Box Article

The Bank's Liquidity Operations to Achieve its Mandates

Highlights

- The box article aims to provide an overview of the Bank's toolkit to manage liquidity in various parts of the financial system.
- Whether as part of maintaining sufficient day-to-day liquidity or as part of alleviating exigent liquidity needs for the banking system, the Bank will conduct open market operations or deploy appropriate funding facilities to fulfil its mandates.

INTRODUCTION

Liquidity management in the financial system by Bank Negara Malaysia can be classified into two broad categories: Banking system liquidity (which primarily affects the liability side of the Bank's balance sheet) and financial market liquidity (which primarily affects the asset side of the Bank's balance sheet).

Banking system liquidity is defined as reserves or balances held by financial institutions in their accounts with the Bank. These reserves are used for settling payments between financial institutions, fulfilling statutory reserve requirements, meeting prudential regulations such as the liquidity coverage ratio, and supporting healthy levels of precautionary buffers as part of liquidity management. When financial institutions have enough reserves to meet these various demands, liquidity is deemed to be sufficient.

However, there are exogenous factors that can affect the level of liquidity in the banking system. These are transactions that are not under the direct control of the Bank. For example, an increase in currency-in-circulation during festive seasons represents a drain on liquidity. This is because financial institutions would swap out their reserves with the Bank to meet customer withdrawals of currency notes and coins. Conversely, when the Government pays salaries or benefits, liquidity increases as reserves flow from Government accounts kept with the Bank into the banking system.

Banking system liquidity, therefore, can fluctuate on a daily or seasonal basis. These fluctuations may require the Bank to step in to ensure liquidity remains sufficient to support the effective functioning of the banking system. In this regard, the Bank has in place a range of facilities in its toolkit to manage banking system liquidity. These facilities have interlinking functions that serve monetary or financial stability objectives. The first section of this box article will elaborate on such facilities in two parts i.e., facilities for liquidity provision and facilities for monetary policy implementation.

The subsequent section of the box article highlights facilities in the Bank's toolkit to support market liquidity (or trading liquidity) in domestic financial markets, specifically in the foreign exchange (FX) and secondary Government bond markets. Market liquidity is a measure of market participants' ability to transact financial assets efficiently without causing a significant market price impact. One indicator to gauge market liquidity is the bid-ask spread, where liquidity can be inferred as tight when transactions cause spreads to widen sharply, creating disruptions to effective price discovery.

Box Article

The Bank's Liquidity Operations to Achieve its Mandates

It is worth noting that the usage of market liquidity facilities tends to have a direct impact on the level of banking system liquidity as well. This is because operations to manage market liquidity in the FX and government bond markets involve changes to asset levels in the Bank's balance sheet, resulting in a corresponding increase or decrease of banking system liquidity (which is a major component of the Bank's liabilities). For example, during episodes of capital inflows, there will be an increase in demand for the domestic currency in the FX market. The Bank will then supply domestic currency in exchange for the foreign currency in the FX market, resulting in an increase in banking system liquidity.

PART 1(a) – BANKING SYSTEM LIQUIDITY: LIQUIDITY PROVISION

Supplying liquidity into the banking system via regular open market operations, facilities embedded in RENTAS, and special liquidity facilities

The Bank conducts regular open market operations to ensure that the banking system's liquidity requirements are met

As a regular part of running its business, the liquidity position of a financial institution could fluctuate between being in surplus and deficit even when the overall liquidity in the banking system is deemed sufficient. If a financial institution requires additional reserves to meet its needs (i.e., it is in a deficit liquidity position), it can borrow via the interbank market from other financial institutions with surplus reserves.

Financial institutions can also borrow directly from the Bank if sourcing reserves via the interbank market is not available or too costly. This may arise where there is friction that hampers the movement of reserves between financial institutions, or there is insufficient liquidity in the overall banking system.

The Bank's instruments to inject liquidity into the banking system are mainly offered on an overnight or short-term basis. For example, the Bank conducts term reverse repurchase agreements (reverse repo) and FX swaps to provide additional liquidity to financial institutions in exchange for eligible securities and foreign currencies respectively. Where there is a need to increase liquidity levels on a more enduring basis, the Bank may also conduct an outright purchase of Government securities in the secondary market from financial institutions to increase the amount of reserves in the banking system. Such transactions are not deemed as deficit financing, and are conducted infrequently via the secondary market to increase the amount of banking system liquidity. Currently, the Bank's holdings are less than 1.2% of total outstanding Government securities.

