price

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▪ Why use core inflation to set a policy target?

- Setting the core inflation at 0.5% -3% ?

Q

▪ Why set inflation at this range?

Source: BOT website

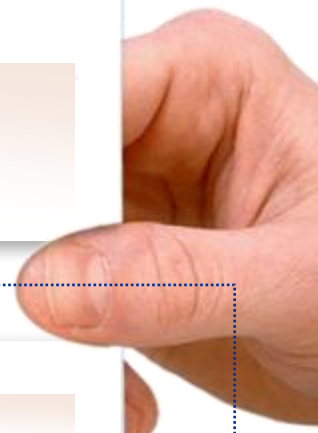
Monetary Policy

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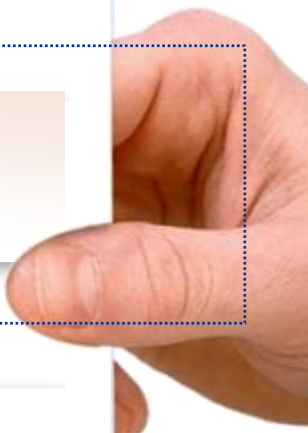


Monetary policy mechanism: Policy Rate

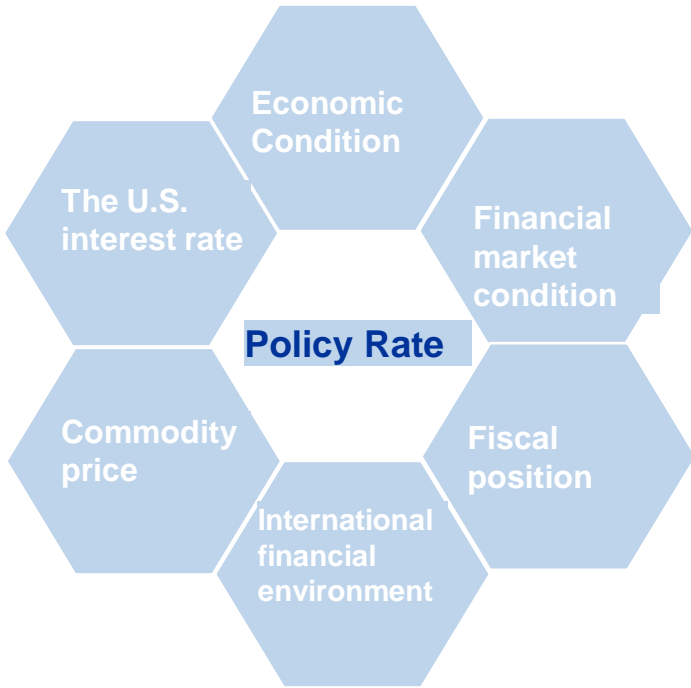
1 Signal the monetary policy stance decided by MPC   

2 BOT: The 1-day bilateral RP rate
FED: FED Fund Rate

3 5 transmission channels



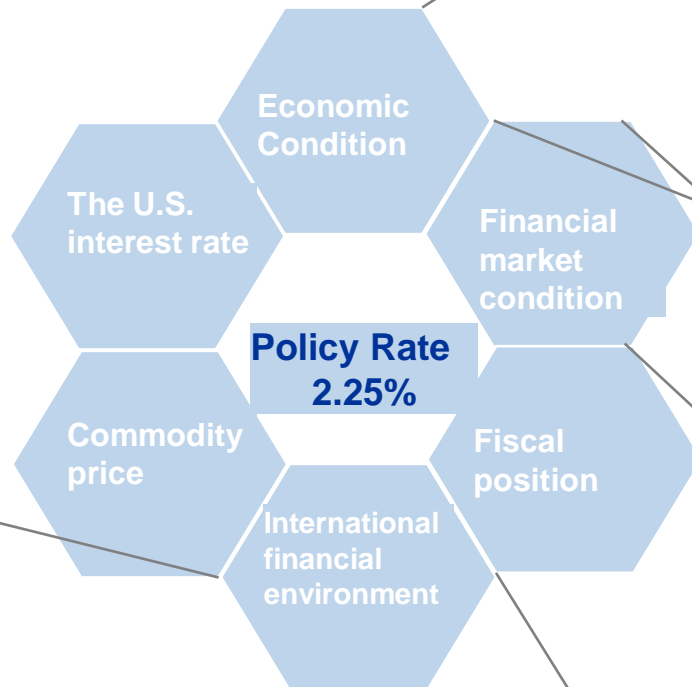
MPC considers risk factors that may affect future inflation and economic growth



Let see the real example!

