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SCB Securities Company Limited

SCB Economic Intelligence Center

EIC expects the MPC to keep policy rate at 0.5% throughout 2021 and 2022 to support the slow economic recovery with smaller chance of another cut in the short run thanks to the easing of the lockdown and significant progress of vaccination.

29 September 2021

Key summary

- **The MPC voted unanimously to maintain the policy rate at 0.5% assessing that the Thai ecocomy would expand 0.7% this year and 3.9% next year. The recovery would be mainly supported by domestic spending thanks to significant progress of vaccination which allowed easing of the lockdown measures to occur faster than expected. This would boost confidence and private consumption during the rest of 2021.**
- **EIC expects the MPC to hold the policy rate steady at 0.5% throughout 2021 and 2022 to support the slow economic recovery in line with tourism and given large economic scars. Nevertheless, EIC assesses that the Thai economy would not return to the pre-COVID size in 2019 until mid-2023. Meanwhile, the chance for the MPC to cut the policy rate further became smaller owing to faster-than-expected easing of the lockdown measures and the economic outlook in the period ahead which would benefit from better vaccine rollouts. Moreover, the unanimous votes to keep the policy rate steady and the MPC communication that "financial measures would be more effective than a further reduction in the policy rate, which was already low" prompted EIC to conclude that the chance for a policy rate cut this year and next year became smaller.**
- **EIC expects the BOT to place its focus on enhancing effectiveness of monetary policy transmission through various financial measures especially through mechanism to reduce credit risks. This would enhance the liquidity distribution to households and SMEs. The BOT will also place emphasis on promoting debt restructuring of financial institutions and considering taking action to curb interest rates in the financial markets should there be volatility arising from tightening global liquidity in the period ahead.**
- **Thailand's financial conditions in the previous period were more tightened due to an increase in Thai government bond yields in line with US treasury yields and larger Thai government bond supply. However, Thai baht weakened due to stronger US dollar, capital outflows from the Thai financial markets, and persistent current account deficit which helped ease Thailand's financial conditions somewhat.**

Key points

The MPC voted unanimously to maintain the policy rate at 0.5% assessing that the Thai economy would expand 0.7% this year and 3.9% next year. At the Monetary Policy Committee (MPC) meeting on September 29, 2021, the MPC voted unanimously to maintain the policy rate at 0.5%. The Committee assessed that the Thai economy in 2021 and 2022 would expand close to the projection from the previous meeting, but uncertainties surrounding the economic outlook remained high. Nonetheless, progress on vaccination and earlier-than-expected relaxation of the containment measures would help support the economy in the period ahead. The most important issue for the Thai economy at present was the implementation of public health measures that would help facilitate the economic and income recovery. The Committee viewed that government measures should be expedited to support the economic recovery. Despite some progress on financial measures, liquidity distribution and debt restructuring should be expedited further for those who were affected. The Committee viewed that financial measures would be more effective than a further reduction in the policy rate, which was already low, and thus voted to maintain the policy rate.

- **The Thai economy was projected to expand 0.7% and 3.9% in 2021 and 2022 respectively,** largely unchanged from the August projection at 0.7% and 3.7%. Although the economy in the third quarter of 2021 was affected by the containment measures and a slowdown in exports, significant progress on vaccination and earlier-than-expected relaxation of the containment measures would help restore private sector confidence and boost private consumption for the rest of 2021. The economy in 2022 would gradually recover mainly owing to domestic spending in tandem with improving confidence. Foreign tourist figures were expected to recover slowly, while merchandise exports would continue to be affected by shortages of containers and semiconductors.
- **The labor market improved** from higher income of workers in the services sector and the self-employed in line with economic acitivities.
- **Headline inflation would remain subdued in line with weak domestic demand.** Headline inflation forecast for 2021 was revised down from June forecast of 1.2% to 1.0% at this meeting, while headline inflation forecast for 2022 was revised up from 1.2% to 1.4%. Nonetheless, headline inflation forecast and medium-term inflation expectations were still anchored within the target.
- **The Thai economy would still be highly uncertain.** Thus, there remained a need to monitor the development in the outbreak and relaxation of containment measures, private sector confidence, as well as the momentum of government measures as these factors would affect the economic recovery going forward.