While the Bank stands ready to provide liquidity as needed, it also aims to incentivise market-driven interbank activity. Central banks should be seen only as the lender of last resort, and in this context, the Bank's lending instruments are typically priced at a premium. Additionally, to ensure that these instruments are regularly available to a diverse set of financial institutions with different creditworthiness at around a single rate, lending is extended on a secured basis against a set of predefined, high-quality, and highly liquid collateral.

Box Article

The Bank's Liquidity Operations to Achieve its Mandates

Table 1: Facilities under Regular Open Market Operations (Liquidity Injections)

Facility/ Instrument	Term reverse repo	FX Swap (Buy/Sell FCY)	Outright purchase of MGS/MGII
Tenor	Up to 1 year	Varies	N/A
Trigger/ Frequency	Regular auctions	As needed	As needed
Rate	Market-determined		
Eligible Participants	FSA/IFSA licensed banks[1]		
Eligible Collateral	Routine eligible collateral[2]	Not applicable	Not applicable

The Bank has embedded liquidity provision instruments into the RENTAS payments system to ensure timely settlements

The Bank operates the RENTAS payments system that is used for real-time gross settlements of transfers of reserves between financial institutions. As these payments are often of large value and high frequency, the Bank also developed liquidity provision facilities within the RENTAS system to ensure timely and reliable settlements. An example of such facilities is the Intraday Credit Facility (ICF) that provides a bilateral credit line between a financial institution and the Bank to ensure that reserve balances are sufficient on an intraday basis for payments to clear. Another facility is the Auto-Collateralised Overnight Funding Facility (ACOFF).

Unlike the ICF, the ACOFF provides an overnight credit line during the MYR Evening Settlement Window and is granted through an outright sale of pledged securities for funding.

Table 2: Facilities for Liquidity Provision Embedded in RENTAS

Facility/ Instrument	Intraday Credit Facility (ICF)	Auto-Collateralised Overnight Funding Facility (ACOFF)
Tenor	Intraday	Overnight
Trigger/ Frequency	Automatic (using K-account on RENTAS)	
Rate	No charge if settled before cut-off	OPR +25bps
Eligible Participants	FSA/IFSA licensed banks	
Eligible Collateral	Routine eligible collateral	

The Bank stands ready to provide access to special liquidity facilities as part of its financial stability mandate

Following Basel III reforms, the Bank introduced the Liquidity Coverage Ratio (LCR) requirements to ensure that financial institutions hold sufficient high-quality liquid assets (HQLA) to withstand acute liquidity stress scenarios over a period of 30 days. When there is a need for financial institutions to support their LCR ratio during times of market stress, the Restricted Committed Liquidity Facility (RCLF) allows financial institutions to temporarily transform their non-HQLA assets into Level 2B[3] HQLA to facilitate their compliance with the regulatory ratio at a more reasonable cost than by accessing the market.

---

[1] FSA – Financial Services Act 2013; IFSA – Islamic Financial Services Act 2013.
[2] Routine eligible collateral are securities accepted under the Bank's Standing Facilities. The full list can be found in the Bank's Policy Document on Standing Facilities issued on 30 July 2020.

[3] Assets to be included in the stock of HQLA can be broken down into Level 1, Level 2A and Level 2B assets. Level 2B HQLA is subject to a limit of no more than 15% of total HQLA held by a bank.

Box Article

The Bank's Liquidity Operations to Achieve its Mandates

Financial institutions are able to tap the RCLF with the Bank on a bilateral basis by committing to a monthly Facility Fee, which is currently set at 75bps per annum. Since inception to date, this facility has never been utilised as financial institutions have been able to maintain LCR levels well above the minimum requirement of 100%. The banking system LCR stands at 157% in March 2023 (Monthly average in 2022: 149%).

