INFORMATION NOTE

ON

MONETARY POLICY IMPLEMENTATION

JABATAN OPERASI PELABURAN DAN PASARAN KEWANGAN
BANK NEGARA MALAYSIA
KUALA LUMPUR

DECEMBER 2012

Monetary Policy Implementation

Objectives of Monetary Policy Operations

Monetary Policy Operations are wholesale and interbank market transactions undertaken by the Bank to manage liquidity in the financial system. The primary objective of such operations is to ensure the average overnight interbank rate (AOIR) in the ringgit interbank money market remains within the corridor of the Overnight Policy Rate (OPR) as set out by the Monetary Policy Committee (MPC) while ensuring the efficient functioning of the conventional and Islamic interbank money market.

Open Market Operations

Open market operations are discretionary market operations and the main mechanism through which the Bank adjusts liquidity in the banking system by absorbing or adding liquidity via various types of instruments to achieve its operating target, the average overnight interbank rate (AOIR). The Bank's counterparties for monetary operations comprise the approved interbank institutions in the domestic interbank market. All approved interbank participants are able to participate directly in monetary operations conducted by the bank, including standing facilities. However, participation in Bank Negara Monetary Notes (BNMNs) auctions is only via appointed Principle Dealers (PDs).

Open market operations with all interbank participants are conducted daily through electronic auctions on the web-based Fully Automated System for Issuing/Tendering (FAST). The auctions can be undertaken in various forms: competitive variable rates, competitive single rate or non-competitive forms. All auction invitations and auction results are published on the FAST website (https://fast.bnm.gov.my). The Bank may also conduct bilateral operations with financial institutions or intervene through agent banks or via money brokers. The instruments of open market operations include the following:

- Uncollaterised direct borrowings through open tender

Uncollateralised direct borrowing remains the principal monetary instrument. The maturity of these borrowings ranges from overnight to a maximum of 6 months, depending on market conditions and the maturity profile of outstanding borrowings. In addition to the fixed tenders, the Bank conducts Range Maturity Auction (RMA) whereby financial institutions are able to choose the preferred maturity date for their ringgit placement with the Bank vis-à-vis a pre-determined range tenure set by the Bank.

- Repo transactions

Repo (repurchase agreement transaction) is where the Bank sells eligible securities, such as the Malaysian Government Securities (MGS) to banks, and at the same time and as part of the same operation, commits to repurchase the equivalent securities on a specified date at a specified price which reflects the repo rate. Repo is used to absorb liquidity from the banking system, for tenure ranging from overnight to 1 year. Apart from absorbing liquidity, repo transactions are also used for the purpose of lending specific MGS requested by financial institutions to enhance secondary market liquidity in the bond market.

Reverse repo, meanwhile, is where the Bank buys eligible securities from banks, and at the same time and as part of the same operation, commits to resell the equivalent securities on a specified date at a specified price which reflects the repo rate. The Bank uses reverse repo transactions to provide liquidity to the banking institutions, including lending operations under standing facilities.

- Auction of Bank Negara Monetary Notes (BNMNs)

BNMNs are short-term securities issued by the Bank. While BNMNs are mainly issued at a discount to their face-value, the Bank can also issue fixed-rate coupon bearing or floating rate BNMNs. BNMNs are usually issued for a longer tenure, ranging from 3-months to 1 year. The frequent issuances and enlarged outstanding size of the BNMNs have helped to deepen the secondary market liquidity of the short-term bills market.

- Outright sales and purchases of Government securities

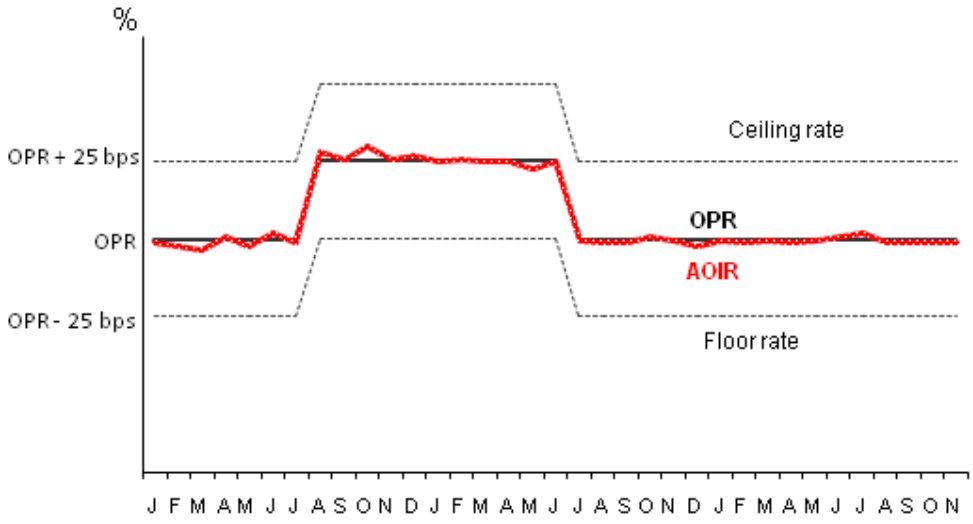
The Bank may purchase or sell eligible securities, namely securities issued by the Government or the Bank to adjust liquidity in the banking system.