The MPC assessed that liquidity in the financial system remained ample but its distribution was uneven due to increased credit risks, particularly among SMEs and households. Nonetheless, the special loan facility for businesses helped enhance credit access for SMEs. On exchange rates, the baht relative to the US dollar exhibited more volatile movements owing to developments of monetary policy in advanced economies and uncertainties in the Thai economic recovery outlook. The Committee would closely monitor developments in both global and domestic financial markets and continue to expedite the new foreign exchange ecosystem.

The MPC indicated that the government measures and policy coordination among government agencies would be critical to support the economic and recovery. Public health measures should strike a balance between containing the outbreak and supporting the recovery of economic activities and income. Fiscal measures should help facilitate the economic recovery by emphasizing on generating income and preparing measures to raise potential growth. Monetary policy must contribute to continued accommodative financial conditions overall. Financial and credit measures should be expedited to distribute liquidity to the affected groups in a targeted manner and help reduce debt burden. These measures included the special loan facility, asset warehousing scheme, and other measures by specialized financial institutions (SFIs). In addition, financial institutions should accelerate debt restructuring to have broader impacts and be consistent with borrowers' long-term debt serviceability.

The MPC would continue 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, the Committee would monitor key factors affecting the economic outlook, namely implementation and relaxation of the domestic containment measures 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.

Implications

EIC expects the MPC to keep the policy rate 0.5% throughout 2021 and 2022, where the chance for the MPC to cut the policy rate further since the previous meeting became smaller due to the earlier-than-expected easing of the lockdown measures and the economic outlook in the period ahead which would benefit from better vaccine rollouts. EIC assesses that in the baseline scenario, the MPC is likely to hold the policy rate at the historical low until the end of 2022 as the outbreak situation continues to improve since the last meeting. The latest situation turned out better than the MPC previous assessment where the infection figures were expected to gradually fall and thus the government could gradually ease the lockdown measures from the beginning of the fourth quarter of 2021 onwards. Moreover, the unanimous votes and MPC communication that "financial measures would be more effective than a further reduction in the policy rate, which was already low" prompted EIC to conclude that the chance for a policy rate cut this year and next year became significantly smaller than the previous meeting. Other factors supporting the MPC to hold the policy rate include the preservation of policy space to be used when necessary in case of the economic contraction and the limited impact of the policy rate cut in boosting the economy. This is because lower interest rates may induce those relying on interest income from deposits to save more and thus spend less. Moreover, the low for long interest rates would also create vulnerabilities to the Thai financial stability in the long run.

