



**NATIONAL BANK OF CAMBODIA**

Riel. Stability. Development.

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# **Monetary Policy Implementation in Cambodia**

**KHOU Vouthy (Ph.D.)**

**Deputy Director General of Central Banking/**

**Director of Economic Research and International Cooperation Department**



The views expressed in this presentation are those of the author and do not necessarily represent the views of the NBC.

# Table of Contents

- I. What is Monetary Policy?**
- II. Monetary Policy Instruments**
- III. Interbank Market Development**
- IV. Development of Foreign Exchange Market**
- V. Promotion of the Use of Riels**



# I- What is Monetary Policy?

- Monetary Policy is the process by which a central bank controls the supply of money in the economy by exercising its control over interest rates in order to maintain price stability and achieve high economic growth.
  - **Contractionary Monetary Policy:** slows the rate of growth in the money supply or outright decreases the money supply in order to control inflation.
  - **Expansionary Monetary Policy:** increases the rate of growth in money supply to spur growth and reduce unemployment.



# I- What is Monetary Policy?

## ➤ Conventional vs. Unconventional monetary policy

### - **Conventional MP**

The policies that mainly act by setting a target for the overnight interest rate in the interbank market and adjusting the supply of central bank money to that target through Open market operation, Reserve requirement, and Standing facility (lending and deposit).

### - **Unconventional MP**

The policies that directly target the cost and availability of external finance to banks, households and non-financial companies. These sources of finance can be in the form of central bank liquidity, loans, fixed income securities or equity by using Direct Quantitative Easing, Direct Credit Easing and Indirect Quantitative Easing/Credit Easing.

- In the US, the Fed loaded its balance sheet with trillions of dollars in Treasury notes and mortgage-backed securities between 2008 and 2013.
- The Bank of England, the European Central Bank and the Bank of Japan have pursued similar policies.



# I- What is Monetary Policy?

## ➤ Monetary Policy Formulation

- The Monetary Policy Committee, chaired by the Governor, a high-level policy committee at the National Bank of Cambodia, was established to assess the ongoing economic and financial developments of the country and to make decisions on monetary policy, with the objective of maintaining price stability.
- Monetary Policy Sub Committee, chaired by Director General of Central Banking, was established to implement monetary policy determined by Monetary Policy Committee.
- Monetary Policy Secretariat: composes of economists, researchers and experts, they monitor and assess macroeconomics and financial sector's context, conduct forecasting and prepare a monetary policy report for MPC.



# I- What is Monetary Policy?

## ➤ Law on the Organization and Conduct of the NBC

- Article 3: The principle mission of the Central Bank is to determine and direct the monetary policy aimed at **maintaining price stability** in order to facilitate economic development within the framework of the Kingdom's economic and financial policy.



# I- What is Monetary Policy?

In order to do so, the law allows the Central Bank to have following functions and duties:

- To determine monetary policy objectives, in consultation with the Royal Government and consideration of the framework of the economic and financial policy of the Kingdom
- To formulate, implement and monitor monetary and exchange policies aimed at the determined objectives
- .....
- To participate in the formulation and supervision of the money and financial markets
- .....
- To set the interest rate





# II- Monetary Policy Instruments

What are the monetary policy instruments at NBC's disposal?

Because of high dollarization and under developed financial markets, the available instruments are limited:

- Exchange Rate Policy
- Reserve Requirement Rate



# II- Monetary Policy Instruments

## ➤ Exchange rate policy

The NBC adopted the stabilized exchange rate regime.

What does it mean?

We leave the exchange rate floating...

BUT intervene when the situation warrants.



# II- Monetary Policy Instruments

## ➤ The impacts of exchange rate's movement

- Depreciation of KHR could penalize the KHR holders, create inflationary pressure, increase interest rate of KHR loans
- Appreciation of KHR could penalize the workers whose incomes are in USD such as garment workers

The NBC has strived to stabilize the exchange rate to enhance the public confidence in Riels, preserve the purchasing power especially for poor people and limit the exchange rate risks.



# III- Monetary Policy Instruments

- NBC monitors very closely the movement of the exchange rate.
- NBC would decide to let it vary or to intervene in the foreign exchange market based on the economic fundamentals and monetary policy's objectives by taking into consideration the impacts of exchange rate's movement.
- The law provides NBC total independence in conducting monetary policy/the exchange rate policy to achieve the monetary policy objective.
- NBC has no obligation to intervene at all time in the market, in particular when the foreign exchange market could provide enough liquidity to the demand and/or the increase in demand is temporary or for speculative purpose.



