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SCB Securities Company Limited

EIC expects a steady policy rate at 0.5% throughout 2021

3 February 2021

Key summary

- **The MPC voted unanimously to maintain the policy rate at 0.5% to support the economic recovery that remained highly uncertain and preserve the limited policy space.**

- **The MPC assessed that liquidity in the financial system remained ample and the cost of funding remained low. However, liquidity was not distributed evenly, and the strength of the baht still raised concerns.**

- **EIC expects the economy to recover gradually, but the MPC would likely keep the policy rate at 0.5% throughout 2021 to preserve the policy space for worse-case scenarios.**

- **Instead of broad-based easing, targeted stimulus measures (ones that are well-designed, targeted, and sufficient) would be the tools of choice. For example, credit guarantee schemes that address target risks and measures that encourage financial institutions to expedite debt restructuring for a broader impact. In addition, the continuity of government measures and policy coordination among government agencies would be critical going forward.**

Key points

The MPC voted unanimously to maintain the policy rate at 0.5% to support the economic recovery that remained highly uncertain and preserve the limited policy space. At the Monetary Policy Committee (MPC) meeting on 3 February 2021, the Committee voted unanimously to maintain the policy rate at 0.50%. The Committee's economic assessments are as follows.

- **Economic growth would continue, but at a slower rate than previous assessment.** This was due to the short-term impact from the new wave of the Covid-19 outbreak and the following containment measures that were more severe and comprehensive than expected. Also, the number of foreign tourists and government spending in fiscal year 2022 were lower than expected. Nevertheless, the impact from this round of outbreak was smaller compared to the first wave, as the containment measures had been less stringent. Moreover, the economy benefited from the swift and targeted government relief, along with recovery in exports in nearly all categories.

- **The economic recovery remained highly uncertain and uneven across sectors.** In the short term, the recovery would depend on the situation of the new wave of the COVID-19 outbreak and corresponding containment measures. At a longer horizon, it would depend on the recovery in foreign tourist, the efficacy and coverage of COVID-19 vaccination, continued and sufficient fiscal support, and developments in the labor market, which became more fragile as the numbers of unemployed and underemployed workers were expected to rise in the short term. Furthermore, recoveries across economic sectors were likely to be more uneven which would affect the sustainability of the economic growth going forward.
- **The financial system remained sound, but vulnerabilities increased in some segments due to the negative shocks from the recent outbreak.** In particular, low-income households and SMEs became more vulnerable.
- **Headline inflation would return to the target in the middle of 2021** and stay close to the lower bound of the target range throughout the forecast period. Medium-term inflation expectations remained anchored within the target.

The MPC assessed that liquidity in the financial system remained ample and the cost of funding remained low. However, liquidity was not distributed evenly, and the strength of the baht still raised concerns. Businesses experiencing slow recovery and households affected by the recent outbreak had limited access to credits due to their fragile financial positions and increased credit risks. With regard to the exchange rates, the movement of the baht was in line with regional currencies. The Committee would closely monitor exchange rate developments, consider additional measures when necessary, and continue to expedite the new foreign exchange ecosystem.

The Committee noted the importance of the continuity of government measures and policy coordination among government agencies in supporting economic recovery going forward. Accommodative monetary policy must be maintained. Meanwhile, financial and credit measures should focus on timely and targeted distribution of liquidity to those in need. These measures include credit guarantee schemes that address target risks and measures that encourage financial institutions to expedite debt restructuring for a broader impact. Also, additional measures should be considered to increase the effectiveness of liquidity distribution and support economic recovery going forward. Moreover, fiscal measures must continue to provide a steady support, especially through expedited budget disbursement under the restoration plan once the new wave of outbreak is contained. At the same time, supply-side policies that support business restructuring and labor upskilling must be implemented, to ensure sustainable recovery in the long run.

The Bank of Thailand identified a list of sectors that need well-designed, targeted, and sufficient supports, based on an analysis of business income prior to and after the new wave of outbreak.

- Sectors related to international tourism experienced large decline in income in both periods. These include hotels, airlines, and condominiums that target foreign demand and with large excess supply. In the periods ahead, these sectors would face uncertainties regarding the timing of the country's reopening and the pace of recovery in foreign tourists.

- Sectors experiencing temporary decline in income during the new wave of outbreak are retail trade, restaurants, and constructions, especially the SMEs.

These two groups of sectors would require well-designed, targeted, and sufficient supports going forward.

The Committee pledged to continue to focus on supporting the economic recovery, under the monetary policy framework with objectives of maintaining price stability, supporting sustainable and full-potential economic growth, and preserving financial stability. Also, the Committee would monitor the adequacy of the government measures and various risks, especially developments of the outbreaks in Thailand and abroad, in deliberating monetary policy going forward. Additional monetary policy tools would be readily employed when necessary.

