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Creating a Functioning Interbank Market

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Cambodia does not have a properly functioning interbank market.

We estimate that at the end of 2014 there was at least $1.0 billion in surplus liquidity in Cambodia, with around $2.0b sitting with banks with surplus liquidity, offset by $1.0b in banks that are net borrowers. This calculation excludes the $890m that banks held in physical cash, and $760m held on deposit with other banks, which we conservatively assume is required for day-to-day operations.

These funds sit mainly with the NBC earning virtually no return. At the end of 2014, total Commercial Bank funds on deposit with the NBC amounted to $3.0b, of which only $1.5b was mandatory in terms of deposit reserve requirements and capital reserves.

This represents a significant level of inefficiency in the financial system. In fact, we estimate that the revenue potential from more efficiently deploying these funds would be in the vicinity of $100m pa, and that is just for the finance sector.

The reason this inefficiency has occurred is because liquidity does not flow easily between those banks that have it, and those that need it, because of the lack of a functioning interbank market.

Whilst there is a system recently put in place by the NBC utilizing Certificates of Deposit to support an interbank market, the interest rates on offer from the NBC are too low to justify the complexity and loss of flexibility for the banks.

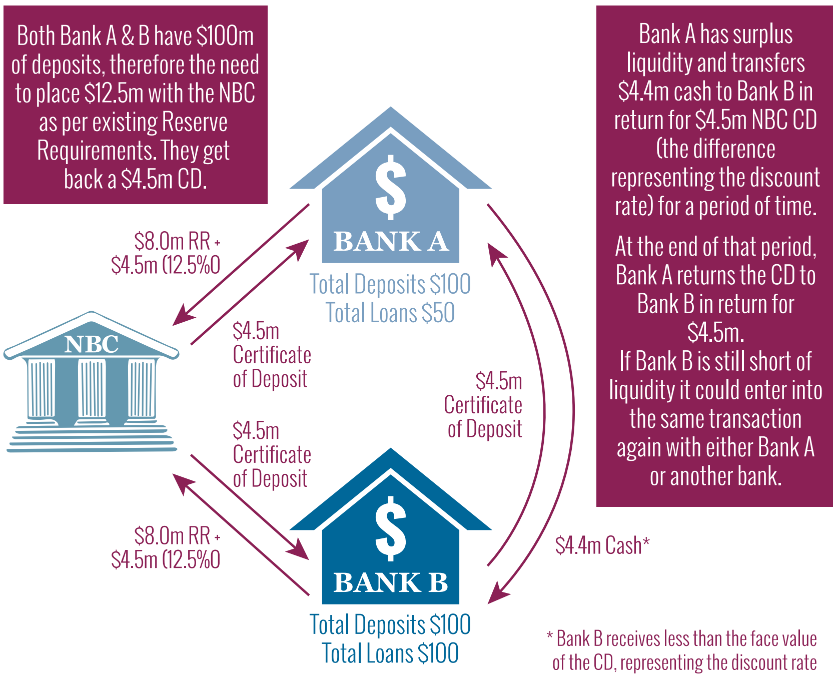
However we believe there is a model that could significantly enhance the functioning of the interbank market, allowing liquidity to move more easily between banks, provide an interest rate benchmark, and provide a much stronger monetary policy tool for the NBC.

This model would require the following key elements:

- Recognition by the NBC that any Deposit Reserve Requirement above the historical 8% level that was for prudential purposes, is a monetary policy measure (ie of the current 12.5%, 4.5% is for monetary policy purposes)
- NBC to issue certificates of deposit (CDs) for this 4.5% (or whatever the prevailing number is). That is, buying these CDs would be mandatory for banks.
- These CDs would not need to pay interest, and would be tradable between banks.
- A register maintained by the NBC of where the certificates are held.
- The CDs would need to be in USD to avoid creating exchange rate mismatches for the banks.

Schematically:

How an Interbank Market Could Work



Benefits for the NBC:

- Provides a monetary policy tool that can be easily adjusted by the NBC to change both market interest rates and system liquidity.
- Provides an observable market interest rate.
- Will increase the efficiency of the financial sector by allowing liquidity to move more easily between banks.
- Provides flexibility to adjust sector liquidity without risking solvency of individual banks - as they can generate additional liquidity by selling CDs, at a price, whereas under the current model, any increase in reserve requirements is a blanket loss of liquidity.

Benefits for Banks:

- Banks lending to other banks have the security of an NBC backed CD, minimizing credit risk for them.
- Less incentive for banks to hoard liquidity.
- An interest rate benchmark will allow more informed pricing.
- Banks will no longer be penalized for being highly liquid.
- This model would be more capital efficient, as the NBC CDs would have zero risk weighting, whereas lending money to a bank is currently weighted at 100%.

For further information

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