# III- Monetary Policy Instruments

## ➤ Reserve Requirement Rate (RRR)

RRR is both monetary policy instrument and prudential tool. Thus far, it has been used occasionally.

When did we change the RRR and why?

- Between 1993 and 1996, RRR was set at only 5%.
- In 1997, RRR was raised to 8% to enhance confidence in the banking system and protect it during the Asian financial crisis.
- In 2008, RRR on foreign currency deposits was doubled to 16% in the wake of the global financial crisis, food and oil prices hike and high credit growth to real estate sector.
- In 2009, RRR was reduced to 12% to spur economic growth during the Global Financial Crisis.
- In 2012, RRR was raised to 12.5% to give a warning signal to banks and financial institutions when credit growth was at high level.
- RRR on Riel deposits was maintained relatively low since 1998 to encourage the use of Riel.



# III- Interbank Market Development

- **Negotiable Certificate of Deposits (NCDs)**: It is a short term debt instrument. It provides banks and financial institutions:
  - Debt instrument to manage liquidity
  - Collateral instrument for interbank market operation
  - Monetary policy tool.
    - Through NCDs, the NBC could absorb available liquidity in the market, and then could influence the credit volume.
    - NBC could fix the interest rates that influence the interbank market rates and then interest rates on loans providing to their clients.



# III- Interbank Market Development

## ➤ Liquidity Providing Collateralized Operation (LPCO)

LPCO serves the following objectives:

- Establish benchmark rate for interbank market. The auctioned rates would influence the interbank rates and interest rates to the clients.
- Encourage banks and MFIs to lower the interest rates of KHR loans. Currently, the interest rate on KHR is higher than USD. Banks and FIs would obtain funds with lower rate through LPCO and
- Support the agricultural sector as this sector widely use Riels.