Also in line with the Bank's financial stability mandate, the Bank is empowered under Section 32 of the Central Bank of Malaysia Act (CBA) 2009 to provide liquidity assistance to any financial institution, for the purpose of averting or reducing financial stability risk. This provision enables the Bank to mitigate and prevent the risk of idiosyncratic liquidity problems or perceived problems, from threatening an otherwise solvent or viable financial institution that may in turn pose a risk to overall financial stability. Liquidity assistance can only be extended to BNM regulated financial institutions and systemic[4] non-BNM regulated entities that are viable. The latter is assessed on a case-by-case basis and must be authorised by the Financial Stability Executive Committee (FSEC),[5] based on an assessment of credible threats posed by the entity to broader financial stability.

The liquidity assistance would take the form of collateralised lending, where the Bank may lend against a wide range of collateral, with appropriate haircuts and subject to terms that would aim to minimise moral hazard, mitigate potential market distortions, and avert contagion to the rest of the financial system. Institutions which have been granted such liquidity assistance are also subject to intensified supervisory scrutiny to mitigate credit risks to the Bank and encourage a swift recovery by the institution.

Table 3: Special Liquidity Facilities

Facility/ Instrument	Restricted Committed Lending Facility (RCLF)	Emergency Liquidity Assistance (ELA)
Tenor	A minimum of 1 month and can be rolled over as needed	Discretionary (as determined by the Bank)
Trigger/ Frequency	By request of FIs (bilateral agreement with the Bank)	Discretionary (triggered by the Bank)
Rate	OPR+25bps for each drawdown, plus 75bps of the agreed size of RCLF for the establishment of the facility	Determined by the Bank
Eligible Participants	FSA/IFSA licensed banks	FSA/IFSA licensed banks; DFIA[7] regulated banks; Other systemic non-BNM regulated institutions
Eligible Collateral	Routine and slightly expanded eligible collateral[6]	Routine and expanded eligible collateral

[4] Systemic institutions are institutions whose distress or disorderly failure may pose a credible threat to overall financial stability.

[5] The FSEC consists of six members, a majority of whom are non-executive members who are independent of the Bank's Management. The FSEC meets regularly and supports the Bank's statutory mandate of preserving financial stability through its powers to decide on specific policy measures that may be taken by the Bank to avert or reduce risks to financial stability.

[6] Specifically for RCLF, the expanded eligible collateral only refers to scripless securities not included under routine eligible collateral.

[7] DFIA – Development Financial Institutions Act 2002.

Box Article

The Bank's Liquidity Operations to Achieve its Mandates

PART 1(b) – BANKING SYSTEM LIQUIDITY: MONETARY POLICY IMPLEMENTATION

Managing liquidity in the banking system via regular open market operations, statutory reserve requirement and standing facilities to ensure that the overnight unsecured interbank rate trades close to the Bank's policy rate

The Bank imposes a statutory reserve requirement (SRR) to manage the level of excess liquidity in the banking system

The statutory reserve requirement (SRR) is a liquidity management instrument to influence the level of excess reserves available in the banking system. Based on current market liquidity conditions, financial institutions are required to set aside a percentage of their reserve balances (determined by the SRR rate) with the Bank into their Statutory Reserve Account (SRA) in RENTAS. These balances are not remunerated. The SRR rate, which is equivalent to a proportion of financial institutions' eligible liabilities was last reduced in March 2020 by 100 basis points to 2% and remains unchanged to date. As at end March 2023, the SRR balance stood at MYR34.2 billion, which is 20.5% of total liquidity in the banking system.

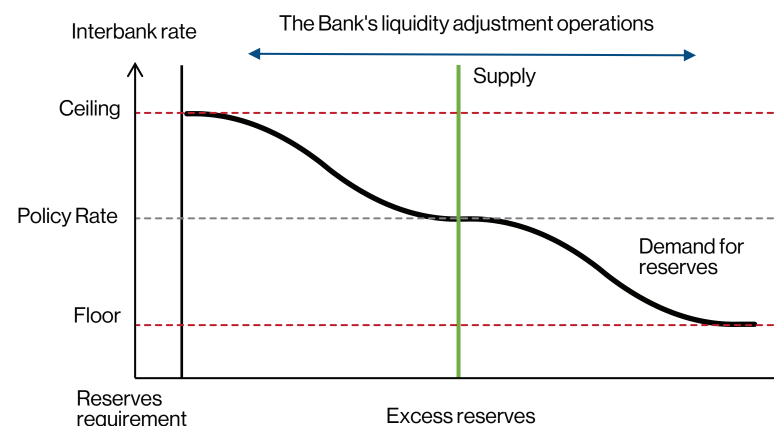
The Bank can both inject and absorb liquidity as part of monetary policy implementation via regular open market operations

The Bank's Monetary Policy Committee meets six times a year and decides on the Overnight Policy Rate (OPR). The OPR is the Bank's policy interest rate that influences, among others, lending and financing rates, as well as deposit rates.