- Foreign currency (FX) swap

The Bank may conduct a foreign currency (FX) swap as another means of absorbing or adding liquidity. In a FX swap, the Bank either purchases or sells the ringgit against a foreign currency while simultaneously agrees to undertake the opposite transaction at a future date. The operation will be equivalent to lending (borrowing) in the interbank market by affecting a purchase (sale).

Standing Facilities

In the event of residual surpluses or shortages, the Bank makes available the overnight standing facility, which is conducted on a bilateral basis with both conventional and Islamic interbank participants. Request for access to the standing facilities using ringgit denominated securities must be made by the interbank institutions by contacting the Bank before 5:30 p.m.. Market participants would access this facility when there are unforeseen technical factors that result in surpluses or shortages late in the day and cannot be covered via the normal money market transactions. Nevertheless, to ensure active trading between market participants beforehand and use of such facilities only as a final option, the interest paid on overnight deposits is set at 25 basis points below the OPR (floor rate) while interest charged on overnight lending is at 25 basis points above the OPR (ceiling rate).



In a liquidity shortage scenario, all lending operations are conducted in the form of repo or sell-buyback/collateralised murabahah (for Islamic banks). Securities that are eligible for reverse repo or sell-buyback/collateralised murabahah transactions for lending operations under standing facilities during normal market conditions are liquid sovereign related securities, e.g. securities issued or explicitly guaranteed by the Malaysian Government / Bank Negara Malaysia, securities issued by multilateral development banks / multilateral financial institutions, and AAA rated domestic securities of financial institutions and corporations. In May 2012, the eligible collaterals were expanded to include non-ringgit securities and foreign currencies of countries which the Bank has signed Cross Border Collateral Arrangement with other central banks. [Please refer to "Guidelines on Standing Facilities (Revised May 2012)" for the complete list].

Statutory Reserve Requirement (SRR)

The Statutory Reserve Requirement (SRR) is an instrument to manage liquidity. Banking institutions are required to maintain balances in their Statutory Reserve Accounts (SRA) equivalent to a certain proportion of their eligible liabilities (EL), this proportion being the SRR rate.

The SRR may be raised to manage the significant build-up of liquidity, which may result in financial imbalances and create risks to financial stability. Conversely, the Bank may lower the SRR if necessary to support the transmission of monetary policy rates to retail rates. However, it is important to note that changes to SRR should not be construed as a signal on the stance of monetary policy, whereby the OPR is the sole indicator.

Daily Monetary Operations

The Bank's daily monetary operations are conducted at 9:30 a.m. ~ 10:15 a.m. and 4:00 p.m. ~ 4:30 p.m., executed via various combinations of monetary instruments.

Liquidity forecast position is announced through FAST before conducting open market operations. The forecast is based on the analysis of various factors, including the maturity of previous direct borrowing, repo transactions and securities issued by the Bank, changes in currency-in-circulation, large payments in and out of the Bank, the Federal Government's and Federal Statutory agencies' account balances with the Bank, and adjustments to banking institutions' balances in their statutory reserve accounts (SRA).

