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The BOT's MPC signaled a slower and uneven economic recovery due to the third-wave outbreak. EIC expects inflation to stay within target and the BOT's MPC to keep policy rate steady at 0.5% through this year and next year.

23 June 2021

Key summary

- MPC voted unanimously to maintain the policy rate at 0.5%, while cutting the Thai economic growth forecast to 1.8% this year, close to EIC forecast since early June at 1.9%. MPC also signaled a slower and uneven economic recovery due to the impact of the third-wave outbreak, with procurement and distribution of vaccines in an adequate and timely manner being the most important issue for the Thai economy at the present.
- MPC assessed that overall liquidity remained ample but its distribution was uneven due to increased credit risks, particularly among SMEs and households that were additionally affected by the third-wave outbreak. The continuity of government measures and policy coordination among government agencies would be critical to support the economic recovery impacted by the new outbreak.
- EIC expects the BOT to keep policy rate steady at 0.5% through 2021 and 2022, despite sign of reflation. However, EIC assesses that headline inflation in 2021 will average at 1.3% which will still be below the midpoint of the inflation target range of 1-3%. Nevertheless, financial system liquidity that is still unevenly distributed will remain a key challenge for the BOT to address urgently, while EIC believes that the success of the new financial rehabilitation measures going forward will depend on the monitoring of problems and constraints in order to adjust conditions for the measures to be more effective.
- Thai government bond yields dropped slightly in line with the US treasuries, while the baht faced weakening pressure from stronger US dollar. EIC assesses that Thai government bond yields may rise at the end of this year in line with US treasuries and expected increase in supply of government bonds. The baht will still face weakening pressure in the third quarter. However, appreciation pressure for US dollar may slow down toward the end of the year. EIC thus maintains its forecast of the baht at the end of the year to stay within range of 31-32 baht per USD.

■ Key points

MPC voted unanimously to maintain the policy rate at 0.5%, with Thai economic growth projections of 1.8% this year and 3.9% next year. At the Monetary Policy Committee (MPC) meeting on June 23, 2021, the MPC voted unanimously to keep the policy rate unchanged at 0.5%. The Committee assessed that the Thai economic recovery would be slower and more uneven than the previous forecast due to the third wave of the COVID-19 outbreak. Downside risks to the economic outlook also remained significant from the new wave of the outbreak. Procurement and distribution of vaccines in an adequate and timely manner was the most important issue for the Thai economy at the present. Moreover, financial measures, particularly special loan facility for businesses as well as debt restructuring, should be expedited. These measures would reduce financial burden for the businesses and households affected by the outbreak in a more targeted manner than cutting the policy rate, which was already at a low level.

- **The Thai economy was projected to expand by 1.8 and 3.9 percent in 2021 and 2022, close to EIC forecast.** The BOT lowered its growth projection on account of lower foreign tourist figures to 700 thousand people in 2021 and 10 million people in 2022 (from previously 3 million and 21.5 million respectively) and domestic demand held down by the third-wave outbreak. Looking ahead, the Thai economy would face downside risks from the possibility of the outbreak situation in Thailand and abroad becoming more severe owing to virus mutations, affecting foreign tourist figures and domestic activities. However, the Thai economy would be supported by higher public expenditure thanks to the latest Emergency Loan Degree and improving merchandise exports in line with global economy recovery.
- **The labor market** would recover more slowly than in the past and would be W-shaped. The labor market would be more fragile, particularly the services sectors and the self-employed, which could cause scarring effects to the economy and would be harder to resolve without timely intervention.
- **Headline inflation would rise temporarily in the second quarter of 2021** due to low crude oil prices in the same quarter of last year, while reflation in advanced economies and supply shortages would have limited impact on Thai inflation. Medium-term inflation expectations remained anchored within the target

MPC assessed that overall liquidity remained ample but its distribution was uneven due to increased credit risks, particularly among SMEs and households that were additionally impacted by the third wave of the outbreak. Long-term government bond yields remained stable. On exchange rates, the Thai baht relative to the US dollar depreciated more 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 Committee 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.

