

## A Money Market for Thailand?

One of the prerequisites for establishing a money market already exists in Thailand — a relatively developed and sophisticated banking system, with a widespread distribution of branches throughout the country. There is also a well-established central bank — the Bank of Thailand — which dates from 1942. It serves as the note issuing authority, as banker to the Government and to the commercial banks and specialised financial institutions, and as the fiscal agent of the Government in its dealings with international monetary organisations. In addition, it has been authorised by the Ministry of Finance to manage public debt, to administer exchange control, and to supervise the commercial banks, the finance companies, the securities companies, and the *crédit foncier* companies. The Bank of Thailand is also the lender of last resort. It may make discretionary loans to commercial banks against government and government-guaranteed bonds — beyond a first tier of accommodation a rather higher penalty rate is charged (this system was introduced when the Bank of Thailand was established in 1942); the interest rate charged on such loans may be varied from time to time. It may also rediscount approved promissory notes at relatively low rates of interest for promotional purposes; eligible paper is restricted to export bills, agricultural and certain industrial bills. The rediscount window may also be used from time to time for such other special purposes as are deemed necessary. In April 1979, a repurchase market for government bonds was established, whereby the Bank of Thailand either buys or sells government bonds subject to an agreement to re-sell or to re-purchase such bonds after an agreed interval of time. By this means, commercial banks that were temporarily short of funds could obtain short-term accommodation, and those with temporarily surplus funds could invest these short-term.

I - The banking and financial system consists of 30 commercial banks (with over 1,700 branches), of which 16 are Thai and 14 are foreign (20 branches), and some 110 finance companies. Thai banks,

together with a number of specialised institutions (The Government Savings Bank, The Bank for Agriculture and Agricultural Cooperatives, The Industrial Finance Corporation of Thailand, The Government Housing Bank, and The Small Industries Finance Office), account for over 97% of deposits and over 95% of total assets. The largest bank is Bangkok Bank, which is also the largest bank in South East Asia. The bulk of bank deposits is savings and time deposits. No interest is paid on demand deposits, but savings deposits can be transferred automatically and at any time to current account. There are ceilings on interest rates. Formerly, the banks lent mainly by way of overdraft and this is still an important means of lending, primarily to provide working capital. Much of the rest would be term loans (many of them for 3 years) to finance the acquisition of fixed assets and to a lesser extent promissory notes (PNs) again to finance working capital.<sup>1</sup> Much financing relates to foreign trade and this — and foreign exchange transactions — is profitable business. The structures of their loan portfolios vary between the banks, but the tendency has been for the importance of the overdraft to decline<sup>2</sup> and for term loans and PNs to increase, the latter — following American practice — being an alternative means of short-term lending. All forms of lending are subject to a loan agreement, which attracts stamp duty — it is lower on PNs. Overdraft limits are normally reviewed every 12 months and PNs tend to have maturities of 1 to 3 months. All banks do some consumer lending, though the bulk would generally be done by certain of the finance companies. Banks are becoming more interested in mortgage loans (primarily to finance house purchase and land, also home improvements). These loans would be made for 10 to 15 years; construction loans are for up to 2 years.

Finance companies, of which there are now about 110, first became prominent in the late 1960s as a means of evading the restrictions on the banks. Since 1972 (and subject to later legislative amendments in 1979), all finance companies have to be authorised and are regulated by the Ministry of Finance and the Bank of Thailand. They base their business on funds borrowed from the public on the basis of an issue of PNs or similar instruments. They may not accept deposits as can the commer-

<sup>1</sup> PNs have been resorted to quite significantly since 1983 — it is a form of lending that is popular in the USA.

<sup>2</sup> Latterly, this has been encouraged by Bank of Thailand guidelines (early 1985), which placed a limit of Baht 50 million on overdrafts. Borrowings have been moved into PNs or term loans.

cial banks. Rates of interest on their PNs are regulated but are appreciably higher than on commercial bank deposits. There is a minimum size of PN that may be issued. Most of the credits granted by finance companies are short-term in character, mainly in the form of call loans and the discount of bills by business and industrial firms. A few finance companies specialise in granting hire purchase finance or instalment credit. Most finance companies (about 80% of the total), in addition to their business financing licence, have been authorised to carry on a 'securities' business (brokerage, dealing, underwriting, and the provision of investment advisory services).

There are three main groups of finance companies — the independent companies, originally founded by small merchants, latterly experiencing some difficulties; a middle group which are rather more soundly based but which have suffered to some extent from the general crisis; and the bigger finance companies affiliated to Thai or foreign banks. They still finance themselves primarily by issuing PNs, but to a lesser extent they also resort to inter-bank borrowing. The largest is Asia Credit, which is associated with Bangkok Bank and with the *Société Générale* in Paris.