Implication

EIC expects the economy to recover gradually, but the MPC would likely keep the policy rate at 0.5% throughout 2021 to preserve the policy space for worse-case scenarios. Given the impact of the new waves of Covid-19 outbreaks both in Thailand and abroad, EIC projects that Thailand's economy would expand by only 2.2% (after -6.5% decline in 2020), a relatively low rate of growth. Thus, we expect the MPC to maintain the policy rate at the current low level to provide continued support to economic recovery.

- **The global economic growth is set to slow in the first quarter of this year, before rebounding in the second quarter onward.** Therefore, Thai export growth would be slightly lower than previously expected. The global economic recovery in the first quarter of 2021 has been delayed, as the new waves of Covid-19 transmissions in various countries prompted governments to tighten containment measures. Nevertheless, authorities in many countries including Thailand have avoided country-wide lockdowns, so the manufacturing sectors have continued to operate as usual. Governments have also announced additional stimulus measures. As a result, the impacts of the new waves of transmissions have been milder than the first one. For the second quarter onward, the global economy is expected to resume the projected recovery path thanks to vaccinations in a number of countries and relaxations of the lockdown measures. According to the IMF projections, the global economy would expand by 5.5% in 2021 (up from 5.2%), and global trade volume would grow by 8%. Meanwhile, EIC revised down the projection for Thai export growth from 4.7% to 4.0%, in light of the temporary slowdown in the global economy in the first quarter and the shortage of containers facing Thai exporters.

- **Recovery in the tourism sector would be limited due to the delay in re-openings of the home countries of Thailand's main tourist groups.** EIC expects foreign tourists to be allowed into Thailand without quarantine requirements in the third quarter of 2021. But this would apply only to those who have been vaccinated and passed virus-screening tests. However, countries with a majority of populations vaccinated by 2021Q3 would mostly be in Europe and North America, which account for only a small share of foreign tourists in Thailand. Meanwhile, Asian countries (which account for three-forth of foreign tourists in Thailand) would not achieve herd immunity until later. The Chinese government is currently expected to allow international travel for Chinese citizens in the forth quarter of 2021 at the soonest, which is later than previously thought. Thus, EIC believes that the number of foreign tourists in 2021 would total only 3.7 million.

- **The new wave of Covid-19 outbreak would have a smaller impact on private consumption compared to the first wave, but it could exacerbate existing scars.** The containment measures implemented in Thailand have been in line with other countries, and Thai companies have been more equipped to cope with the new wave of outbreak. Furthermore, government supports and financial measures have helped shore up the economy and provide some cushion against household income loss. Thanks to these efforts, the impact on domestic demand from the current outbreak is expected to be smaller than that from the first wave. However, the new wave of transmissions may exacerbate the economic scar especially among SMEs and workers in the already-fragile service sector.

Against such backdrop, we expect the MPC to maintain the policy rate at 0.5% throughout 2021, to support the economic recovery that remained highly uncertain amid declining household and business income. Additional rate cuts are currently unlikely, as the MPC would prefer to preserve the limited policy space for future downside risks. Examples of risks that could prompt another rate cut (one 25-bps cut at most) include (1) an interruption in vaccine distribution or lower-than-expected vaccine efficacy, (2) a delay in virus containment in Thailand or new waves of transmissions, (3) economic scars especially massive business closures and vulnerable labor market leading to an increase in business and household debts to levels that threaten overall financial stability, (4) domestic political instability that reduces investors' confidence, and (5) faster pace of appreciation in the baht compared to trading partners currencies that impedes recovery in external demand.

Going forward, instead of policy rate cuts, other economic stimulus measures that are well-designed, targeted, and sufficient, such as fiscal stimulus packages, would play a more important role. In EIC's view, additional policy rate cuts would not be effective because the policy rate is a blunt tool that is not designed to address problems in a targeted manner as the MPC hopes.

- **Fiscal measures would play an increasing role in shoring up the economy.** Such measures should target sectors of the economy most heavily impacted. Currently, the government has 640 THB bn remaining room for stimulus spending, 500 bn THB of which comes from the 1-trillion THB borrowing decree and the remaining 140 bn THB comes from the central budget (40 bn THB from the Covid-19 relief budget and 99 bn THB from emergency spending budget).

- **The MPC may ease monetary policy further using tools other than the policy rate.** Recently, the BOT announced an extension of the credit relief measures to June 2021. Since these measures are applied on a case-by-case basis (instead of a blanket support), they offer a more targeted support to households compared to a policy rate cut, which would have wider implications on financial institutions stability and effectiveness of policy transmission. In the coming periods, the BOT will likely announce relaxations to the soft loan program requirements to increase the lending incentives. In particular, the lending allowance could be expanded, the lending rates charged by financial institutions could be raised, and the government credit guarantee coverage could be expanded.

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