# Notice to readers

**Dear readers:**

The economic report contained in this report was produced by SCB Economic Intelligence Center (SCB EIC) and SCB Securities (SCBS) has been granted permission by Siam Commercial Bank to distribute this report to its clients. In doing so, SCBS has reviewed the report and agrees with the contents of this report.

SCBS is distributing this economic research report on its own behalf for general information only.

SCB Securities Company Limited

# EIC expects a steady policy rate at 0.5% throughout 2021, but sees a possibility of additional government bond purchase by the BOT if financial conditions continue to tighten.

24 March 2021

## Key summary

- **The MPC voted unanimously to leave the policy rate unchanged at 0.50% per year. On economic growth, the Committee expected the Thai economy to expand 3.0% this year followed by 4.7% next year, amid significant downside risks.**
- **The liquidity in the financial system remained ample and the cost of funding remained low. However, liquidity was not distributed evenly, so the BOT, in collaboration with the MOF and other related parties, introduced a new credit measure to support businesses hit by Covid-19 (under 350 bn THB budget).**
- **Concerns of a potential rise in US inflation led to a surge in US government bond yields, which drove the Thai government bond yields higher. In the coming periods, financial conditions may tighten and volatilities could increase, but to a smaller degree compared to the Taper Tantrum episode in 2013.**
- **EIC believes that if the surge in US government bond yields continues, causing a sharp rise in the Thai government bond yields, financial conditions could tighten to levels inconsistent with the slow recovery of the Thai economy. In such circumstance, the BOT may step in to purchase additional government bonds in the secondary market to put a brake on the steepening yield curve.**

## Key points

**The MPC voted unanimously to leave the policy rate unchanged at 0.50% per year. The Thai economy was expected to expand by 3.0% this year followed by 4.7% next year.** At the Monetary Policy Committee meeting on 24 March 2021, the Committee voted unanimously to maintain the policy rate at 0.50%. The Committee assessed that economic expansion would continue, but downside risks and uncertainties remained high in the periods ahead. Therefore, support from the continued low policy rate remained necessary, and the limited policy space should be preserved to allow the Committee to act at the appropriate and most effective timing in the future. Details of the Committee's economic assessments are as follows.

- **The Thai economy was projected to expand by 3.0% and 4.7% in 2021 and 2022 respectively, which is slightly lower than the previous projection (3.2% and 4.8%).** This was driven by the downward revision in foreign tourist figures to 3 and 21.5 million in 2021 and 2021 (from the previous projections of 5.5 and 23 million, respectively), and the impact of the new wave of COVID-19 outbreak. Nevertheless, the faster-than-expected recovery in trading partner economies led to upward revisions in merchandise exports growth to 10% and 6.3% in 2021 and 2022, respectively (from the previous projections of 5.7% and 5.0%). Major risks in the periods ahead included the efficacy and distribution of COVID-19 vaccines, the recovery in foreign tourist figures, and the continuity of fiscal support.
- **Stability of the financial system remained sound overall.** However, there were vulnerabilities in some areas because of the new wave of COVID-19 outbreak, especially among low-income households and SMEs.
- **Headline inflation was projected to return to target by mid-2021 and stay close to the lower bound of the target throughout the forecast period.** Headline inflation forecast for 2021 was revised upward from 1.0% to 1.2%, while the forecast for 2022 was unchanged at 1%. Medium-term inflation expectation remained anchored to the target range.

**The Committee assessed that liquidity in the financial system remained ample and the cost of funding remained low. However, liquidity was not distributed evenly.** Businesses that experienced slow recovery and households additional impacted by the new outbreaks became more financially fragile, leading to higher credit risks. The Thai government bond yields rose in tandem with the US government bond yields. Meanwhile, the Thai baht depreciated against the US dollar in line with regional currencies. The Committee pledged to closely monitor developments in the financial markets and their implications on the recovery in the period ahead, and continue to speed up 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.** Monetary policy must continue to be accommodative. Moreover, financial relief measures for businesses affected by the pandemic should focus on well-targeted liquidity distribution, debt reduction, and post-pandemic recovery support. At the same time, financial institutions should speed up debt restructuring. As for the government, fiscal measures must continue to sustain the economy. Particularly, budget disbursement under the restoration plan should be expedited once the new wave of the outbreak is contained. In addition, the government should simultaneously implement supply-side policies to support business restructuring and upskilling of labor, which would help support sustainable economic recovery in the long term.