For the rest, the financial system is comprised of life insurance companies; over 1,000 agricultural cooperatives spread throughout the country (they are organised by farmers and lend money directly to their members, which provide the capital resources and these are supplemented by borrowings from the Bank for Agriculture and Agricultural Cooperatives); about another 1,000 savings cooperatives (or registered credit unions) organised for example on an occupational basis by schoolteachers, university employees, provincial police units, employees of public entities and government departments (the main source of loanable funds has been the paid-up share capital of their members); pawnshops (both incorporated and unincorporated and usually small, which provide modest loans often for financing consumption expenses, sometimes small business loans to those with relatively low incomes); a number of 'government pawnshops' are regulated by the Department of Public Welfare, others — 'municipal pawnshops' — being run by municipalities; they trade mainly on the basis of their own resources; some 30 *crédit foncier* companies, which lend against immovable property, or buy immovable property with the sellers' right of redemption and which may raise medium-term funds (not less than 3 years) from the public; they must be authorised by the Bank of Thailand and are subject to its regulation.

Finally, there is a number of specialised financial institutions, which include the Government Savings Bank (in its present form dating from 1947) and which mobilises small savings through a network of branches like a typical savings institution; it also operates as a commercial bank through its Banking Department; in addition to its extensive network of branches throughout the country, it operates mobile units; apart from a certain amount of lending to enterprises and individuals, the bulk of its funds is invested in government securities; it also has a small life insurance business; the Bank for Agriculture and Agricultural Cooperation (established in 1966), which provides credits to farmers, farmers' groups, and cooperatives, mostly at short and medium-term, with a limited number of long-term loans (over 3 years); almost half of its funds come from the commercial banks, the remainder from capital (mostly subscribed by the Ministry of Finance) and reserves, deposits, and a loan from the Bank of Thailand; the Industrial Finance Corporation of Thailand (1959), which superseded the Industrial Bank of Thailand (1952) and is owned substantially by the Thai commercial banks, but with Government representation on its Board as long as it is accommodated by government loans or carries government guarantees for its borrowings; it extends medium and long-term loans to industry and may take up equity holdings in its customers' businesses; it also issues guarantees to commercial banks on behalf of customers who wish to open letters of credit; its surplus funds are usually lent as call money to commercial banks; apart from capital and reserves, its principal sources of funds are long-term borrowings (mainly from the Asian Development Bank, with long-term credit from the Bank of Thailand, the Thai Government, and the *Kreditanstalt für Wiederaufbau*, The International Bank for Reconstruction and Development, Syndicated Yen Loan, Syndicated Singapore Loan, Commonwealth Development Corporation, and Japanese EXIM Bank); all foreign borrowings are guaranteed by the Thai Government and, since 1971, the Bank of Thailand has accorded it certain rediscount facilities; the Government Housing Bank (1953), which is owned by the Government and under the supervision and control of the Ministry of Finance and assists persons of moderate means to purchase houses of their own; its principal sources of funds in addition to capital and reserves have been loans from the Ministry of Finance and the Government Savings Bank; since 1973, it has been permitted to accept deposits from the public; and the Small Industries Finance Office (1964); its principal objectives are to provide financial assistance to small industrial enterprises,

including cottage and handicraft industries at relatively low rates of interest, also technical assistance to these enterprises; credits are limited to Baht 1 million with repayment over 10 years and a period of grace of 1 to 2 years; it is managed by a Committee appointed by Cabinet and is funded by Government budget appropriations, which are then deposited with the Krung Thai Bank (which is virtually government-owned) to supplement matching amounts (at present in a ratio of 3 to 1) for the purpose of lending to small industries; loan applications are approved by SIFO, but the Bank undertakes the actual lending and assumes all the credit risks.

## II - What next are the chief ingredients in the money market?

First, there is an inter-bank market in call money, which may be overnight or money may be lent for a fixed term of from 7 days up to 6 months. Normally, it is unsecured. The usual participants are Thai banks as lenders and foreign bank branches and finance companies as borrowers. It used to be said that in Thailand the commercial banks did not like borrowing from each other; they would rather go to the Bank of Thailand and may be pay more. There were two main reasons: (a) a banker did not wish to lose face in the event of his being short of funds; and (b) he would not wish to reveal his position to a competitor. However, this seems to have been less true in more recent times and especially since the Bank of Thailand introduced its RP facility (see below). But some banks still seem to be shy of borrowing in the inter-bank market — they would prefer either to borrow from the Bank of Thailand or to go abroad for their money. All banks apply internal limits to inter-bank borrowers — some are more creditworthy than others — and all deals are done direct. There are no brokers. (If there had been brokers, perhaps there would have been less shyness.) Moreover, in Thailand, it is thought that borrowing quotas or limits are still sometimes decided more on the basis of friendship and personal relationships than as a cool commercial calculation. Also, small banks tend to have a special relationship with one or more large banks. So, too, with finance companies, though some banks prefer to lend to them against a PN. Only selected banks and large finance companies (which may both lend and borrow) would get the quoted rate — BIBOR<sup>3</sup> — the existence of which has tended to promote more deals between