Accelerating the procurement and distribution of vaccines would prevent the outbreak from being prolonged. Moreover, fiscal measures would play a crucial role in driving the economic recovery amid high uncertainties. Thus, the government should accelerate the disbursement of relief and other fiscal support measures to provide adequate and continuous economic stimulus as well as address vulnerabilities in the labor market. Meanwhile, monetary policy must remain accommodative. The new financial rehabilitation measures to support business recovery post-COVID-19 and other measures by specialized financial institutions (SFIs) should accelerate the distribution of liquidity to the affected groups in a targeted manner, reduce debt burden, and support the economic recovery. In addition, financial institutions should accelerate debt restructuring.

MPC continued to put emphasis 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. In addition, the Committee would monitor key factors affecting the economic outlook, namely the distribution and efficacy of COVID-19 vaccines, the possibility of the outbreak situation in Thailand and abroad becoming more severe owing to virus mutations, as well as the adequacy of fiscal, financial, and credit measures. The Committee would stand ready to use additional appropriate monetary policy tools if necessary.

■ Implication

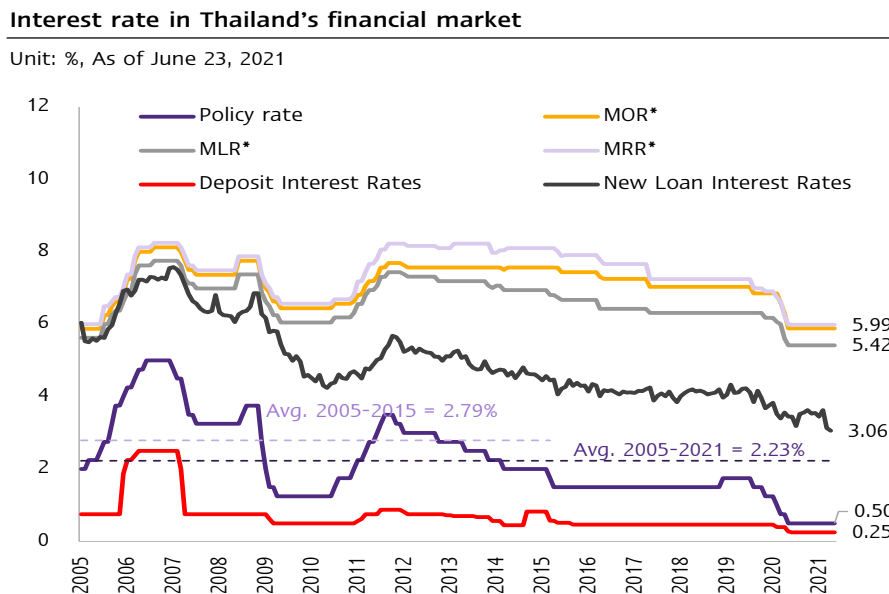
Global demand recovered strongly, while supplies were constrained by shortages of particular goods and raw materials causing inflation to rise in many countries. However, upward pressures were expected to decline in the second half of 2021. A rise in global inflation in the previous period was supported by 1) pent-up demand and spending from rising excess savings, leading to a surge in prices of goods and services following the city reopening, 2) surging commodity prices which was major contributor for rising producer prices, 3) growing global housing markets causing house prices to increase especially in developed countries like the US and the UK, which, in turn, result in higher house rents, 4) labor wages which remain high, where labor markets in some countries (like the US) remain tight as low-income workers have yet to fully return to the labor market, and 5) technical factor from low-base effect in the previous year. Nevertheless, pressures from import prices on inflation in emerging markets including Thailand are expected to be limited due to low imported contents, while domestic factors will have more impact on inflation the period ahead. These factors include size of output gap, size of stimulus measures, central bank's credibility, and demand-supply imbalance in each country.

