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SCB Securities Company Limited

EIC expects MPC to hold policy rate at 0.5% throughout 2021 and 2022 given better economic recovery outlook, while there is no pressure for rate hike to ensure price stability like other central banks.

10 November 2021

Key summary

- The MPC voted unanimously to maintain the policy rate at 0.5% assessing that the Thai economy had bottomed out in the third quarter of 2021 and entered the recovery phase following the easing of the lockdown measures and the country re-opening. Meanwhile, downside risks to the economic projection decreased on account of the accelerated vaccination progress. Domestic spending gradually recovered following the easing of the lockdown measures partially offsetting the adverse impact of higher global energy prices. However, the fragile recovery would remain subject to uncertainties. Looking ahead, the recovery of economic activities and employment would remain uneven across economic sectors. Headline inflation would increase temporarily owing to supply-side factors, particularly the energy prices which would likely decline by early next year. Nevertheless, headline inflation would remain within the target, with upside risks including the elevated global energy prices persisting longer than expected and global supply constraints becoming more prolonged.
- Although demand-supply mismatch has caused inflation to continue accelerating in many countries, putting pressures on monetary policy conduct of many central banks around the world, EIC views that such pressures to hike policy rate of other central banks would not influence the MPC to accelerate the policy rate hike. This is as Thailand's inflation remains low at present. Consequently, the MPC does not need to accelerate the hike to ensure price stability like other countries. In addition, Thailand's external stability remains sound. There is thus no need to raise policy rate to reduce risk of capital outflows or large currency depreciation.
- Therefore, EIC expects the MPC to hold the policy rate at 0.5% through 2021 and 2022 on the back of better economic recovery outlook following the easing of the lockdown measures. EIC assesses that the Thai economy in 2022 will recover more strongly on account of growing exports, domestic demand recovery following the easing of the city lockdown, widespread vaccination, and government liquidity support (the rest of the 500-billion baht Royal Decree)

Key points

The MPC voted unanimously to maintain the policy rate at 0.5% assessing that the Thai economy had bottomed out in the third quarter of 2021. At the Monetary Policy Committee (MPC) meeting on November 10, 2021, the MPC voted unanimously to maintain the policy rate at 0.5%. The Committee assessed that the Thai economy had bottomed out in the third quarter of 2021 and entered the recovery phase following the relaxation of containment measures and the re-opening of

the country. Meanwhile, downside risks to the economic projection decreased on account of the accelerated vaccination progress. However, the fragile recovery would remain subject to uncertainties. Headline inflation increased temporarily mainly due to the global energy prices. The Committee viewed that the continued accommodative monetary policy would help support overall economic growth, and thus voted to maintain the policy rate. In addition, the ongoing financial and fiscal measures, with the focus on rebuilding and enhancing potential growth would play an important part in bolstering the robust recovery of income.

- **The Thai economy would expand at a pace close to the previous projection for 2021 and 2022 (0.7% and 3.9% respectively)** on the back of domestic spending that gradually recovered following the relaxation of containment measures, partially offsetting the adverse impact of higher global energy prices. Looking ahead, fiscal support would decline following the substantial stimulus earlier. Merchandise exports would decelerate in tandem with growth in trading partner economies, while foreign tourist figures were expected to recover slowly.
- **The labor market improved from higher income of workers in the services sector and the self-employed in line with economic activities.** Looking ahead, the recovery of economic activities and employment would remain uneven across economic sectors. Retail sales, restaurants and manufacturing sectors would likely recover the fastest, while construction and real estate sectors would recover the slowest as they were the most affected sectors. Factors to be monitored included 1) the new wave of the outbreak, 2) higher costs driven by external factors, 3) supply disruptions, and 4) weak purchasing power.
- **Headline inflation would increase temporarily owing to supply-side factors, particularly the energy prices which would likely decline by early next year.** Nevertheless, headline inflation would remain within the target, with upside risks including the elevated global energy prices persisting longer than expected and global supply constraints becoming more prolonged. However, the slow recovery of income and purchasing power would lead to subdued demand-side inflationary pressures. Meanwhile, medium-term inflation expectations remained anchored within the target.
- **The fragile economic recovery outlook would still be subject to uncertainties.** Thus, there remained a need to monitor the outbreak situation following the country re-opening, the momentum of fiscal support, and the pass-through of global energy prices, as these factors would affect the economic recovery going forward.

The MPC assessed that liquidity in the financial system remained ample but credit risks remained a challenge to liquidity distribution, particularly to SMEs and households. The special loan facility for businesses helped in part alleviate the problem. Government bond yields increased in tandem with those of developed markets. On exchange rates, the baht relative to the US dollar exhibited more volatile movements owing to 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, particularly through supporting SMEs in hedging against risks from exchange rate volatility.