<sup>3</sup> Bangkok Inter-bank Offered Rate. It was introduced on March 4, 1985. It is based on the inter-bank rate and may be for overnight money, or for 7 days, or a month. Indeed, quotes could go out to 3 months.

banks. The smaller banks would have to pay more and rates are negotiable. Hence, the inter-bank market is a rather imperfect market.

The big banks — and especially the largest, Bangkok Bank — with their widespread networks of branches depend for the management of their funds throughout the day on advice from big customers of anticipated large inflows or outflows, also from their branches (in the case of Bangkok Bank from all its Bangkok branches and from about 10 big upcountry branches, under which regional centres smaller branches are grouped). The big banks — also some of the smaller banks — tend to be strong in retail deposits; that is why they tend to be lenders in the inter-bank market. The branches of the foreign banks with a less well developed deposit base but creditworthy names tend to be borrowers (also from abroad and other branches within their own organisation). But from time to time, even the big Thai banks will operate also on the borrowing side, depending on movements in their accounts. In addition, there are of course seasonal movements and therefore some fluctuation in the availability of funds. For example, there are seasonal shortages (which affect all banks) at Christmas and Chinese New Year; such fluctuations also occur because of the flow of exports (*e.g.* in March and October); the peak season is December to February — this is the crop season, Thailand being a major producer of commodities, though the pattern can vary a lot from year to year. There is also a tax season (end of March), when there are a lot of payments to be made. However, when money is available, funds tend to flood into the inter-bank market and rates can fall to very low levels (largely because of Bank of Thailand's reluctance to come into the market to 'mop up' — *e.g.* by way of reverse RPs, *i.e.* selling under an agreement to repurchase).

All the 30 banks and certain of the larger finance companies (about 20) operate in the inter-bank market. The size of the inter-bank market in Thailand is difficult to estimate; it is also subject to seasonal peaks and troughs (the peaks come when the movement of the crops has to be financed — December to February). Because of a 'savings gap' — deposits that are less than adequate to support the amount of business that the banks do — the inter-bank market is relatively small and the banks either have to borrow from the Bank of Thailand or from abroad (see below). The transactions of the large banks might be for Baht 200 million, while those of finance companies could be as low as Baht 2 to 5 million, though generally the minimum amount of a transaction is Baht 5 million. Inter-bank transactions (and, indeed, RP transactions at

the Bank of Thailand) close at 3.30 p.m. When a loan is made a cheque has to be taken round to the Bank of Thailand — exceptionally, this may be possible up to 4.00 p.m. In practice, market participants try to complete their deals by Noon.

III - The second element that needs to be considered in the money market is the role of the Bank of Thailand and, in particular, its open market operations, which beginning in April 1985 have been based on RPs (purchases of securities subject to an agreement to re-sell) and reverse RPs (sales of securities subject to an agreement to re-purchase).

However, before considering these transactions in greater detail, something must be said about the government securities on which these transactions are based. Government bonds are issued in maturities of 5, 10, or 15 years; they carry a fixed rate of interest (somewhat similar to that paid on a 12-months bank deposit, which is itself regulated and therefore not particularly attractive, though interest paid on bonds is tax-free). There is a captive market in government bonds, since banks, finance companies and *crédit fonciers* are required to buy and to hold as part of their cash ratio (in the case of banks) and as part of their liquidity ratio (in the case of finance companies and *crédit fonciers*) a certain percentage of their deposits and/or borrowings in liquid form, part of which (in the case of finance companies) must be held as 'unobligated' government securities.<sup>4</sup> The relevant percentages may be varied from time to time. Some banks (*e.g.* foreign banks) would only hold this minimum requirement, since government bonds are not regarded as a good investment, but to the extent that banks carry more than the requirement, it serves to increase the holdings of government securities on which to base resort to RPs at the Bank of Thailand. In addition, there is a small secondary market in government securities and the Bank of Thailand is a dealer in them, being prepared both to buy and to sell; it is also attempting to widen the market by selling government paper at retail in smaller amounts. But the combined effects of a captive market and of the RP facility at the Bank of Thailand is probably sufficient to explain why the secondary market is small; not even switches are attractive, though nearer due date a bank may well sell its securities outright to the public and in that way help to develop a market in government bonds.<sup>5</sup>

<sup>4</sup> Unobligated in the sense of being held beyond the captive market requirement.