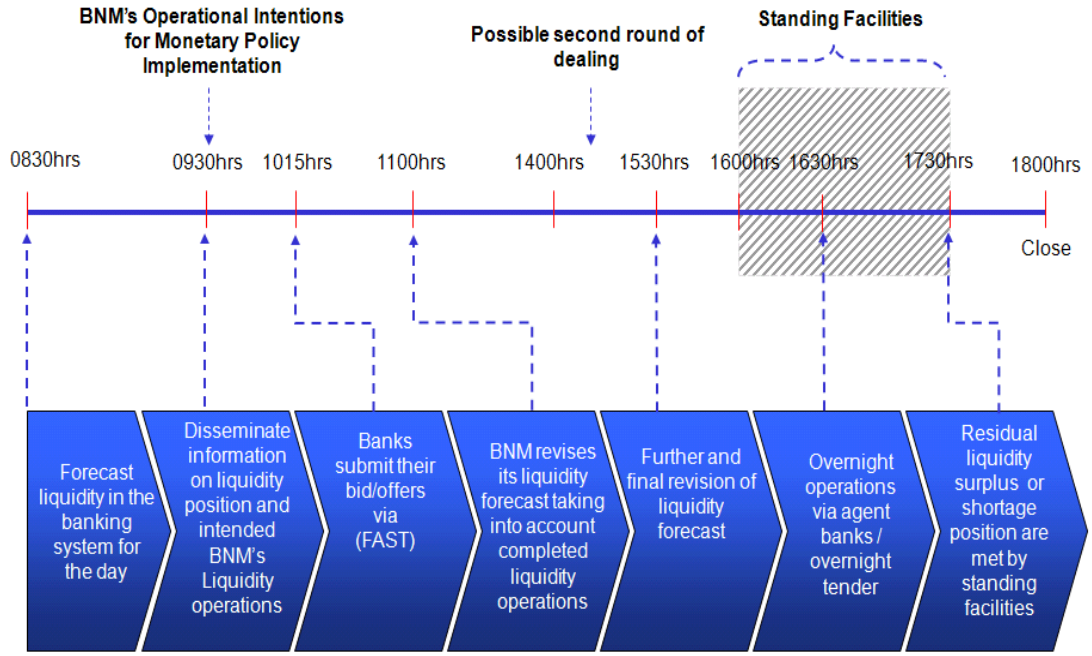
In the morning operations, the main instruments are:

i) Uncollateralized direct borrowings, range maturity auction (RMA), and repo for short term liquidity management
ii) Issuance of BNMNs to cater for longer term liquidity management.

Meanwhile, both the overnight tenders and standing facilities are be made available to the market participants in the evening to manage any surplus or deficit of liquidity in the system for the day.

All approved interbank participants are able to participate directly in monetary operations conducted by the bank, including standing facilities. However, participation in BNMN auctions is only via appointed Principle Dealers (PDs).

Schedule of Daily Monetary Operations



Islamic Money Market Operations

Unique to Malaysia, the settlement of large-value payments within the Islamic banking sector is conducted via a separate system of Islamic current accounts maintained at Bank Negara Malaysia. This separation ensures a clear segregation of funds between conventional and Islamic banking at the settlement level to ensure compliance from the Shariah perspective. Nonetheless, liquidity in both systems are linked given third-party payments between banking customers in the two sectors, as well as the participation of conventional banking institutions in Islamic banking products.

The primary objective of the Bank's monetary operations in the Islamic money market is to ensure sufficient liquidity for the efficient functioning of the Islamic interbank market. The monetary policy target is only implemented in the conventional money market, where interest rate based instruments are the

primary funding instrument. The Bank influences Islamic interbank market liquidity through an array of Shariah-compliant instruments, the main instrument being the Wadiah Acceptance (guaranteed custody). Through the Wadiah Acceptance, the Bank manages liquidity in the context of a surplus liquidity environment by inviting Islamic banking institutions to place their surplus funds with the Bank, based on the concept of Wadiah Yad Dhamanah (savings with guarantee). The Bank also uses Commodity Murabahah Programme (CMP) to manage liquidity. CMP utilises mainly crude palm oil-based contracts as the underlying commodity transactions to facilitate liquidity management via a commodity trading platform such as Bursa Suq Al Sila', or other commodity providers.

For longer-term liquidity management, the Bank issues Bank Negara Monetary Notes-i (BNMN-i) which are structured based on Islamic concepts of Murabahah (BNMN-Murabahah), Ijarah (BNMN-Ijarah), Bai Bithaman Ajil (BNMN-BBA) and Istithmar (BNMN-Istithmar). The key objectives of issuing BNMN-i are to increase efficiency and flexibility in liquidity management in the Islamic money market by diversifying Islamic financial instrument and expanding the Shariah concept used in BNM's Islamic monetary operation.

Further details on on the Islamic Interbank Money Market can be obtained at http://iimm.bnm.gov.my/