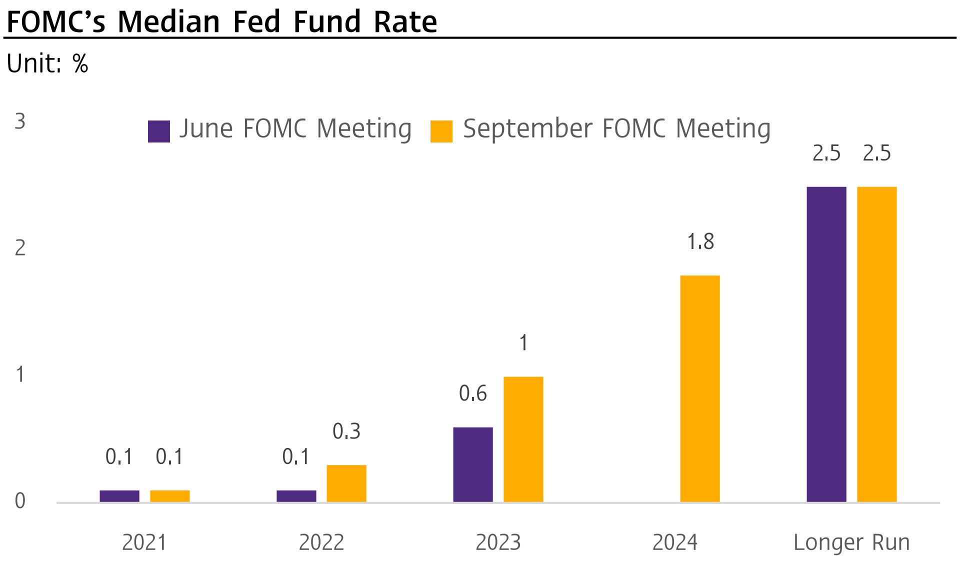
The policy rate hike in the period ahead is expected to be gradual as the Thai economic recovery would be slow in line with the slow recovery of tourism and given large economic scars reflected by higher unemployment rate, rising household debt, and more fragile financial positions of businesses. Therefore, the Thai economy would not return to the pre-COVID size in 2019 until mid-2023. Moreover, Thailand's inflation would likely remain low. Although Thai baht has weakened, this would not lead inflation to accelerate much, while the BOT could also take action to ensure the baht stability in the period of fast depreciation by purchasing foreign assets. Thus, there is no need for the BOT to quickly raise the policy rate to curb the baht.

Nevertheless, the BOT will still put its focus on improving effectiveness of the monetary policy transmission through various financial measures, especially through mechanism to reduce credit risks. This would enhance liquidity distribution to households and SMEs as the MPC has communicated. The BOT will also place emphasis on promoting debt restructuring of financial institutions to be better in line with the problem of each group of borrowers, as well as considering taking action to curb interest rates in the financial markets should there be volatility arising from tightening global liquidity next year.

Thailand's financial conditions were more tightened due to an increase in Thai government bond yields in line with US treasury yields and larger Thai government bond supply. However, Thai baht weakened due to stronger US dollar which helped ease financial conditions for Thai exporters.

US treasury yields rose following the Federal Open Market Committee (FOMC) meeting on September 21-22 where the monetary policy stance turned out to be more hawkish than the previous meeting. This is as the Median Dot Plot from the recent meeting suggests members' views on a faster hike of the fed fund rate. The first hike is expected at the end of 2022 which is faster than the market expectation of 2023 prior to the meeting. In addition, Median Dot Plot also reflects that members may raise the fed fund rate at least 3 times during 2022-2023 (Figure 1). Furthermore, EIC expects that the Fed would formally signal QE Tapering at the FOMC meeting this November and begin the QE Tapering process in December 2021. The Fed is expected to cut the asset purchase by 15 billion US dollar per month (UST $10 billion and MBS $5 billion), leading the QE Tapering process to likely end in the middle of 2022.

Figure 1: Median Dot Plot from the latest FOMC meeting (September) reflects a more hawkish monetary policy stance of the Fed.