**The Bank of Thailand, the Ministry of Finance, and related parties introduced two new financial support measures totaling 350 bn THB to support business recovery from the Covid-19 pandemic.** The measures include a revised soft loan program totaling 250 bn THB and an asset warehousing program totaling 100 bn THB. The details of each program are as follows.

- **The soft loan facility (new soft loan program) is designed to improve the ability of banks in distributing liquidity to businesses in need.** It features a number of improvements on the previous program. First, the pool of eligible borrowers is expanded to include both new and existing borrowers. Second, the credit limit is raised (from up to 20% of loan outstanding to 30%, and 20 mn THB for new borrowers). Third, the tenor of the BOT's funding is extended (from 2 to 5 years). Forth, the interest rate cap is lifted (from a maximum of 2% to 5%). Furthermore, this loan facility will be supported by a credit guarantee scheme through the Thai Credit Guarantee Corporation (TCG) and certain relevant taxes and fees would be exempted or reduced.

- **The Asset warehousing program allows businesses heavily impacted by the pandemic but with viable business models and collaterals to reduce or delay their debt burden through restructuring.** Under the program, after the collaterals are transferred to the financial institutions, businesses have the first rights to repurchase the assets within 3-5 years at the agreed transferred price plus an additional carry cost of 1% and an asset maintenance cost. In addition, during the program, businesses may lease their assets from financial institutions and continue business operations. The rents paid to financial institutions will be deducted from the amounts to be repurchased by the businesses at a later date. Such scheme would shield businesses from having to sell collaterals at fire-sale price and provide opportunity to resume operations, hire workers, and generate income again after the pandemic.

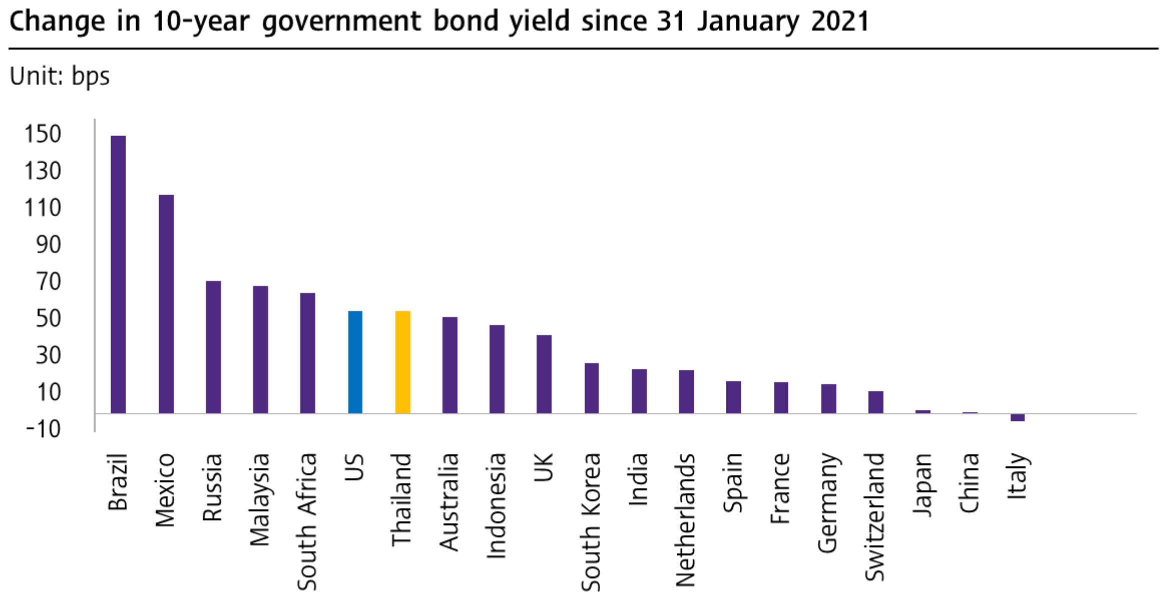
**The Committee would continue to emphasize supporting economic recovery,** under the monetary policy framework with objectives of maintaining price stability, supporting sustainable and full-potential economic growth, and preserving financial stability. Also, the Committee would monitor the adequacy 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

