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EIC expects the MPC to keep rate on hold at 0.5% through 2022 given that inflation risk and monetary policy of major economies will not put pressure for the MPC to quickly raise the policy rate

23 December 2021

Key summary

- **The MPC voted unanimously to maintain the policy rate at 0.50% assessing that the Thai economy would grow 0.9% in 2021 and would continue to expand 3.4% and 4.7% in 2022 and 2023, respectively. The Thai economy was expected to continue recovering and return to the pre-COVID level in the beginning of 2023. Meanwhile, headline inflation would increase temporarily in the first half of 2022 mainly in line with energy prices, but was expected to subside in the second half of 2022. Nevertheless, the spread of the Omicron variant would be a key risk to the economic outlook in the period ahead.**
- **The Committee indicated that 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. In addition, financial institutions should accelerate debt consolidation and 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.**
- **EIC expects the MPC to keep rate on hold at 0.5% throughout 2022 as the impact of the Omicron outbreak will mostly be limited to the first half of next year and the economy will gradually recovery in the latter half of the year. The first policy rate hike can possibly occur in 2023 and the hike would be gradual and in line with the slowly recovering Thai economy. EIC assesses that the Thai economy will likely return to the pre-COVID level in 2023.**
- **EIC expects the monetary policy of major economies that will likely tighten in 2022 to have a limited impact on the Thai economy and not to pressure the MPC to quickly raise the policy rate like other emerging markets (EMs). This was because 1) Thailand's inflation will likely remain low due to limited demand pressures given the gradual economic recovery, 2) the baht may weaken somewhat in the short run, but not to a large degree, and will likely strengthen in the latter half of 2022, and 3) Thailand's external stability remains strong. However, although Thailand is less susceptible to the tightened monetary policy in the US, China's economic slowdown may significantly affect the Thai economy.**

Key points

The MPC voted unanimously to maintain the policy rate at 0.50% assessing that the Thai economy would grow 0.9% in 2021 and would continue to expand 3.4% and 4.7% in 2022 and 2023, respectively. At the Monetary Policy Committee (MPC) meeting on December 22, 2021, the MPC voted unanimously to maintain the policy rate at 0.5%. The Committee assessed that the Thai economy would continue to recover. Headline inflation increased temporarily mainly due to energy prices, but there remained a need to monitor developments of global inflation and cost pass-through. Meanwhile, the spread of the Omicron variant would be a key risk to the economic outlook and therefore warranted close monitoring. **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 grow 0.9 percent in 2021 and would continue to expand 3.4 and 4.7 percent in 2022 and 2023, respectively** (from September projection of 0.7%, 3.9% and 4.7% in 2021, 2022 and 2023). Such growth would be driven by domestic spending and a gradual improvement in foreign tourist figures. Meanwhile, the recovery in various business sectors was expected to improve in line with economic activities. The Committee assessed that the Omicron outbreak would affect the economy in early 2022 with some downside risks that the impact could be more severe and prolonged than expected depending on the severity of the outbreak and the strictness of corresponding containment measures. **In addition, there remained a need to monitor the labor market recovery**, especially with regard to employment and income which were still below pre-pandemic levels.

- **Inflation was expected to remain within the target in the medium term, with headline inflation projection at 1.2, 1.7, and 1.4 percent in 2021, 2022, and 2023, respectively** (from September projection of 1.0%, 1.4% and 1.4% in 2021, 2022 and 2023). Headline inflation would increase temporarily in the first half of 2022 due to supply-side factors, particularly energy prices, which were expected to subside in the second half of 2022. Headline inflation would gradually decline to the lower bound of the target range in the remaining of the forecast period. In addition, the likelihood of increasing inflationary pressures remained low due to limited cost pass-through of businesses given the slow economic recovery as well as weak employment and labor income. The survey suggested that 55% of businesses decided not to raise the prices in the next 3 months, while 34% of buisnesses will likely increase prices at less than 20%. Nevertheless, the Committee assessed that headline inflation would be subject to upside risks given higher global inflation and thus warranted close monitoring.

The MPC assessed that liquidity in the financial system remained ample but credit risks remained a challenge to liquidity distribution, particularly to SMEs. Government bond yields were mostly unchanged. On exchange rates, the volatility of the baht relative to the US dollar remained high due to uncertainties surrounding the COVID-19 situation which could escalate as well as monetary policy in advanced economies amid high inflationary pressures. 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 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. Fiscal measures should support the economic recovery in a targeted manner, with a focus 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 consolidation and 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

EIC expects the MPC to hold the rate through 2022 while the first policy rate hike can occur as early as 2023. The impact of the Omicron outbreak is expected to be limited to the first half of next year and the economy will gradually recover in the latter half of the year. The first policy rate hike can possibly occur in 2023 and the hike would be gradual and in line with the slowly recovering Thai economy. EIC assesses that the Thai economy will likely return to the pre-COVID level in mid-2023 (vs the BOT forecast of early 2023)