Changes in the OPR is the sole indicator of the stance of the Bank's monetary policy, which is aimed at promoting monetary stability that is conducive to the sustainable growth of the Malaysian economy.

Operationally, the OPR is an immediate policy target that needs to be transmitted to the economy by the Bank. The Bank does this by guiding the overnight unsecured interbank rate to trade close to the OPR. This is achieved by adjusting the level of liquidity in the banking system, which the Bank has direct control over in order to achieve its monetary stability objectives. If there is a system-wide liquidity deficit, without open market operations, the overnight unsecured interbank rate will likely trade higher than the OPR. Conversely, if banking system liquidity is in surplus, financial institutions would have little incentive to trade reserves with each other, pushing the overnight unsecured interbank rate lower than the OPR.

Chart 1: Illustration of the Bank's liquidity adjustment operations to influence interbank rate to trade close to the Bank's policy rate



Box Article

The Bank's Liquidity Operations to Achieve its Mandates

With this, the Bank seeks to manage banking system liquidity via injection and absorption instruments. Most of these instruments have a temporary effect on liquidity i.e., the Bank only injects/ absorbs liquidity for a fixed tenor before the facility matures at a later date. For example, the Bank can conduct uncollateralised money market term tenders to remove liquidity from the banking system. The maturity of the Bank's term tenders ranges from overnight to a maximum of six months, depending on market conditions and the maturity profile of outstanding placements. In addition to fixed tenders, the Bank also conducts Range Maturity Auctions (RMA), in which financial institutions are able to choose the preferred maturity date for their placement with the Bank vis-à-vis a predetermined range tenor set by the Bank.

While uncollateralised overnight and term tenders are currently the Bank's main instruments to absorb liquidity, the Bank also issues its own securities for the same purpose. In December 2006, the Bank introduced Bank Negara Monetary Notes (BNMNs), replacing the previous iteration called Bank Negara Bills (BNBs). The Bank in November 2017 began issuing Bank Negara Interbank Bills (BNIBs), a version of BNMNs which is only available and tradable between licensed banks with the aim of enhancing the intermediation of liquidity in the interbank money market. BNIBs are issued with a tenor ranging from 3 months to 1 year and the issuance and pricing of these securities form a key component to build the short-term money market curve, aid financial institutions in managing their liquidity positions for varying tenors, and help meet the needs of financial institutions for liquid assets.

When there is a need to remove liquidity in banking system on a more enduring basis due to an abundance of overall liquidity in the banking system, the Bank may also conduct an outright sale of eligible securities that it holds–namely securities issued by the Government–to decrease the level of liquidity in the banking system.

Table 4: Facilities under Regular Open Market Operations (Liquidity Absorption)

Facility/ Instrument	Uncollateralised term tenders	Bank Negara Interbank Bills (BNIBs) – Local Currency	Outright sale of MGS/MGII
Tenor	Overnight to 6 months - Fixed - Determined by FIs (range maturity auctions)	1 month to 1 year	Not applicable
Trigger/ Frequency	Overnight, weekly	As needed	As needed
Rate	Market-determined		
Eligible Participants	FSA/IFSA licensed banks	Only available and tradable between FSA/IFSA licensed banks	FSA/IFSA licensed banks