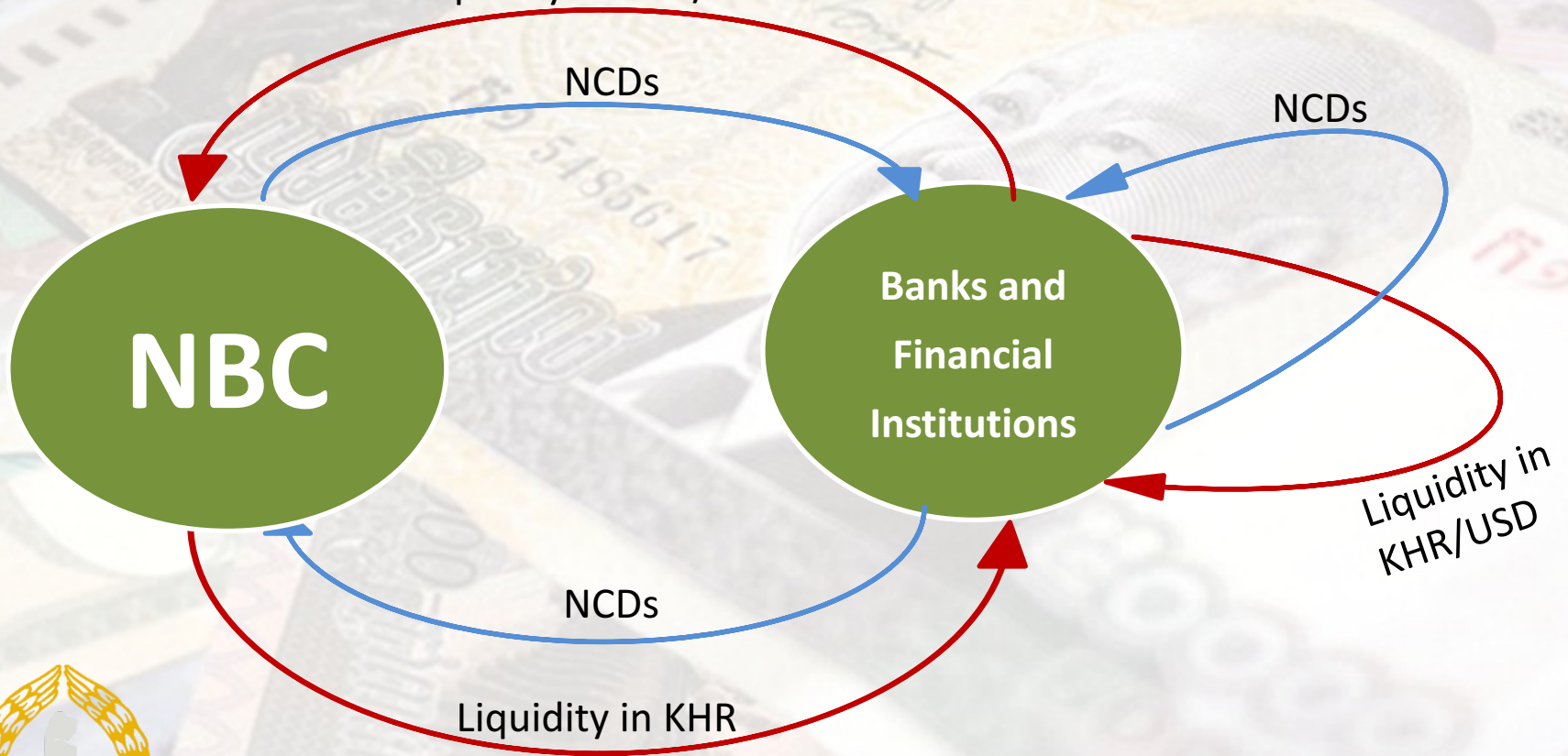


# III- Interbank Market Development

Liquidity Providing and Absorbing  
Through NCDs and LPCO

Liquidity in KHR/USD

Interbank markets





# III- Interbank Market Development

- **Future Monetary Policy tool: Marginal Lending Facility (MLF)**
- Conceptual Basis of Marginal Lending Facility
    - Facility through which central bank lends to banks
    - From perspective of counterparty also referred to as borrowing facility
    - Liquidity management instrument to meet ad hoc unexpected liquidity need (which remains uncovered despite OMOs and interbank market).
    - Provides a regular access to central bank credit at predetermined conditions



# III- Interbank Market Development

- Marginal Lending facility (MLF) vs Lender of Last Resort (LOLR)
  - Historically, no clear distinction between LOLR and MLF
    - Marginal Lending facility and LOLR were not explicitly separated
    - E.g. in US, use of discount had reputation of revealing grave liquidity problems of banks taking recourse
  - Today, consensus that marginal standing facility should be clearly separated LOLR.
    - To make sure that MLF is at discretion of banks while LOLR is at discretion of central bank.
    - To stress that MLF bears no stigma



# III- Interbank Market Development

## Distinction between MLF, and LOLR

### MLF

- Part of normal operational framework
- Monetary policy instrument: Facilities liquidity management and interest rate steering
- Use at discretion/initiative of central bank counterparties
- Broad eligibilities/access
- Predefined (standardized) term and condition
  - .Regular frequency & maturity
  - .Normal repayment & collateral conditions
- High degree of ex ante transparency: specific condition for use are publicly announced