Monetary Policy Committee's Decision on 16 October 2013

- U.S. Economy expand at a moderate pace
- The impact from the US government shutdown
- Debt ceiling
- Timing of QE tapering and the US fiscal impasses



- Signs of recovery in a number of euro area economies
- China: Recovery in exports, manufacturing, and investment
- North Asian economies improved on export
- ASEAN economies
- The Thai economy:
 - Export
 - Private consumption
 - Investment
 - Inflation

- Debt ceiling pose risk to global financial and economic stability

- Signs of recovery in a number of euro area economies
- China: Recovery in exports, manufacturing, and investment
- ASEAN economies

- Delay in fiscal reimbursement especially for infrastructure projects
- Household debt decelerated

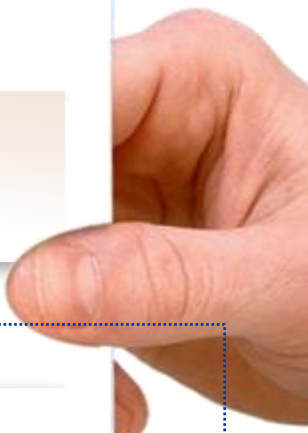
Source: BOT website

Monetary policy mechanism: Policy Rate

1 Signal the monetary policy stance decided by MPC   

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3 5 transmission channels



5 transmission mechanism

- Interest rate channel
- Exchange rate channel
- Expectations channel
- Asset price channel
- Credit channel

Monetary Policy

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Monetary Policy Instrument

The BOT's operational framework consists of a set of instruments which can be classified into 3 categories

- 1 Reserve Requirements
- 2 Open Market Operations (OMOs)
- 3 Standing Facilities

1) Reserve requirement

Key points

- Commercial banks are required to maintain a minimum reserves on average over 14 days, equal to specified percentage of the previous period's average level of commercial banks' deposit/liability base
- The reserve base comprises of deposits, borrowing (BE, PN,etc)
- **RR ratio = 6%**
- The end-of-day balances of the banks' reserves assets over a maintenance period
 - Facilitate banks' own liquidity management
 - Reduce daily volatile in short-term interest rate
- BOT may influence the country's borrowing and interest rates by changing the amount of funds available for banks to make loans with.
- Rarely uses the reserve requirements as the monetary policy tool because **it would cause immediate liquidity problems for banks with low excess reserves.**

Source: BOT website

Reserve Requirement- Summary

Summary table for Reserve Requirement

Purpose

- To avoid excessive daily volatility in money market interest rates

Eligible security

- Cash deposit at BOT
- Government bond and bills
- FIDF bonds, BOT bonds, State-owned Enterprise bonds

Frequency of operations

- Averaged over 2-week period

Remark

- Require 6% of deposit and short-term foreign borrowings of the previous 2-week period

Source: BOT website

2. Open Market Operation (OMOs)

Objective

- End goal of OMO is to affect **the short-term market interest rates**
- For BOT, OMOs are the **primary instrument** used to maintain the policy rate

4 types of Open Market Operations

- 1) Bilateral Repurchase Operations (BRP)
- 2) Issuance of Bank of Thailand bills/bonds
- 3) Foreign Exchange Swap
- 4) Outright Purchase/ Sale of Debt Securities

Source: BOT website

2. Open Market Operation (OMOs)

4 types of Open Market Operations

Bilateral Repurchase Operations

- Purpose: to **temporary add or drain** reserves available in the banking system.
- Eligible securities: Government bonds
- Counterparties: Primary Dealer

Issuance of BOT bills/ bonds

- Purpose: to **absorb** short-term and long-term liquidity
- Counterparties: eligible bidders
- Type of BOT bonds: discount instruments, fixed-coupon bond, floating-rate bond, saving bond

Foreign Exchange Swap

- Purpose: to **provide/ absorb** short-term and long-term BHT liquidity
- Counterparties: onshore/ offshore commercial banks

Outright Purchase/ Sale of Debt Securities

- Purpose: to **permanently inject/absorb** liquidity
- Eligible securities: Government bonds and bills, SOEs bonds

Source: BOT website

3. Standing Facilities

Standing Facilities

What is it?

- Financial institutions can **borrow “Standing Facilities” or deposit funds** at the BOT overnight to adjust their liquidity position at the end of the day
 - Financial institutions with insufficient liquidity could borrow funds by pledging eligible securities as collateral, vice versa with excess liquidity
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Mechanism

- Interest rates on standing facilities = the Pollicy Rate +/- a margin
 - These rate will set a cap and a floor on overnight market interest rate, forming **“interest rate corridor”**
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Source: BOT website