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SCB Securities Company Limited

EIC expects MPC to keep policy rate on hold through 2021 despite the Thai economy slowing down further from the third wave of the COVID-19 outbreak

5 May 2021

Key summary

- **The MPC voted unanimously to maintain the policy rate at 0.50% although the Thai economy would expand at a much lower rate due to third wave of the COVID-19 outbreak. The Committee viewed that the most vital challenge for the Thai economy at present was procurement and distribution of vaccines in an adequate and timely manner.**
- **The MPC assessed that credit measures and expedited debt restructuring would reduce financial burden in a more targeted manner than cutting policy rate which was already at a low level.**
- **Thai financial conditions became more accommodative in some dimensions with the Thai government bond yields declined in line with US treasury yields and Thai baht weakened relatively greater than trading partners' currencies. However, distribution of liquidity remained uneven, particular to SMEs due to increased credit risks.**
- **EIC expects the MPC to keep the policy rate steady at 0.5% through 2021. The MPC would also place greater emphasis on enhancing monetary policy effectiveness in distributing liquidity to affected businesses, accelerating debt restructuring, and extending the period of reduced FIDF contributions.**

Key points

MPC voted unanimously to maintain the policy rate at 0.50% and assessed that the Thai economy would expand at a much lower rate due to third wave of the COVID-19 outbreak. At the Monetary Policy Committee (MPC) meeting on May 5, 2021, the MPC voted unanimously to keep the policy rate unchanged at 0.5%. The Committee viewed that the most vital challenge for the Thai economy was procurement and distribution of vaccines in an adequate and timely manner, where crucial financial measure would be the distribution of liquidity to the businesses and households exacerbated by the new outbreak. In particular, credit measures and expedited debt restructuring would reduce financial burden in a more targeted manner than cutting policy rate. The Committee thus voted to maintain the policy rate to preserve the limited policy space.

- **The Thai economy would expand at a much lower rate due to the third wave of the outbreak which affected domestic spending and the recovery of foreign tourist figures** following the longer-than-expected delay in the re-opening of the country and the uncertain international travel restriction measures. The main driving force of the economy would be merchandise exports, which improved in line with the expansion of trading partner economies.

However, the impact on the overall labor market employment would be limited. Meanwhile, the government's relief and financial measures additionally announced would partly support the economic recovery in the short term. Nevertheless, fiscal stimulus for fiscal year 2022 would somewhat decrease owing to the expedition of budget disbursement under the Emergency Decree for the current fiscal year.

- **Headline inflation would temporarily increase in the second quarter of 2021 due to very low level of crude oil prices in the same quarter of last year.** Medium-term inflation expectations have remained anchored within the target.
- **Significant risks to the Thai economy in the period ahead include** (1) the distribution and efficacy of COVID-19 vaccination (2) uneven recovery across economic sectors resulting in more vulnerable labor markets which would affect household income and private consumption and (3) more fragile financial positions, particularly SMEs and tourism businesses that had lower debt servicing capability in line with lower incomes, while households' savings-to-income ratio fell leading to lower capability to cope with expenses.

According to BOT assessment, if the government is able to procure and distribute 100-million doses of vaccines in 2021 as planned, this will result in Thai GDP expanding 2% in 2021 and 4.7% in 2022. (excluding potential additional government measures) However, in the worse case, if the precurement and distribution of vaccines are delayed, this will result in GDP only expanding at 1% in 2021 and 1.1% in 2022.

- **In the case where government is able to distribute 100-million doses of vaccines in 2021 as planned, this will result in Thai GDP expanding 2% in 2021 and 4.7% in 2022.** Foreign tourists will register 1.2 and 15 million in 2021 and 2022, respectively, where herd immunity is expected in the first quarter of 2022 and umployment is forecasted to be 2.7 million at the end of 2022.
- **In the case where government can only distribute 64.4-million doses, Thai GDP will expand 1.5% in 2021 and 2.8% in 2022**. In this case, total GDP through 2021-2022 will be lower than in the case of 100-million-dose vaccine distribution by 3% (THB 460 billion). In addition, foreign tourist figures will fall to 1 million in 2021 and 12 million in 2022, where herd immunity is expected to delay to the third quarter of 2022 and umployment will be 2.8 million at the end of 2022.
- **In the case where vaccine distribution is below 64.4-million doses in 2021, Thai GDP will only expand 1% in 2021 and 1.1% in 2022.** Total GDP through 2021-2022 will be lower than GDP in the case of 100-million-dose vaccine distribution by 5.7% (THB 890 billion). Moreover, foreign tourists will record 0.8 million in 2021 and 8 million in 2022 with herd immunity delayed to the fourth quarter of 2022 and unemployment registering 2.9 million at the end of 2022.

The MPC assessed that overall liquidity remained ample and financing costs were still low, but distribution of liquidity remained uneven due to increased credit risks. Credit expansion thus needs to be comprehensively monitored after the beginning of the soft loan facilitiy for businesses. Long-term

Thai government bond yields declined from the previous period, while Thai baht weakened against the USD relatively greater than regional currencies. The Committee would closely monitor developments in both the global and domestic financial markets and continue to expedite the new foreign exchange ecosystem.