Looking ahead, inflationary pressures are expected to gradually decline in the second half of 2021 as stimulus measures will gradually expire, commodity supplies will gradually increase in line with higher prices, and pressures from wages will slow down as more workers return to the market.

EIC expects the BOT to keep policy rate steady at 0.5% through 2021 and 2022, despite sign of reflation. However, EIC assesses that headline inflation in 2021 will average at 1.3% which will still be below the midpoint of the inflation target range of 1-3%. Moreover, the COVID-19 outbreak situation has not yet subsided and remains highly uncertain with delay in COVID-19 vaccine distribution. This will affect the economic recovery in the period ahead. There is, therefore, a need for MPC to keep interest rates in the financial market at low levels to support the economy recovery. EIC expects the MPC to raise policy rate at the earliest in the second half of 2023 as EIC assesses that GDP will not return to 2019 level until the first half of 2023, while GDP will likely be below potential level through 2023 (output gap remains). In addition, an increase in policy rate will be gradual and the peak will be lower than previous cycles as potential growth is expected to fall and monetary policy needs to support rising debt burdens of both households and government. (Figure 1)

Moreover, BOT will focus on targeted measures to enhance liquidity distribution and assist borrowers affected by the COVID-19 outbreak. The BOT has reviewed its policies to additionally assist affected borrowers and encouraged financial institutions to accelerate debt restructuring by taking into account potential and adaptation opportunities of borrowers. On June 10, 2021, the BOT extended debt relief measures for SME borrowers and third-phase debt relief measures for retail borrowers covering 4 loan types namely credit card, personal, auto title, and housing loans. These measures were extended until December 31, 2021 (from previous expiration on June 30, 2021). Moreover, the BOT is considering on extending the period of reduced FIDF contributions. Nevertheless, financial system liquidity that has yet to be evenly distributed remains key challenges for the BOT that needs to be urgently addressed. This is reflected by contraction in SME loans despite low-base effect. In addition, loans approved under the financial rehabilitation measures account 40 billion baht from total limit of 250 billion (data as of June 14, 2021) EIC believes that the success of the financial rehabilitation measures going forward will depend on the monitoring of problems and constraints in order to adjust conditions for the measures to be more effective.

Figure 1: EIC expects the BOT to keep policy rate steady at 0.5% through 2021



Source: EIC analysis based on data from the Bank of Thailand

Following the FOMC Meeting on June 16, 2021, Thai government bond yields fell slightly in line with US treasuries. At the Meeting, the Fed raised its GDP forecast and inflation in 2021 to 7% and 3.4% respectively, and signaled a possibility of a faster rate hike from first hike in 2024 as previously expected to 2 times in 2023. Following the end of the FOMC Meeting, 10-yr US treasury rose 8 bps to 1.58% before falling to current level of 1.49%, whereas Thai government bond yield dropped slightly to current level of 1.81%.