**Concerns of a potential rise in US inflation led to a surge in US government bond yields. This drove the Thai government bond yields higher, tightening financial conditions.** The passage of the 1.9 tn USD stimulus budget by the US government prompted concerns among market participants that the US economic growth and inflation could rise sharply going forward. Thus, investors began to demand higher risk premium to compensate for higher inflation risks. Moreover, with inflation rising, the Fed may have to start tightening its policy stance sooner than expected by tapering the asset purchase program. Hence, the yield on the 10-year US Treasury has climbed 55 bps since the end of January 2021, and the US dollar has appreciated 2%. **In Thailand, spillovers from the US market also**

caused financial conditions to tighten, with the 10-year government bond yield rising 55 bps since the end of January 2021 (Figure 1).

**Figure 1: Thai and regional government bond yields rose led by the surge in the US government bond yields.**




Source: EIC Analysis based on data from Bloomberg.

**Going forward, Thailand's financial conditions can tighten further in line with the rise in US government bond yields, but the degree of the tightening would be limited.** Yields on the US government bonds would continue rising on the back of the economic recovery and inflationary pressures. Furthermore, when the Fed begins to signal the possibility of QE tapering, it can cause global financial markets to become more volatile and financial conditions to tighten. Nevertheless, EIC believes that for this round of QE tapering, the Fed would be able to communicate more clearly and effectively. Thus, the impact of the tapering on financial conditions both in the US and in Thailand would be smaller compared to the 2013 taper tantrum episode.

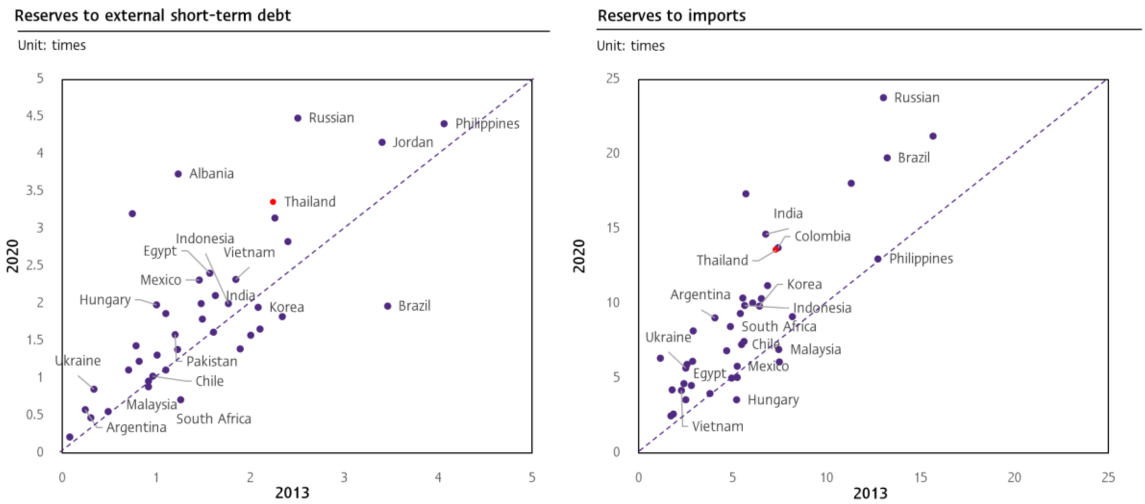
1. **The Fed would be more careful in signaling the tightening of monetary policy stance.** During the Taper Tantrum episode in 2013, financial conditions in the US tightened sharply after the Fed signaled the possibility of tapering for the first time. One month after the announcement, 10-year US Treasury yield surged 61 bps and the S&P500 dropped by around 6%. Also, emerging market economies experienced massive capital outflows of over 21 bn USD, while their stock indices fell around 16%. In the end, the Fed had to delay the tapering plan to help ease monetary conditions. Given lessons from this episode, the Fed will likely be more cautious with the signaling of policy tightening this time around.
2. **The Fed has communicated clearly that it is currently not in a rush to reduce policy accommodation.** Under the Fed's new Average inflation targeting (AIT) framework, market