The MPC viewed that the continuity of government measures and policy coordination among government agencies would be critical to support the economic recovery impacted by the new outbreak. The measures to accelerate the procurement and distribution of vaccines would prevent the outbreak from being prolonged. Fiscal measures should ensure the continuity of fiscal impulses, mitigate the impacts of the outbreak, and support the economic restoration going forward. Monetary policy must remain accommodative. The new financial rehabilitation measures to support business recovery post-COVID-19 should accelerate the distribution of liquidity to the affected groups in a targeted manner, reduce debt burden, and support the economic recovery. Financial institutions should also accelerate debt restructuring for borrowers. The Bank of Thailand (BOT) would closely monitor the progress and assess the efficacy of financial and credit measures.

The MPC continued to emphasize 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. In addition, the MPC would monitor key factors to the economic outlook, such as the new outbreak situation, distribution and efficacy of vaccines, and the adequacy of fiscal measures as well as existing financial and credit measures. The MPC would stand ready to use additional appropriate monetary policy tools if necessary.

Implications

EIC expects the MPC to keep the policy rate on hold at 0.5% through 2021 and also place emphasis on measures to distribute liquidity to affected businesses and accelerate debt restructuring. The MPC would likely hold the policy rate at this current level to support the economic recovery, particularly in the period where the economy is affected by the new wave of COVID-19 outbreak. EIC believes that the opportunity for the MPC to cut the policy rate further is low due to the following factors.

- **Monetary policy transmission faces more limitations with policy rate at very low level.** Another policy rate cut may not be able to boost demand much further as purchasing power and confidence of consumers relying on interest income from deposits may fall in line with deposit rates. This will affect consumption outlook. Moreover, investment may not be stimulated much in the period of high uncertainties.
- **Policy rate cut may help reduce financing costs somewhat but will not play a role in distributing liquidity** to businesses and households with increased credit risks. Therefore, liquidity access of those affected by the outbreak remains key issue.
- **Deposit rates have gradually fallen to around 0, potentially leading to accumulation of vulnerabilities in the financial sector** from search-for-yield behavior. This could result in

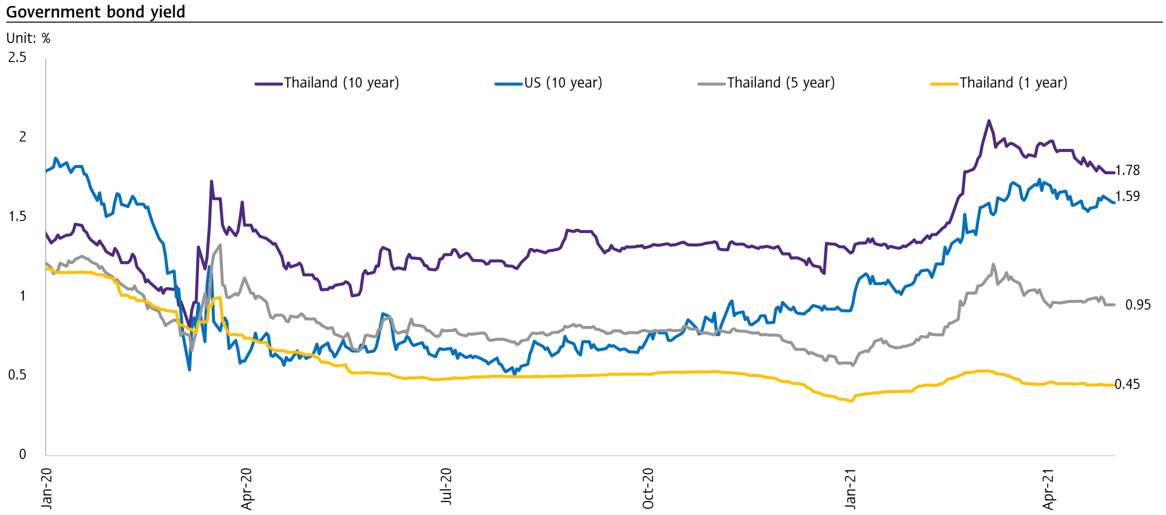
underpricing of risks, especially among savers that lack appropriate financial knowledge and literacy.

EIC thus assesses that the BOT will focus on enhancing the effectiveness of implemented measures including soft loan facility for businesses and asset warehousing program. The BOT may consider extending the period of reduced FIDF contributions. In this light, the BOT has amended conditions for the previous soft loan facility to include the affected target groups and increase flexibility for practicality. Moreover, the BOT may extend the period of the reduced FIDF contributions from the previous announcement of FIDF contribution reduction to 0.23% for 2 years (the announcement was made since April 2020).