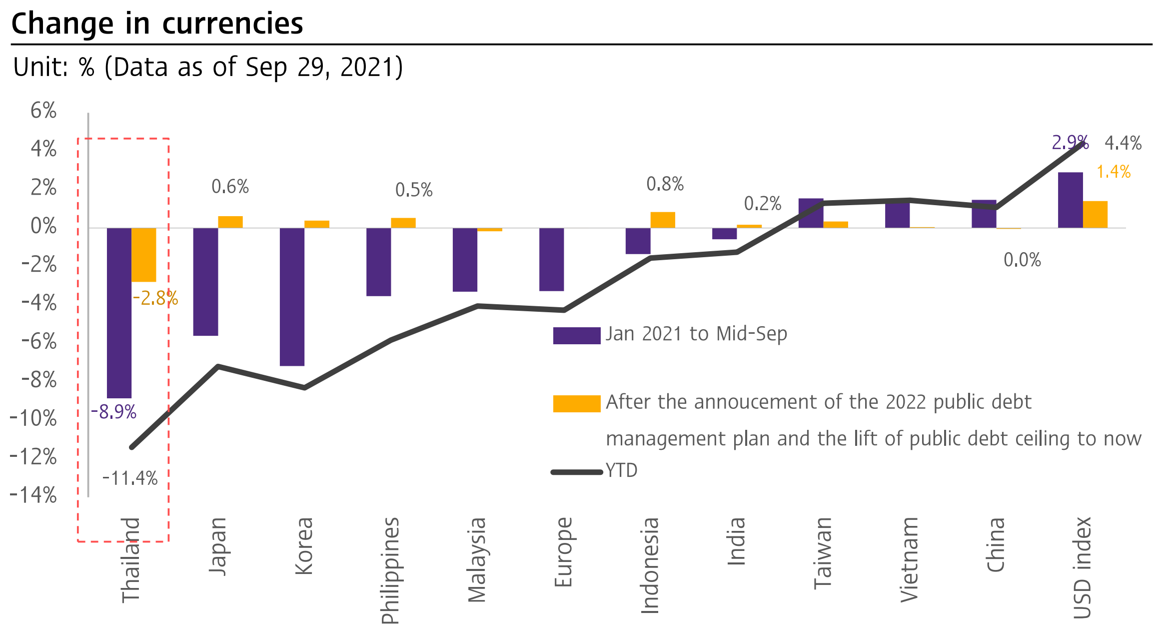


Source: EIC analysis based on data from the Federal Reserve

The rise in the US treasury yields and larger Thai government bond supply resulted in a fast increase in Thai government bond yields in the previous period and consequently more tightened financial conditions. In mid-September, the Public Debt Management Office (PDMO) has announced the 2022 public debt management plan which suggests that the government plans to raise funds in the fiscal year 2022 totalling 3.1 trillion baht. The plan includes the new borrowing of 1.3 trillion baht, management of existing debt of 1.5 trillion baht, and debt repayment of 0.3 trillion baht. The government plans to raise funds through issuing more government bonds than the previous fiscal year, where government bond issuance would account around 50% of the total financing. Following the announcement, Thai government bond yields rose. In addition, the increase in Thailand's public debt ceiling from 60% to 70% to GDP would lead government bond supply to rise in the period ahead. By lifting the public debt ceiling by 10%, the government thus has room to incur additional debt of around 1 trillion baht. Should the outbreak situation worsen and cause the economy to recover more slowly than expected, this would cause the Thai government bond yields to rise further.

Thai baht weakened due to stronger US dollar, capital outflows from the Thai financial markets, and persistent current account deficit. This helped ease financial conditions for Thai exporters. Since the FOMC meeting, US dollar has strengthened around 0.7%, while foreign investors continued to sell Thai government bonds in the past week following the annoucement of the 2022 public debt management plan and the lift of public debt ceiling. This caused Thai baht to weaken 11.4%YTD to 33.8 baht per USD (Figure 2). Nevertheless, the baht and capital movements will likely remain volatile in the short run. Factors that could pressue the baht to weaken further include 1) risk of the new wave of infections following the easing of the lockdown measures and 2) the Fed's QE Tapering which could lead to capital outflows from EMs including Thailand. However, the baht could also strengthen due to the better economic recovery outlook in line with the city reopening after vaccination rates become higher. In addition, stronger baht can occur due to the weakening of US dollar in tandem with slower economic recovery outlook due to a more prolonged COVID-19 outbreak than expected, contrary to continuously high inflation level and the issue on US public debt ceiling which could result in delay in the Fed's QE Tapering plan than the market expectation. EIC thus expects Thai baht to be within the range of 33.3-33.8 baht per USD at the end of 2021.

Figure 2: Investors sold Thai government bonds following the annoucement of the 2022 public debt management plan and the lift of public debt ceiling, causing the baht to weaken.



Source: EIC analysis based on data from Bloomberg

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