Box Article

The Bank's Liquidity Operations to Achieve its Mandates

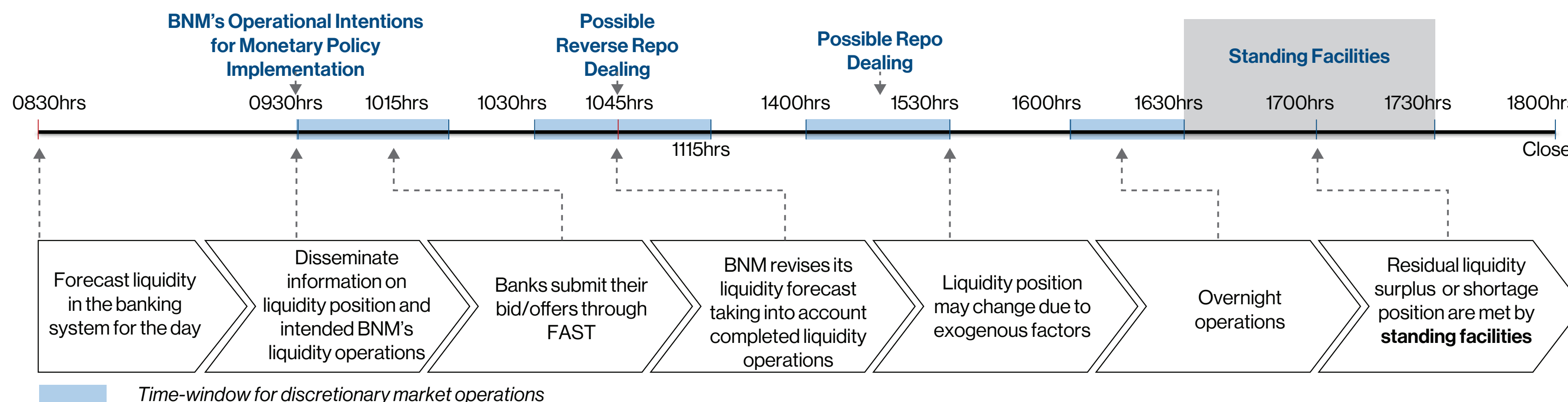
The Bank also administers the overnight standing facilities, an interest rate corridor which reinforces the OPR

In order to ensure that overnight unsecured interbank rate trades within a pre-determined band around the OPR, the Bank implements the overnight standing facilities. The standing facilities are, in essence, a corridor which form a floor rate and a ceiling rate at which the Bank will provide a deposit facility and a lending facility, respectively. This corridor is transparent to financial institutions, with the ceiling rate set at 25bps above OPR and the floor rate set at 25bps below OPR. The use of the standing facilities serves as a final option should liquidity surpluses or deficits arise late in the day owing to unforeseen factors that cannot be covered by normal money market transactions. This 50bps corridor band thus promotes active trading between market participants as they seek to avoid having to transact with the Bank at punitive rates at the end of the trading day.

Table 5: Corridor Bands of the Overnight Standing Facilities

Facility/ Instrument	Standing deposit facility	Standing reverse repo facility
Tenor	Overnight	
Trigger/ Frequency	Daily	
Rate	OPR – 25bps	OPR + 25bps
Eligible Participants	FSA/IFSA licensed banks; DFIA regulated banks	
Eligible Collateral	Not applicable	Routine eligible collateral

Chart 2: Daily Schedule of the Bank's Regular Open Market Operations



Box Article

The Bank's Liquidity Operations to Achieve its Mandates

FINANCIAL MARKET LIQUIDITY: FX MARKET

Providing foreign currency liquidity via operations in the domestic FX market and establishing bilateral/multilateral swap arrangements

In addition to liquidity facilities for the banking system, the Bank also has in place facilities to ensure orderly domestic FX market conditions

Given Malaysia's deep trade and financial integration with the global economy, international reserve holdings are vital as a tool that can be deployed to insulate the domestic economy against excessive shocks caused by internal or external developments. For example, during episodes of high market volatility driven by capital flow reversals, the Bank may step in as needed to support the domestic FX market liquidity or to attenuate excessive volatility in the Malaysian ringgit by selling foreign currency outright to the market. These interventions are consistent with Malaysia's flexible exchange rate regime, allowing necessary macroeconomic adjustments to take place in an orderly manner.

Apart from outright transactions, the Bank also utilizes FX swaps to manage the US dollar liquidity in the domestic FX market. Depending on liquidity conditions, the Bank will use FX swaps to temporarily absorb or inject liquidity in either the Malaysian ringgit or foreign currency. Another instrument that the Bank utilises to manage onshore foreign currency liquidity is the foreign currency Bank Negara Interbank Bill (FC BNIB), which can be issued in the US dollar and is only tradable among interbank market participants.