<sup>5</sup> Banks tend to hold their bonds until — with the effluxion of time — they have 3 to 5 years to run; it is at this stage that they may be sold to the public. They may also sell them to take out capital gains when interest rates go down.

It is against this background that the government bond repurchase market, established on April 9, 1979, can now be considered. It was part of the Money Market Development Project initiated by the Bank of Thailand. The intention was to increase the liquidity of government bonds held by the commercial banks and also by the Government Savings Bank, the agricultural credit institutions (including the Bank for Agriculture and Agricultural Cooperation), and the Government Housing Bank, as well as the finance companies. It was also hoped it would open the way for the effective implementation of short-term interest rate policy and open market operations.

As we have already indicated, all banks and finance companies are required to hold government bonds. Hence, the basis existed for introducing RP facilities. If the Bank of Thailand wants to make money available to the financial system, it will buy government securities for a period under an agreement to sell these securities back to the bank or finance company concerned, the difference in price representing the cost of the accommodation furnished. These deals may be done overnight, for 3 days, for 7, 15, or 30 days, sometimes for 60 days. Overnight and 3 day RPs are the most popular. If it was intended to 'mop up' money, the Bank of Thailand would sell securities on an RP basis. This it would tend to do very reluctantly and only very occasionally. There are no limits on the amount of business that can be done by way of RPs, which is determined by demand and supply in the market.

Although in the RP market the Bank of Thailand would argue that it has gradually become a 'dealer' — say, from 1980 onwards, after which it built up the number and volume of transactions to quite a good figure, some of its banking critics regard it as no more than a broker and to a large extent this is true, since not all of the RPs are done with the Bank of Thailand itself; one bank can do an RP with another bank through the Bank of Thailand as broker and without being identified. The facilities have also now been extended to some finance companies, to the Government Savings Bank, and to other specialised financial institutions.

In size, the RP market is said to be normally rather smaller than the inter-bank market, but again there are seasonal fluctuations. The rates at which business is done are 'administered' or 'indicated', but appear to be related to those that obtain in the inter-bank market because they compete for the same money. Since all transactions go through the Bank of Thailand, it is a means whereby the Bank of Thailand can indicate its views. At first, the Bank of Thailand acted only as a broker, but then it began to influence rates, pushing them up or down. There are trading

periods in the morning and afternoon. Banks put in their bids to the Bank of Thailand whether for sale or purchase on an RP basis and the Bank of Thailand marries the transactions matching one bank with another and announces the results at the end of the trading session whether morning or afternoon, but at a price which is decided upon by the Bank of Thailand itself. In effect, the Bank of Thailand advises the borrower how much he can have and what the actual rate is at which it will do business. Indeed, the RP is legally done with the Bank of Thailand, whether it be a borrowing or a lending transaction; the Bank of Thailand guarantees the transaction. Broadly speaking, it is supply and demand that determines the rate, but it can be nudged a bit by the Bank of Thailand itself. The Bank of Thailand takes a small commission — 0.001% whenever an RP is done through the Bank of Thailand. And for that matter the Bank of Thailand may be the buyer on an RP basis, especially when all the commercial banks are short of money. But the Bank of Thailand could charge very high rates, if funds were very short. RP transactions are really a smoothing out operation with a view to effecting a marginal adjustment.

IV - Third, there are Treasury bills, which are offered to and bid for by the public at the Bank of Thailand on Fridays; some will be bought by the Bank of Thailand itself. The minimum amount is Baht 100,000. They have been issued since May 1980 for periods of 3 to 30 days, 31-60 days, 61-120 days, and 121-183 days. These periods may be changed from time to time.<sup>6</sup> This is in addition to short-term loans that are made by Bank of Thailand to the Government unsecured and up to 25% of the Government's 'ordinary' annual expenditure. For the rest, the Government borrows through the sale of Treasury bills and government bonds, which may be denominated in Baht or in foreign currencies. Treasury bills are normally purchased from the Bank of Thailand by commercial banks, large finance companies, and others at the same rate as Bank of Thailand has paid for them. Holdings of such bills by commercial banks vary with their liquidity positions. There is virtually no secondary market for Treasury bills in Thailand. Treasury bills tend to be held to maturity. However, before RPs were introduced, banks in need of money could sell Treasury bills to the Bank of Thailand and this is still done. But Treasury bills have never been popular — the

<sup>6</sup> See BANK OF THAILAND *Quarterly Bulletins* and especially March 1985, p. 32 (n.).

rate of interest has been too low, though latterly it has been lifted closer to the government bond yield.<sup>7</sup> This item would represent less than 1% of a bank's total assets.