The MPC noted that the government measures and policy coordination among government agencies would be critical to support the economic recovery. Public health measures should strike a balance between containing the outbreak and supporting the recovery of economic activities particularly after the re-opening of the country. Fiscal measures should be more targeted in facilitating the economic recovery by focusing on generating income and expediting measures to rebuild and enhance potential growth. Monetary policy should 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 in a sustainable manner through the scheme launched on September 3, 2021 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 the outbreak situation following the re-opening of the country, the adequacy of fiscal, financial, and credit measures, and the global energy price pass-through. The Committee would stand ready to use additional appropriate monetary policy tools if necessary.

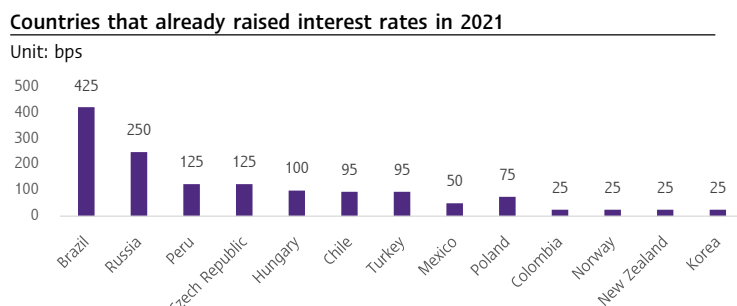
■ Implications

Demand-supply mismatch has caused inflation to continue accelerating in many countries, putting pressures on monetary policy conduct of many central banks around the world. The key factor driving inflation to accelerate in many regions is supply disruption, which became more prolonged than many have expected. This was caused by raw material shortages in the manufacturing sector, labor shortages, delayed shipments due to container shortages, as well as closure of major shipping ports in some countries. There were also power shortages in many areas, causing energy prices to rise. This affected prices of goods particularly of those with high proportion of energy consumption in their production. As a result, prices of goods have increased worldwide. Moreover, city re-opening of advanced economies gave rise to pent-up demand, while part of the savings accumulated during the COVID-19 crisis were spent. This consequently led to demand-supply mismatch and caused inflation to accelerate.

Accelerating inflation pressured central banks in many countries to tighten their monetary policy as inflation was expected to stay high longer than many central banks have anticipated and higher than their inflation targets. Central banks thus had to adjust their monetary policy faster than the market expectation in order to calm inflation, especially in countries where inflation has been rising rapidly and with financial stability risk. Tighter monetary policy was thus needed to curb inflation and ensure financial stability although the economies had yet to fully recover (Figure 1). For instance,

Brazil's inflation rose continually to 10.25% in September, causing the central bank to raise the policy rate to 4.25% this year, with the latest hike of 1.5% in October.

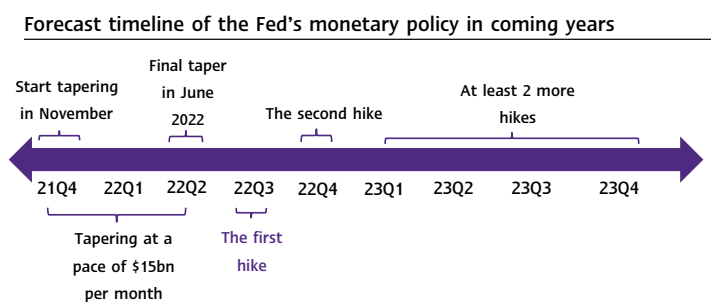
Figure 1: Central banks in many regions globally started to hike the policy rate in 2021 to calm inflation



Source: EIC analysis based on data from Bloomberg

Moreover, central banks in advanced economies have also signaled a reduction in monetary policy easing through tapering the asset purchases. The Federal Reserve (Fed) has formally announced the QE tapering at the Meeting in November, where it will begin the first tapering in November with the reductions of 15 billion US dollars a month (consisting of the cut in purchases of government bonds of 10 billion US dollars a month and of mortgage-backed securities (MBS) of 5 billion US dollars a month). The QE tapering process is expected to end by the middle of 2022. Moreover, the market expects the US core PCE and core PCI inflation after the tapering process ends to stay above 3% and 4% respectively. Therefore, inflation that will likely remain high after the end of the tapering process, along with the US labor market that will likely meet the Fed's target, may result in the possibility of the 2 policy rate hikes in 2022, with the first hike in the third quarter of 2022 and another hike in the fourth quarter of 2022 (Figure 2).