Additionally, the Bank has access to bilateral and multilateral swap arrangements to manage varying foreign currency demands in the onshore financial markets. The Bank has established access to the US Federal Reserve's Foreign and International Monetary Authorities (FIMA) Repo Facility, which acts as an added source of US dollar liquidity especially during periods of higher volatility in the global FX markets. The Bank has also set up foreign currency swap lines with regional central banks which allows the Bank to obtain foreign currencies to facilitate demand in the domestic FX market. The Bank's participation in multilateral cooperation has also resulted in initiatives such as the Chiang Mai Initiative Multilateralisation and the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) Repo Lines. More recently, the Bank joined the Bank for International Settlements Renminbi Liquidity Arrangement (RMBLA) reserve-pooling arrangement among a number of central banks in Asia Pacific.

Table 6: Facilities to Enhance FX Market Liquidity

Facility/ Instrument	Outright foreign currency transactions	FX Swap
Tenor	Spot and forward	Varies
Trigger/ Frequency	As needed	
Rate	Market-determined	
Eligible Participants	Eligible counterparties	
Eligible Collateral	Eligible counterparties[8]	FSA/IFSA licensed banks

[8] Eligible counterparties: Counterparties approved by the Bank for its FX operations, based on powers stipulatedunder the Central Bank of Malaysia Act 2009 for the purposes of maintaining efficient and effective functioning of the exchange rate regime and the FX market.

Box Article

The Bank's Liquidity Operations to Achieve its Mandates

Table 6 (continued): Facilities to Enhance FX Market Liquidity

Facility/ Instrument	Bank Negara Interbank Bills (BNIBs) – Foreign Currency	Swap and repo arrangements with foreign central banks
Tenor	1 month to 1 year	Varies
Trigger/ Frequency	As needed	
Rate	Market-determined	Varies
Eligible Participants	Only available and tradable between FSA/ IFSA licensed Banks	Not applicable
Eligible Collateral	Not applicable	Varies

PART 2(b) – FINANCIAL MARKET LIQUIDITY: SECONDARY GOVERNMENT BOND MARKET

Enhancing liquidity in the secondary government bond market via bond repo

The Bank conducts repo operations to enhance secondary market liquidity for government bonds

In an effort to improve the liquidity in Malaysia's secondary bond market, the Bank conducts repurchase operations to supply illiquid, off-the-run bonds to the secondary bond market. These bonds are often from the Bank's own holdings but can be also sourced from the Institutional Securities Custodian Programme (ISCAP). ISCAP supports the Bank's strategic goal of improving bond market liquidity by releasing captive holdings of bonds which are usually held to maturity by institutional investors and financial institutions.

Under ISCAP, participants (usually domestic long-term institutional investors) can choose to lend a pre-defined set of government bonds (uncollateralised lending) to the Bank in exchange for a lending fee. The Bank will then borrow these securities and use it as part of the repo operations to enhance market liquidity in the government bond market.

CONCLUSION

The Bank has established clear internal frameworks and conducts ongoing surveillance to ensure effective liquidity management

The Bank continues to expand and sharpen its surveillance and research capabilities to ensure that liquidity remains sufficient for effective intermediation. As an open economy with high real sector and financial market linkages with the rest of the world, Malaysia is exposed to global developments, including economic cycles and funding stresses from abroad. Capital flows can thus be large and volatile, and the ability of financial markets to effectively intermediate these flows acts as a shock absorber to shield the real economy.

The various liquidity tools available to the Bank allows effective responses to liquidity needs and stresses in the financial system, whether arising from developments in a particular financial institution or the wider financial system. The deployment of liquidity management tools is governed by well-defined operational procedures, decision-making frameworks and authorities to preserve market discipline and manage financial risks to the Bank.

Box Article

The Bank's Liquidity Operations to Achieve its Mandates

References

Adrian T., Laxton D., Obstfeld M. (2018). "Advancing the Frontiers of Monetary Policy". International Monetary Fund.

Bank Negara Malaysia (2021). "Building Buffers: Roles and Functions of Bank Negara Malaysia's International Reserves". BNM Annual Report 2020

McLeay M., Radia A., Thomas R. (2014). "Money Creation in the Modern Economy". Bank of England Quarterly Bulletin Q1 2014