V - Fourth, a Transferable Certificate of Deposit (TCD) was introduced in 1984 (initially by the Thai Farmers' Bank, later by other large banks, but still not by all banks). About five banks now do business in TCDs. Rates on fixed deposits (which would include TCDs) are subject to ceilings, but are slightly higher than the yields on government bonds. TCDs have to be registered in a name and, when transferred from hand to hand, have to be re-registered in the new name at the original office. There is a withholding tax on TCDs (recently raised to 15% from 12½% for individuals but only 1% for corporations). The final holder of the TCD pays the tax, but this will be reflected in the price as and when the TCD changes hands. The minimum amount is Baht 100,000 — it has to be small to accommodate the individual market and, indeed, if any sort of market is to develop at all, but it is scarcely as yet a money market instrument. Also because TCDs are subject to an interest rate ceiling and to a withholding tax, the development of a secondary market is inhibited.

VI - Fifth, there are bankers' acceptances and commercial bills, also PNs (some of which are resorted to seasonally — *e.g.* to finance movement of crops like rice and tapioca). As at mid-1985, the commercial banks in Thailand had made advances (overdrafts and term loans) in the amount of Baht 340.7 billion. Bills of all kinds (but excluding PNs) amounted to Baht 115 billion, of which Baht 90.3 billion represented domestic bills, only Baht 6 billion import bills, but Baht 18.7 billion trust receipts. Interest rates are subject to a ceiling, which for both advances and bills at that time was 19.0% (yields on government bonds were 12.5%).

Accommodation made available by the commercial banks in Thailand goes primarily to finance manufacturing and wholesale and retail trade (Baht 118.3 billion and Baht 117.6 billion respectively in mid-1985.<sup>8</sup> Import finance amounted to Baht 31.5 billion and credits to agriculture to Baht 36.4 billion. Although much financing of the wholesale and retail trade may be based on domestic bills, it is known

<sup>7</sup> See Table 22, "Structure of Interest Rates" in BANK OF THAILAND *Quarterly Bulletins*.

<sup>8</sup> BANK OF THAILAND *Quarterly Bulletin*, June 1985, p. 19.

that commercial bank lending is concentrated to a large extent on financing foreign trade,<sup>9</sup> which would involve also moving goods to and from the ports (much of which would be on the basis of domestic paper). To this should be added the figures for import bills and trust receipts (see above). Both bankers' acceptances and commercial bills constitute ideal money market instruments. Bankers' acceptances are traded a little (unofficially) by the finance companies but not by the banks.<sup>10</sup>

On July 4, 1986, Citibank N.A. introduced the Citinote, a money market instrument that matures within three months. It is evidenced by bills of exchange. Denominations are Baht 1 million and multiples of Baht 1 million to facilitate a wider participation by investors. The notes are quoted on an effective percentage yield basis set by a Weekly Tender Panel, which tends to move in line with money market rates. The notes are traded in the secondary market on a discount basis by banks, finance companies, corporations, provident funds, or individuals (including Citicorp Finance & Securities (Thailand) Ltd., which is prepared to accept Citinotes prior to maturity). The primary markets consist of a number of large financial institutions, which are members of the Tender Panel. These panelists purchase Citinotes for the purpose of their own investment in prime credit paper, meanwhile ensuring sufficient liquidity in their portfolios by resorting when necessary to the secondary market. Withholding tax applies; commercial banks and finance companies are also subject to business tax.

There could also be a considerable further growth in bill finance, since many of the smaller businesses seek accommodation by discounting post-dated cheques with certain of the banks and finance companies — this is a popular means of obtaining working capital and has become something of a convention in Thailand. Such post-dated cheques are never rediscounted or traded; discount rates tend to be fairly high. They may have maturities of 1 month or 3 months and up to a year; 6 months is not uncommon. Sometimes, cheques are guaranteed by a commercial bank, which send them on to a finance company for discount, when for example a bank is up against its ceiling on its risk assets ratio.

<sup>9</sup> Foreign trade in Thailand represents about one-third in value of the Gross National Product.

<sup>10</sup> Another possible development could be letters of credit, but the big corporations are not interested in them and the small firms are not sufficiently creditworthy to resort to them. However, this latter circumstance could be overcome by seeking a bank guarantee of the customer's name, for which of course the bank would charge a fee.