Monetary policy of major economies especially the US will likely continue to tighten in 2022. This could put pressure on the economic recovery and monetary policy of emerging markets (EMs). At the Federal Open Market Committee (FOMC) Meeting in December, the Federal Reserve (Fed) announced the faster QE Tapering, reducing the bond purchases by USD 30 billion in January 2022 (from previously USD 15 billion), while the dot plot also suggests possible 3 policy rate hikes in 2022. European Central Bank (ECB) has also announced to reduce the bond purchases under the Pandemic Emergency Purchase Programme (PEPP) in the first quarter of 2022, while signaling the end of the purchases in March 2022. Moreover, the Bank of England (BOE) has raised its policy rate to 0.25% (from 0.1%) in December. ***(Further details in BOX: Tightening monetary policy of major economies)*** Major central banks can thus be said to have started easing the monetary policy accommodation and entering the tightening cycle. This could pose risks to EMs on capital outflows and currency depreciation. Countries with large deficits, high public and external debts, high inflation, and low international reserves will see more severe impact from the tightened monetary policy of the Fed. (Figure 1)

Figure 1: Thailand's external stability remains sound with low inflation, low public and external debts, large international reserves, and baht stability.

Vulnerability to American Monetary Policy*

	Current account balance[1]	Gross public debt[1]	Foreign exchange reserve[1]	Consumer Prices[2]	External debt[3]	Export to China[1]	Vulnerability Index Score
Argentina	8	19	20	20	18	9	20
Sri Lanka	18	20	15	12	20	2	19
Pakistan	14	15	16	17	13	6	17
Brazil	13	16	17	16	6	15	16
Turkey	16	5	4	19	19	3	15
India	15	17	9	14	5	5	13
Malaysia	4	14	12	5	17	18	11
South Africa	5	13	7	9	16	11	10
Mexico	10	12	10	13	8	7	9
Indonesia	11	6	14	2	11	12	7
Philippines	9	11	11	8	4	10	6
Korea	2	8	8	4	14	17	5
Thailand	12	10	2	1	7	16	4
Vietnam	7	7	1	3	9	20	3
Russia	1	1	5	15	3	13	2
Saudi Arabia	3	2	3	6	2	14	1

Unit: [1] As % of GDP, [2] %YOY, [3] As % of reserves

Note: *Red = Most vulnerable, Green = Less vulnerable

Source: EIC analysis from the data of CEIC and The Economist

Source: EIC analysis based on data from CEIC, Bloomberg and The economist

However, EIC expects such factor to have a limited impact on the Thai economy and not to pressure the MPC to quickly raise policy rate like other countries due to the following reasons.

1) **Thailand's inflation remains low.** In November 2021, Thailand's inflation records 2.7% and EIC expects inflation to average 1.2% in 2021. Inflation will accelerate slightly to 1.6% in 2022 but will still be within the BOT's target range of 1-3%. This is different from the situation in other EMs where central banks had to quickly hike policy rate to curb inflation or fast currency depreciation. For example, Brazil's inflation has continued to rise to 10.7% in November (from 8.4% in mid-2021), prompting the central bank to raise policy rate by 5% in the latter half of 2021 to 9.3% in December. For Thailand, such pressure remains limited which is consistent with the BOT survey that suggests that most businesses are unlikely to adjust their prices in the next 3 months. This reflects constraints of businesses in passing on the higher costs to consumers given slowly recovering purchasing power.

2) **The baht may weaken somewhat in the short run, but not to a large degree.** The baht may exhibit volatile movement in the short run in line with the Omicron outbreak situation which could affect investor sentiment. Meanwhile, the start of monetary policy normalization of major central banks may also induce volatility and some outflows of capital from the region including Thailand. Therefore, in the first half of 2022, the baht may weaken to the range of

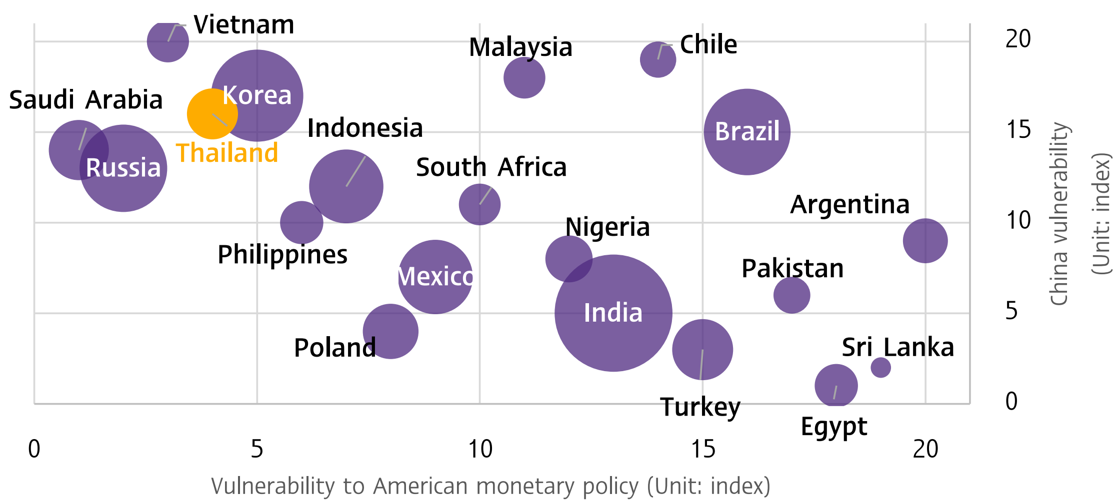
33.5-34 baht per USD. However, EIC expects the baht to gradually strengthen to a range of 32-33 baht per USD at end-2022 on the back of the more pronounced economic recovery and smaller current account deficit given potentially larger foreign tourist figures as well as falling freight costs next year. Moreover, EIC assesses that the short-term baht weakening will not drive inflation to accelerate much due to low FX passthrough to domestic prices of goods and services. BOT can also intervene in the FX market in times of rapid baht depreciation by selling its high level of international reserves. There is thus no need for the BOT to quickly raise the rate to manage the baht, unlike many EMs that have low international reserves.