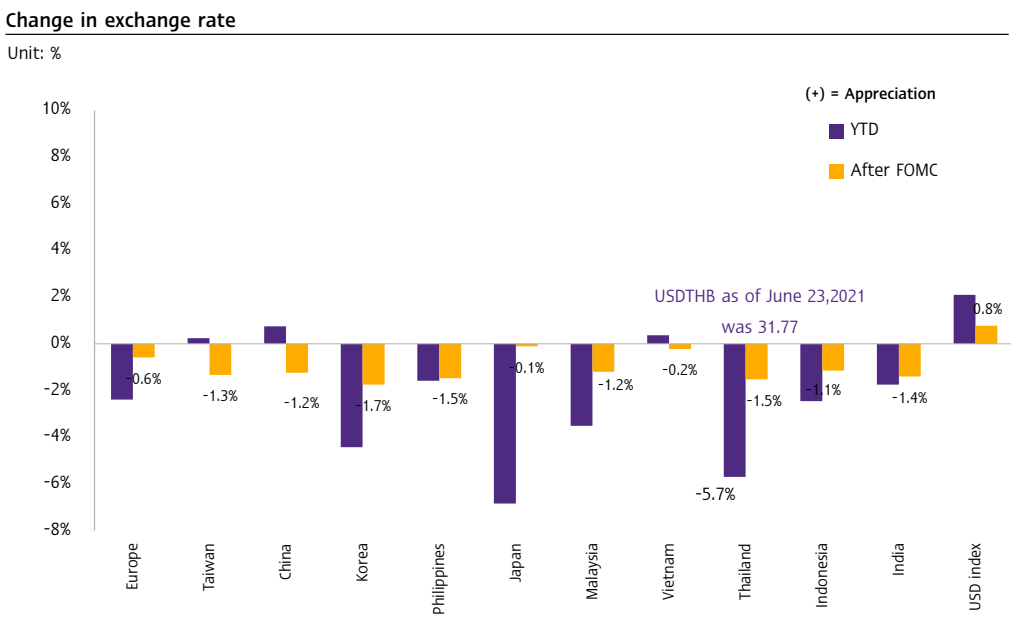
- **EIC expects 10-year US treasury at the end of 2021 to rise to a range of 1.80-1.90%.** Factors driving down 10-year US treasury in the previous period include the followings. 1) Average inflation targeting (AIT) framework that the Fed adopted for its monetary policy conduct puts weight on the average inflation instead of merely considering the current inflation rate. The implementation of AIT framework coupled with a signal on rate hike in 2023 brought down inflation expectation which will likely stay around the target of 2%. 2) US employment rate is still below forecasts as labor has not fully returned to the market. However, EIC expects 10-year US treasury at the end of 2021 to rise on account of 1) US economic growth and inflation that are expected to remain high and employment rate that is expected to improve, causing US treasury to rise further, and 2) communication on QE Tapering in the second half of this year.
- **EIC expects 10-year Thai government bond yield at the end of 2021 to rise slightly in line with US treasury and stay within the range of 2.0-2.1%.** The Thai economic recovery was aggravated by the new wave of COVID-19 outbreak in the previous period which resulted in a slower recovery than the previous forecast. This will pressure Thai government bond yields to fall. However, EIC expects 10-

year Thai government bond yield at the end of 2021 to rise slightly in line with US treasury and stay within the range of 2.0-2.1%. This is as the Thai government is expected to issue more bonds to cater rising government financing needs. Moreover, outflows from the Thai bond market in response to US QE Tapering may prompt Thai government bond yields to rise.

Following the FOMC Meeting, the baht faced weakening pressure from stronger US dollar. EIC expects the baht to still face weakening pressure in the third quarter. However, appreciation pressure for US dollar may slow down toward the end of the year. EIC thus maintains its forecast of the baht at the end of the year to stay within range of 31-32 baht per USD. Since the FOMC Meeting to date, the US dollar index strengthened 0.78% to 91.84, which pressured the baht to weaken 1.52% to 31.77 in the same period. (Figure 1)

EIC assesses that the baht will face higher pressures from strengthening US dollar in the third quarter as the Fed may likely start to communicate regarding QE Tapering. However, EIC expects US dollar appreciation to slow down during the end of the year as a result of economic recovery in other advanced economies especially EU which will gradually accelerate in the next quarter. Meanwhile, US economic recovery will start to slow down. In addition, the ECB will likely reduce its bond purchases within the third quarter, while the Fed will likely begin to taper in early 2022. These factors will hold down US dollar strengthening. In addition to better outlook of COVID-19 situation in response to vaccination progress and Thailand’s current account deficit, the baht is expected to stay within the range of 31-32 baht per USD at the end of 2021.

Figure 2: Since the FOMC Meeting to date, the US dollar index strengthened 0.8%, pressuring the baht to weaken 1.5%



Source: EIC analysis based on data from Bloomberg

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