VII - At times when domestic resources are less than adequate, the larger banks will go into the Asian dollar and currency markets to obtain access to funds. Despite exchange control, they are free to operate in the Asian dollar market. The only limit placed on them by the authorities is a ceiling on their exposure in foreign currencies (not to exceed 20% of capital). Some banks in the Euro-dollar market match borrowings and loans — both in amounts and on interest rates (on the basis of LIBOR + a margin). The banks in Thailand may lend foreign currency on to Thai customers, but if they lend in Thailand they are subject to withholding tax. (On the other hand, if they borrow from an overseas branch of a Thai bank, they can avoid withholding tax.) Banks may borrow and lend in a number of foreign currencies. The customer is often very interested in this because he can thereby enjoy lower interest rates. However, the customer will have to repay in the same foreign currency, though he can cover himself forward against the exchange risk and the bank will provide this facility. Alternatively, a bank may borrow in Asian dollars and then do a swap into Baht. Some customers always do it on a swap basis. Sometimes a customer will borrow direct against a bank guarantee. Foreign borrowing is mostly to finance trade. The three main markets that are employed are Singapore, Hong Kong, and Tokyo (for most banks more or less in that order; some may not use Tokyo). Singapore, where the Asian dollar market goes back to 1968, is still very much the most important Asian dollar market. Although there are foreign exchange brokers in Bangkok, most of the large banks would call other banks directly and not go through brokers.

VIII - It is now possible to consider how best to develop a money market in Thailand. The more obvious basic conditions seem to have been satisfied. (1) There already exists a relatively well developed banking and financial structure, though it perhaps requires to attain a rather higher degree of sophistication than presently exists. (2) The Bank of Thailand — as central bank — now appears to possess adequate powers and instruments with which to influence the liquidity both of the banking system and the economy as a whole (e.g. the Bank of Thailand RP facility on the basis of government bonds). (3) There remains to consider whether there is an adequate revolving fund of cash available. Thailand is relatively diversified on the export side — some eight items account for 55% of export income — and there is a fair degree of stability in earnings. The largest commodity items are rice,

tapioca, rubber, and maize; other items like sugar, tin, and frozen shrimp and squid are relatively small. On the manufacturing side, textiles is large (and is second only to rice) and integrated circuits is significant (larger than tin).<sup>11</sup> In addition, there is tourism and services (said to be as important as rice). There is some fluctuation in export earnings — the export season tends to relate to the first and last quarters of the year and there is a need for a good deal of cash in between. However, Thailand has over the years successfully accommodated this situation and probably there is still more free cash available in the system than is currently apparent. It would be the role of a money market to tap these resources and to put the money to work.

What kind of impediments are there likely to be? (1) There may be obstacles of a legal character. The Civil and Commercial Code defines as negotiable instruments cheques, PNs, and bills of exchange. TCDs are not negotiable and come under a separate statute. If it were proposed to convert TCDs into negotiable certificates of deposit (NCDs), it would require an amendment to the Code, which may be difficult. At the same time, the Code is over 60 years old (dating from 1923) and there is clearly a need for a reconsideration of the law. It may also be necessary to resort to a new Banking Act. There is evidence to suggest that legal constraints are discouraging further money market developments. There is also a fear that a revision of the law may be a slow and tortuous process. (2) As with other money markets, taxation may be a further impediment and there is a case for removing stamp duties where they have been imposed (in any case, stamp duties rarely raise very much revenue and are costly to collect). Withholding tax, which applies to all borrowings except at call, can also be a barrier to further developments and the recent rise in the tax on deposits (see above) is discouraging. It has been argued, too, that there is a need to reduce the business tax on risk assets (which are defined as any asset with a maturity longer than overnight). There should be a case, for example, for treating as risk assets only those assets with maturities of longer than 12 months. (3) Interest rates have so far been regulated or administered and there is not likely to be a major development of money market instruments unless interest rates are freed. However, since it is probable that some interest rates would rise — at least in the short run — there is likely to be a disinclination on the part of the

<sup>11</sup> See BANGKOK BANK *Annual Report* 1984, p. 30.

Government to accept higher market rates of interest when it can finance itself more cheaply on the basis of regulated rates. But the development of a money market almost necessarily presupposes a pricing of money market instruments on the basis of market rates of interest. Associated with such a development, it would be necessary gradually to reduce the degree of captivity of markets such as those in government bonds. (4) It is sometimes said (not only in Thailand) that reserves imposed by the central bank add (in the case of Thailand)  $\frac{1}{2}\%$  to the cost of deposits. This may be true, but in the view of many experts the imposition of required reserves by the central bank is a most proper act, if only from a prudential point of view. A more positive step would be the abolition of the captive market in government securities (see above). (5) There is said to be in Thailand too much emphasis on short-term money (though that could be money for up to a year). It was argued that there was a need for longer term money (say, for up to 5 years), but would an unsophisticated and/or undeveloped market be able at this stage to handle the buying and selling of longer dated instruments? It would be necessary first to build up confidence in the relevant instruments and in the efficiency of market processes and that may take time.