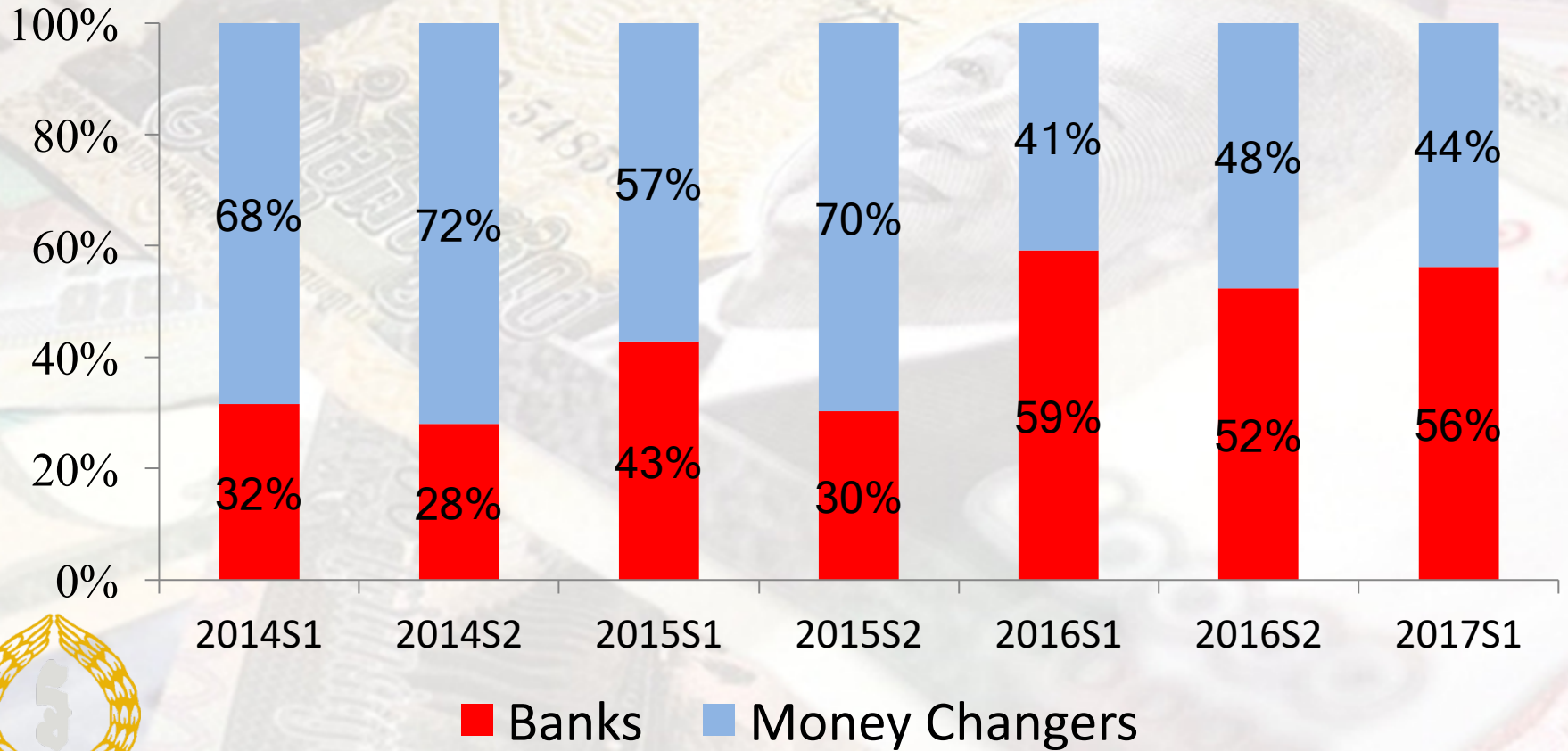
### LOLR

- Part of central bank emergency facility
- Financial stability instrument: Aims to prevent financial stability
- Use at discretion of central bank
- Access at discretion of central bank only to selected predominantly systematically important institution.
- Specific terms and conditions set as needed
  - .Irregular frequency & maturity
  - .Relaxed repayment and collateral conditions
- Ex ante ambiguity over condition and specification of rules.



# IV- Foreign Exchange Market Development

Proportion of KHR amounts that Banks and Money Changers bought from NBC



# IV- Foreign Exchange Market Development

- To develop a wholesale foreign exchange market in which banks play as a market maker and
- To enhance the regulations on the foreign exchange market.



# V- Promotion of the Use of Riels

- **The Government and the NBC have implemented policies to promote Riels on market-driven and gradual basis.**
  - The National policies to promote Riels have been reviewed by Economic and Financial Policy Committee before submitting to the Head of the Government.
  - These policies would continue to encourage the use of Riels in the economy.
  - Promotion of Riels is not solely NBC's tasks, but all agents in all sectors: public institutions, corporates, financial institutions, NGOs, individuals etc. take part in this process.
  - Banks and Financial Institutions should participate actively in this policy implementation.



# V- Promotion of the Use of Riels

Why promotion of the use of Riels is important, in particular to banks and financial institutions?

- Could obtain sustainable source of funds
- Lower costs of funding
- Reduce liquidity risks
- Mitigate exchange rate risks and
- Enhance the role of lender of last resort of the NBC to help banks and financial institutions in case of urgent liquidity need.



# V- Promotion of the Use of Riels

Issues for Banks and Financial Institutions to consider:

- Further emphasize the services in Riels such as: opening account in Riels, make KHR banknotes more available in ATMs
- Lower fees and costs of service delivered in Riels such as payments or transfers
- Encourage clients to borrow or deposit in Riels
- Actively participate in the foreign exchange market
- Use NCDs as collaterals to borrow funds in the interbank markets to create the secondary market for NCDs
- Participate in LPCO when needing Riels or expanding operations in Riels
- Comply with regulation that requires banks and financial institutions to provide at least 10% of their loans portfolio in Riels by 2019 and
- Contribute to the promotion of Riels in business.







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