3) **Thailand's external stability remains strong** as reflected by low external debt to GDP (36% to GDP) where 98% of Thailand's public debt is domestic debt. Moreover, Thailand has a small share of short-term external debt (38% of total external debt), high level of international reserves (3 times short-term external debt), and falling current account deficit in line with revenue, services, and transfer balances. EIC expects Thailand's current account to register a smaller deficit of 0.7% to GDP at end-2022 (from the projection of 2.8% to GDP in 2021). Therefore, risk to external stability that will cause large capital outflows from Thailand is low.

Although Thailand is less susceptible to the US monetary policy, China's economic slowdown could significantly affect the Thai economic recovery. (Figure 2) This is because Thailand has a large share of goods exports to China (5.9% to GDP). As a result, China's economic slowdown may put pressure on the Thai economic recovery and warranted BOT's monitoring in 2022.

Figure 2: Although Thailand is less susceptible to the tightened monetary policy in the US than other EMs, China's economic slowdown could significantly affect the Thai economic recovery.

Economic vulnerability to American monetary policy and China's economic slowdown



Source: EIC analysis based on data from CEIC, Bloomberg and The economist

BOX: Tightening monetary policy of major economies

Global financial conditions will likely continue to tighten in line with monetary policy of major central banks given the inflationary pressures and well-recovered economy. At the FOMC Meeting during 14-15 December, the Fed has announced to accelerate the QE Tapering by reducing the bond purchases by USD 30 billion in January 2022 from previously USD 15 billion in November and December 2021. This is due to supply-demand imbalances which cause the US inflation to continue rising. In November, US inflation soared to 6.8%, the highest level in 40 years. In addition, the labor markets will likely continue recovering as unemployment rate is also falling fast during the past 2-3 months. Monetary policy accommodation by injecting liquidity to boost the economy will be less needed.

Moreover, the median dot plot suggests a more hawkish stance for most of the Fed's Committee as the market has expected, with 3 policy rate hikes in 2022, 3 hikes in 2023, and 2 hikes in 2024 (totaling 8 hikes or 200 bps in the next 3 years). **EIC expects the Fed's first hike to be as early as the second quarter of 2022** as according to the latest FOMC statement, the Fed signaled that inflation is rapidly increasing. EIC views that US inflation may have already reached the target. In addition, given the spread situation and changed labor market structure, labor participation rate has thus declined. This may provide an opportunity for the US to reach full employment faster than expected.

ECB has announced to ease monetary policy accommodation at the Meeting in December due to concerns on inflation. ECB has announced to cut asset purchases under the Pandemic Emergency Purchase Programme (PEPP) in the first quarter of 2022, while signaling to end the purchases under the PEPP in March 2022. EIC expects the purchase amount under the PEPP to fall to an average of EUR 40 billion a month in the first quarter of 2022 (from previously EUR 65 billion a month in the fourth quarter of 2021). Nevertheless, after the PEPP ends, ECB is likely to increase the asset purchases under the Asset Purchase Programmes (APP) from normally EUR 20 billion a month to EUR 40 billion a month in the second quarter and EUR 30 billion a month in the third quarter of 2022 (Temporary QE bridge will amount a total of EUR 90 billion). ECB will then decrease the purchase amount to EUR 20 billion again in October 2022 until 2023. Moreover, EIC expects the ECB to start the first hike in 2024.

In addition, BOE has raised its policy rate to 0.25% (from 0.1%) amid the Omicron outbreak. BOE is the first major country to have raised the policy rate since the start of the COVID-19 outbreak as UK inflation soared to 5.1% in November, the highest level in 10 years. The labor markets that are expected to tighten and the Omicron outbreak may also add pressures to inflation given supply-side constraints. BOE expects inflation to be 5% at end-2021 and rise to the highest level at 6% in April 2022. BOE thus decided to hike the rate at its latest Meeting. Nevertheless, EIC assesses that the BOE will likely hike the policy rate 3 more times in 2022 if the Omicron outbreak does not have a severe impact on the economy

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