Thai financial conditions became more accommodative in some dimensions with Thai government bond yields declined in the previous month in line with the US Treasury yields. 10-year Thai government bond yield recorded 1.78%, down 19bps from the beginning of April, while 10-year US Treasury yield registered 1.59%, down 14bps during the same period (Figure 1)

- **US Treasury yields fell in April 2021 inconsistent with US economic indicators, both non-farm employment and Producer Price Index (PPI), that rose continually.** This reflects strong economic recovery. Nevertheless, decline in US Treasury yields was due to 3 factors as follow.
  1) **Market participants have already priced in to some degree that the Fed will likely tighten monetary policy,** where most market participants expected the Fed to start raising policy rate for the first time in the first quarter of 2023, faster than the Fed's signal of 2024. This reflects that market participants assessed that the US economy would expand rapidly and pressure the Fed to raise policy rate faster than it has signaled. Therefore, despite continually better US economic data outturns, US Treasury yields will not increase given some degree of market expectations.
  2) **Investors downgraded the positive outlook on US economic growth and inflation in the medium and long terms due to geopolitical tensions and vaccine suspension.** Moreover, investors also viewed that the US inflation will likely increase more rapidly in the short run than in the medium and long runs, resulting in lower long-term US Treasury yields.
  3) **Regarding the US Treasury bond purchases by foreign investors in early April,** the US Treasury stated that such purchases by Japanese investors in the second week of April 2021 were expected to be mainly from pension funds. This resulted in lower US Treasury yields driven by higher demand.
- **Thai government bond yields will likely decline in line with falling US Treasury yields. Such decline will also be driven by the Thai economy that is expected to slow down further** with rising number of infections from the third wave of COVID-19 outbreak and slow vaccine distribution. As a result, the Thai economy will likely expand at a slower pace than previously expected, pressuring Thai government bond yields to fall.

Figure 1: Thai financial conditions became more accommodative in some dimensions including lower Thai government bond yields

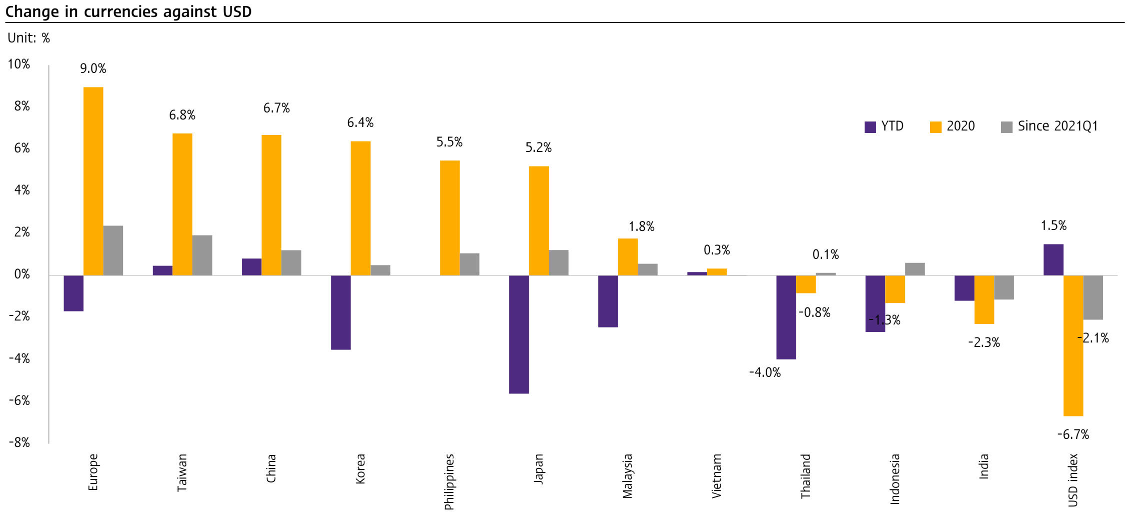


Source: EIC analysis based on data from Bloomberg

Despite weakening USD, Thai baht also weakened against regional currencies on account of current account deficits and intensifying domestic outbreak situation. The baht recorded 31.2 baht per USD, weakened 4% from the beginning of the year, as the baht depreciated relatively greater than other regional currencies. However, the baht remained stable relative to the previous quarter despite decline in US dollar index by 2.1% during the same period (Figure 2). Factors causing the baht to weaker include the followings.

1. **Thailand registered current account deficits since the beginning of the year.** In the first quarter of this year, Thailand's current account recorded a deficit of THB 77 billion, the lowest level since 2013. This was primarily due to contraction of foreign tourists at 99.7% in the first quarter. Moreover, although merchandise exports expanded 0.2%YOY in the first quarter, merchandise imports also grew 7.2%YOY, resulting in trade deficits of THB 12 billion.
2. **Domestic outbreak situation intensified with relatively limited vaccination progress, affecting investor confidence.** Capital flows to Thailand thus have yet to recover much. Although there were capital inflows to bond market in 2021, there were also outflows from the equity market at similar levels.

Figure 2: Altough the baht faced appreciation pressure from weakending USD, the baht depreciated on account of current account deficits and intensifying domestic outbreak situation.



Source: EIC analysis based on data from Bloomberg

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