Figure 2: The QE tapering process is expected to end by the middle of 2022 and the Fed may raise the policy rate for the first time in the third quarter of 2022



Source: EIC analysis based on data from Bloomberg

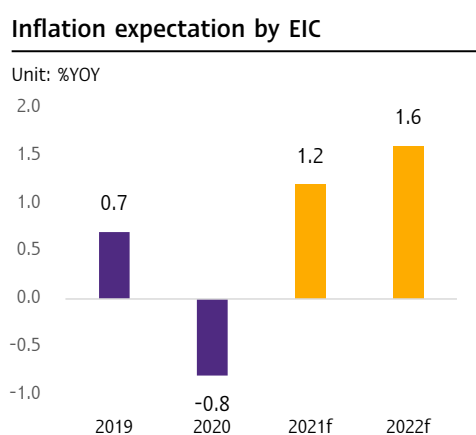
The European Central Bank (ECB) started the tapering of asset purchases under the Pandemic Emergency Purchase Programme (PEPP) in the fourth quarter this year, by cutting the asset purchases in the fourth quarter to 70 thousand euro a month (from an average of 80 thousand euro a

month in the third quarter). EIC expects the ECB to cut the asset purchases to 50 thousand euro a month in the first quarter of 2022, where the PEPP is expected to end in March 2022. Nevertheless, the ECB is expected to maintain its purchase under the Asset purchase programmer (APP) at 20 thousand euro a month until 2023. However, after the PEPP ends, the ECB may increase the amount of the purchase under the APP by 20 thousand euro a month over a 6-month period (Temporary QE bridge) to prevent liquidity from deteriorating significantly after the PEPP ends.

EIC expects the MPC to hold the policy rate at 0.5% through 2021 and 2022 on the back of better economic recovery outlook following the easing of the lockdown measures. EIC assesses that the MPC will keep the policy rate at the historical low until the end of 2022 as the outbreak situation continues to improve and economic activities have started to recover in the fourth quarter. In addition, EIC expects the Thai economy in 2022 to recover more strongly on account of growing exports, domestic demand recovery following the easing of the city lockdown, widespread vaccination, and government liquidity support (the rest of the 500-billion baht Royal Decree)

- **Thailand’s inflation remains low at present. Therefore, the BOT does not need to accelerate the policy rate hike to ensure price stability like other countries.** Although the accelerating inflation in other countries puts pressure on many central banks to tighten their monetary policy. However, Thailand’s inflation is still currently at low level and is likely to be affected by higher global energy prices to a limited extent. EIC forecasts that in the base case, Thailand’s inflation will record 1.2% in 2021 and 1.6% in 2022 (Figure 3), which is still within the BOT inflation target of 1-3%. Therefore, EIC views that there is no pressure for the BOT to accelerate the policy rate hike like other countries.

Figure 3: Thailand’s inflation is expected to be within the BOT inflation target of 1-3%



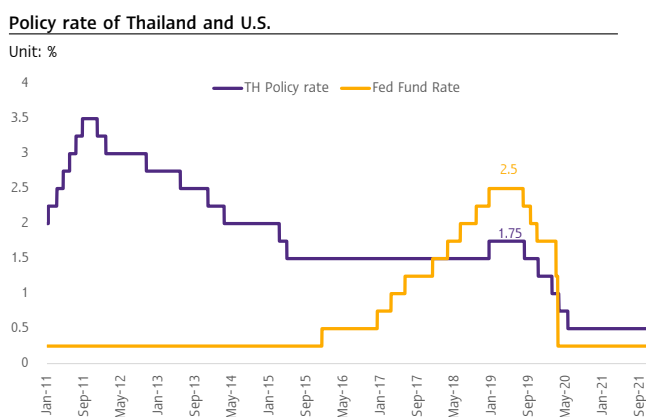
Source: EIC analysis based on data from the Bank of Thailand and CEIC

- **Moreover, although central banks in other countries, such as the US, are likely to hike policy rate twice in 2022, EIC estimates that such events will not pressure the MPC to accelerate the policy rate hike.** This is because Thailand’s external stability remains sound, as reflected by low external debt (36% to GDP), small share of short-term external debt (38% of total external debt), and large international reserves (3 times short-term external debt). Risks

of large capital outflows or rapid currency depreciation are thus limited. Consequently, the need to raise policy rate to preserve stability in the Thai financial markets is not much. Moreover, despite some depreciation of the baht, the pass-through to Thailand's inflation was insignificant. Pressure to raise the policy rate due to weaker baht is thus limited.

- In the past, the Fed raised the policy rate 8 times during 2017-2019, the BOT only raised the policy rate once (Figure 4) given the continued expansion of the Thai economy in line with the economic potential. The hike was also to reduce risk to financial stability as the low for long policy rate has resulted in the search-for-yield behavior. Therefore, past events have reflected that pressures from monetary policy implementation in other countries have limited impact on the Thailand's monetary policy, partly thanks to sound external stability.

Figure 4: Although the Fed is likely to raise the policy rate, this will not pressure the MPC to accelerate the policy rate hike thanks to Thailand's sound external stability



Source: EIC analysis from the data of Bloomberg

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