participants believe that the Fed will not rush into tightening its policy even when US inflation exceeds 2%. In addition, at its latest meeting, the Fed signaled that it would keep policy rate unchanged until 2023, despite upward revisions in 2021 US growth projection from 4.2% to 6.5%, and expectation that headline inflation would reach 2.4% in 2021 before slowing to 2.0% in 2022. Such signals by the Fed have assured the market that the tapering will not begin until much later, and would be carried out in a gradual manner.

3. **The strong global growth outlook would help mitigate the impact from tightening financial conditions, unlike in 2013.** Based on a Bloomberg survey, market participants expect the US economy to expand by as much as 5.6% this year (compared to 1.8% in 2013), and the unemployment rate to decline to 5.7% (compared to 6.7 percent in 2013). For the global economy, they growth to register at 5.6% and 4.1% in 2021 and 2022, respectively, compared to 3.4% in 2013. Such robust recovery in the US and global economies would strengthen investors' confidence, which would in turn mitigate the degree of tightening in global financial conditions, despite Fed tapering.

**External positions of emerging market economies are much stronger than in 2013, making them more equipped to withstand volatilities in the global financial conditions.** External stability reflects the ability of a country to cope with volatilities in global financial conditions. EIC found that in 2020, various external stability indicators reflect improvements in emerging market economies' external positions. In particular, the ratios of foreign reserves to short-term debt and foreign reserves to import value have increased, especially for Thailand (Figure 2).

**Figure 2: External positions of emerging market economies are much stronger than in 2013**




Source: EIC Analysis based on data from IMF.

**EIC expects the MPC to hold the policy rate at 0.5% in 2021. However, if financial conditions continue to tighten, the BOT may purchase additional government bonds to ease the monetary policy.** The Committee is expected to maintain the policy rate at the current level to support the economic recovery. Meanwhile, the policy focus would be in distributing liquidity, which remains ample on aggregate, to businesses that experience slow recovery and households that suffer from the pandemic in a more targeted manner. Most recently, the BOT, the MOF, and other related parties, introduced additional financial rehabilitation measures to support viable businesses to continue their operations and maintain employment through the pandemic, and also transform themselves for the post-Covid-19 world.

**One source of concern is the risk that financial conditions may tighten abruptly if government bond yields rise quickly. EIC believes that if the surge in US government bond yields continues, causing a sharp increase in the Thai government bond yields, the domestic financial conditions could tighten significantly. In such case, the BOT may step in to purchase more government bonds in the secondary market.** During the first wave of COVID-19 outbreak in March 2020, the yield on 10-year Thai government bond surged from 0.81% to 1.72%. and the BOT bought a total of 85 bn THB in government bonds. Since 2021, however, the BOT has so far only bought 8 bn THB in government bonds in February. Thus, we believe that the central bank still has more room for further purchase when necessary. Moreover, if the government bond yields rise too quickly, the BOT may employ additional tools such as Yield Curve Control to place a cap on yields in order to sustain the still-gradual and highly fragile recovery of the Thai economy.

By: Wachirawat Banchuen (wachirawat.banchuen@scb.co.th)

Senior Economist

Pongsakorn Srisakawkul (pongsakorn.srisakawkul@scb.co.th)

Analyst

Economic Intelligence Center (EIC)

Siam Commercial Bank PLC.

EIC Online: www.scbeic.com