IX - For the rest, there are a number of questions that need to be answered as a means of exploring how best to develop a money market in Thailand. These are: 1) Is it possible to extend the range of money market instruments that is available, also the volume of transactions? 2) What new money market institutions or arrangements might it be necessary or desirable to establish? 3) And, finally, what are likely to be the advantages of establishing a fully-fledged money market in Thailand? These are the questions that we shall attempt to answer.

1) The types of instrument presently available include call money and money available for short periods; RPs against government securities; Treasury bills, though at current rates these are not tradeable; TCDs, which are not issued by all the banks — only five do business in TCDs; bankers' acceptances, which are bought and sold (unofficially) by finance companies — not by banks; the new Citinotes; post-dated cheques, which are discounted with banks or finance companies, but are not traded; and commercial paper issued by large corporations — this could be sold to banks with excess liquidity. Ideally, this would require a broker to place the relevant paper and one would question whether Thailand would be big enough for a market in such paper to develop.

Possible new developments that one would favour would be the encouragement of a more active call money market, bringing in brokers (see below); RPs other than those done with the Bank of Thailand might also be done through a broker. If an active secondary market is to develop for government bonds, there must be a progressive reduction in the degree of captivity — not at one fell swoop but not too gradually either. A move towards market determined pricing is also desirable — nobody is going to trade bonds in any volume if the underlying return is unattractive. Similarly with Treasury bills. This might be achieved by resorting to tender issues or auctions both for government bonds and Treasury bills.

With regard to TCDs, there is a case at an early stage for their conversion to NCDs. If there are legal obstacles, these must be removed. More banks that at present issue TCDs should be encouraged to issue NCDs, but there would need to be some monitoring by the Bank of Thailand to ensure that only creditworthy names were permitted to make such issues. It is anticipated that ceilings on interest rates would be removed and rates would henceforth be market determined. Moreover (probably through dealers — see below), large corporations with surplus funds to invest should be approached to invest such funds in NCDs and (through dealers) a secondary market could be developed so that such corporations could (at market prices) disinvest at any time should they desire to do so.<sup>12</sup>

Again, bankers' acceptances already exist and are traded unofficially by finance companies — why not by banks? They should be encouraged to do so. Post-dated cheques seem to be a customary form of finance (though in some countries they would be illegal). Apart from their general use and the general acceptability of the system in Thailand, there is no reason — with Bank of Thailand leadership — why these should not be converted to a system of commercial bills, for which a secondary market could in due course be developed, commercial bills being another instrument in which corporations with temporarily surplus cash could — if they so chose — invest. Commercial paper issued by large corporations is already said to exist — it could be sold to banks with excess liquidity, but for it to be a useful money market

<sup>12</sup> It is understood that — although they are not traded — the PNs issued by finance companies in order to raise funds are sometimes bought by big corporations for the purpose of adjusting their cash positions. The NCD would be an even more appropriate instrument and one in which one could expect a secondary market to develop.



instrument one would need a broker (similar to Goldman Sachs in New York) to place it and a secondary market in which it could be bought and sold. But one would question whether potential transactions in Thailand would be big enough to justify an attempt to develop along these lines.

2) (a) In the inter-bank market, which comprehends the banks and some (large) finance companies, there is a case for encouraging the establishment of money brokers (which may become brokers in other areas as well — *e.g.* foreign exchange). The objective would be a more competitive and less cosy market than currently exists, with a greater emphasis on impersonal relationships, though some borrowers would remain more creditworthy than others and internal limits on the amount of lending to particular parties (which would be communicated to the brokers when necessary) would be retained. Ideally, there should be more than one broker, so that there will be competition in brokerage commissions as well. And as the market becomes more competitive hopefully there will be a narrowing of the spread in the rates charged and money will become more homogeneous. This is particularly important in an unsecured market. Liquidity is a function of homogeneity.

(b) In order to encourage even greater competitiveness, there is a case for progressively reducing the degree to which the government securities market remains captive (i) by requiring progressively lower percentages of deposits to be held in government securities and (ii) introducing tenders or auctions, both for government bonds and Treasury bills (this will require the assent of the Ministry of Finance and initially will tend to result in higher costs for government borrowing, but if markets are to be developed this is the price that must be paid). In addition, there is a case for increasing the number and range of issues both for government bonds and for Treasury bills, so that there is a good run of maturities and an adequate supply of paper to feed in to the markets. In this way one can expect the number of transactions (turnover) to increase progressively and for the markets to establish a competitive structure of rates. Furthermore, one would expect the Bank of Thailand to become a true dealer on a continuing basis, quoting bids and offers for a full range of maturities.

(c) As well as money brokers (as above), the development of the money market will certainly require the establishment of financial

intermediaries similar to the discount houses or authorised dealers that exist in other countries where money markets have been developed. There is no particular case for following the example of London and setting up discount houses and one would prefer to call them 'authorised dealers' for that is what they would be. One would expect them to act as principals and to hold a portfolio. This could be financed by borrowing call money or — to a certain extent — by 'fixtures'. Also, one would expect them to deal actively in the market, which would mean that on the whole they would not hold securities in portfolio for very long, *i.e.* "sit on them". There may be a case for importing some specialist expertise, if not foreign capital, but it is possible that two or more active and experienced Thai security houses, or subsidiaries thereof<sup>13</sup> set up for the purpose, might be "run in" as appropriate intermediaries — more than one such institution would be desirable in order to ensure adequate competition. (Indeed, more than two — to avoid duopoly.) However, while such institutions might be developed from domestic sources, some outside advice from parties with practical experience elsewhere may well be desirable. Necessarily, prior to authorisation, these dealers would need to be required by the Bank of Thailand to meet certain conditions — *e.g.* a minimum capital, adequate management and expertise, approval of the types of assets that would be eligible for holding in portfolio, appropriate multipliers or ratios for assets in relation to capital (examples could include a figure for government bonds and Treasury bills, which did not exceed *x* times capital and reserves, with a lower multiplier for private sector paper like NCDs or commercial bills), and, finally, for 'authorised dealers' the Bank of Thailand would have to allocate borrowing limits and permission to hold an account at the central bank. Such accommodation might possibly be made available at concessionary rates during the early stages of market development, though with an appropriate penalty rate for true lender of last resort facilities. Moreover, if the private sector were unwilling initially to set up such an intermediary, the authorities might consider an 'official dealer' to prime the pump as it were, with the proviso that if private sector capital and expertise were later to seek entry, this would be encouraged, subject only to appropriate conditions. If more than one private institution secured entry, eventually the 'official' dealing operations might be phased out.

<sup>13</sup> A security house itself would not be appropriate, because in Thailand they are also usually finance companies and this is not a good mix of business.

3) (a) As active dealings in some volume in an increased range of instruments are developed, one would expect an increase both in the number and strength of the links between institutions in the main financial sectors (even with some institutions in the 'unorganised' sector like the chit funds). In other words, the financial system would become more integrated in the sense that a firmer nexus would have been forged between both individual institutions and different financial sectors (like the banks, specialised institutions, and finance houses). The links would be brought about by an increasing number of institutions prepared to deal actively in more than one market, thereby developing a consistency between rates and yields for a range of different financial and credit instruments; these would now be dealt in in the complex of markets that would form a developed money market.<sup>14</sup>

(b) All this should lead to the more economical use of cash. Apart from cash reserves required by the authorities, banks and other financial institutions can now deploy their cash more economically, as evidenced by more or less stable behaviour patterns with regard to holdings of cash, any necessary adjustments being effected by movements into and out of other (earning) liquid assets, or by the acceptance of lower cash ratios, in which case there is an obvious economy in the holding of cash; on occasion, there has been evidence elsewhere of both developments. To the extent that the proportion of deposits held in the form of bank cash ceases to fluctuate significantly, other liquid assets must assume the function of providing a cushion and, though the liquid assets ratio itself may remain highly variable, there is likely to be an increasing emphasis on the desirability of observing an effective minimum (whether this be required by the authorities or not). Nevertheless, full advantage is unlikely to be taken of opportunities to economise cash unless there also exists a central bank (as in Thailand) that is capable and willing to act as a fully-fledged lender of last resort, when the central bank will become the ultimate source for the system's marginal requirements of cash. In these circumstances, too, it becomes possible for the authorities to evoke responsive action on the part of the commercial banks merely by exerting a minimum amount of pressure (whether by an increase in required reserves or the imposition of penalty rates on central bank accommodation). At the same time, the central bank's willingness to act as a lender of last resort is a prior condition of the

<sup>14</sup> See J.S.G. WILSON, *Banking Policy and Structure* (London and New York, 1986), p. 369.

commercial bank's readiness to observe such patterns of behaviour. Moreover, unless the banks are confident that assistance will be made available as necessary, they will fight hard to retain a degree of independence by keeping substantial reserves in liquid form.

(c) Where a reasonable range of financial and credit instruments exists and secondary markets have been developed in which dealings in them can take place, adjustments in terms of assets and liabilities management can be effected more easily and this should result in the more efficient and profitable operation both of banks and similar types of financial institution.<sup>15</sup> At the moment, marginal adjustments by banks in Thailand can really only be made through the inter-bank market or on the basis of RPs at or through the Bank of Thailand, and on the whole only at short term. For the larger banks, access to the Euro-and Asian currency markets may also be employed.

*Hull*

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<sup>15</sup> See J.S.G. WILSON, "How Assets and Liabilities are Managed around the World", *The Banker*, June 1985 and *Banking Policy and Structure*, pp. 346ff.