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SCB Securities Company Limited

FLASH

SCB Economic Intelligence Center

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31 March 2022

EIC expects the MPC to leave rate at 0.5% throughout 2022 as inflation surged mainly due to supply-side factors and will likely return to target next year.

KEY SUMMARY

The MPC voted unanimously to maintain the policy rate at 0.5%.

The Committee assesses that the Thai economic recovery will continue to grow at the rate of 3.2% and 4.4% in 2022 and 2023 respectively, despite impacts from sanctions against Russia which led to higher energy and commodity prices and a slowdown in external demand. Average inflation for the full year 2022 will exceed the target range but is expected to decline and return to target in early 2023 with energy and food prices stabilizing. Headline inflation is projected to be at 4.9% and 1.7% in 2022 and 2023 respectively. The Committee assesses that recent increases in inflation have stemmed primarily from cost-push factors, while demand-pull inflationary pressures have remained subdued. The Committee thus voted to maintain the policy rate at this meeting to help facilitate a sustained economic recovery.

EIC expects the MPC to leave the policy rate at 0.5% throughout 2022 due to the followings.

1) The MPC is expected to put emphasis on domestic economic conditions, which remain fragile and where growth is still lower than pre-covid level. EIC has revised down the Thai economic forecasts for 2022 to 2.7% due to declining households' purchasing power given a surge in inflation. Meanwhile, an increase in energy and raw material prices led to rising costs of businesses, thereby reducing profit margin and potentially slowing investment. Moreover, the number of tourists will likely recover slower than the previous forecast as a result of Russia-Ukraine war. Some tourists may delay their travels due to inflation and consumption that will be affected. 2) A surge in Thailand's inflation was mostly due to supply-side factors, while demand pressures remain weak. In addition, inflation is expected to remain high for just a period of time and will return to target next year. Meanwhile, medium-term inflation expectations remain anchored within the target. 3) Higher debt, especially Thai household debt, results in a larger impact of policy rate hike on consumption and investment than in the past.

Nevertheless, EIC assesses that the fast monetary policy tightening of the Fed may lead to global recession risk, which will affect demand and Thai exports going forward.

EIC expects the Federal Reserve (Fed) to hike policy rate in every remaining meetings of this year (totalling 7 times in 2022) with high probability that the Fed will raise policy rate 50 bps at the meetings in May and June this year. This is because US inflation will remain high. However, the Fed's fast monetary policy tightening to curb inflation may increase risk of US economic recession through rising borrowing costs and interest burden of both businesses and consumers. This will affect consumption, investment, and economic recovery through 4 channels including 1) higher borrowing costs of both businesses and consumers, 2) higher debt burden which is already at high level, 3) deteriorating financial positions and profitability of businesses, and 4) falling asset prices such as real estate as well as returns from stock market. Moreover, fast policy rate hike will cause the 2-10 spread to narrow which could lead to the situation where long-term government bond yield is lower than short-term one or inverted yield curve. This is often followed by the economic recession. According to past statistics, economic recession often occurs around 1-2 years following the negative 2-10 spread. Nevertheless, in the baseline case, the US recession may not occur next year but the Fed's policy rate hike should be carefully monitored.

KEY POINTS

The Committee voted unanimously to maintain the policy rate at 0.5%, assessing that the Thai economy will grow at the rate of 3.2% and 4.4% in 2022 and 2023 respectively.

At the Monetary Policy Committee (MPC) meeting on March 30, 2022, the MPC voted unanimously to maintain the policy rate at 0.5%. The Committee assesses that the Thai economic recovery will remain intact in 2022 and 2023, despite impacts from sanctions against Russia which led to higher energy and commodity prices and a slowdown in external demand. Average inflation for the full year 2022 will exceed the target range but is expected to decline and return to target in early 2023 with energy and food prices stabilizing. The Committee assesses that recent increases in inflation have stemmed primarily from cost-push factors, while demand-pull inflationary pressures have remained subdued. The Committee thus voted to maintain the policy rate at this meeting to help facilitate a sustained economic recovery.

- **The Committee assesses that the Thai economy will continue to grow at the rate of 3.2% and 4.4% in 2022 and 2023 respectively (from the previous forecasts in December 2021 at 3.4% and 4.7% in 2022 and 2023)** The growth is driven by improving domestic demand and tourism. The impact of the Omicron variant outbreak on economic activities is expected to be more contained than previous waves. Sanctions against Russia have pushed the cost of goods higher but will not derail the overall recovery path. Nonetheless, downside risks to growth remain, including (1) prolonged shortages of raw materials in certain industries and (2) the impact of higher prices on living costs for households and production costs for businesses, particularly toward vulnerable groups. The Committee will closely monitor developments in the abovementioned situations closely

- **Headline inflation is projected to be at 4.9% and 1.7% in 2022 and 2023 respectively** (from the previous forecasts in December 2021 at 1.7% and 1.4%). Inflation will exceed 5% in the second and third quarters of 2022, driven mainly by rising energy prices and the pass-through of food prices. However, inflation is projected to decrease and return to the target range in 2023 owing in part to the assessment that the rise in energy prices would not persist. Upside risks to inflation remain, primarily from higher-than-expected oil prices and cost pass-through from producers to consumers. The Committee judges that the rise in inflation has been mainly due to cost-push factors. Meanwhile, demand-pull inflationary pressures remain subdued in line with a slow recovery of income. In addition, the Bank of Thailand has constructed an underlying inflation indicator based on common components of headline inflation, where the latest indicator does not signal concerning inflationary pressures. Also, medium-term inflation expectations remain anchored within the target range. The Committee will continue to closely monitor inflation dynamics to ensure that medium-term inflation expectations will be consistent with the monetary policy target.

The MPC assesses that overall financial conditions remain accommodative. Liquidity in the financial system remains ample, although liquidity distribution still varies across economic sectors. On exchange rates, the baht has depreciated relative to the US dollar due to concerns over the Russia-Ukraine war and the expectation of monetary policy normalization in advanced economies. The Committee will 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 cited that the government measures and policy coordination among government agencies would be critical to support the economic recovery amid heightened uncertainties. Fiscal measures should support the economic recovery in a targeted manner, with a focus on generating income and alleviating living expenses for vulnerable groups. Monetary policy should contribute to continued accommodative financial conditions overall. Financial and credit measures have helped distribute liquidity and reduce debt burden, especially for those whose incomes have not yet fully recovered. The measures have 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 to have broader impacts and be consistent with borrowers' long-term debt serviceability.

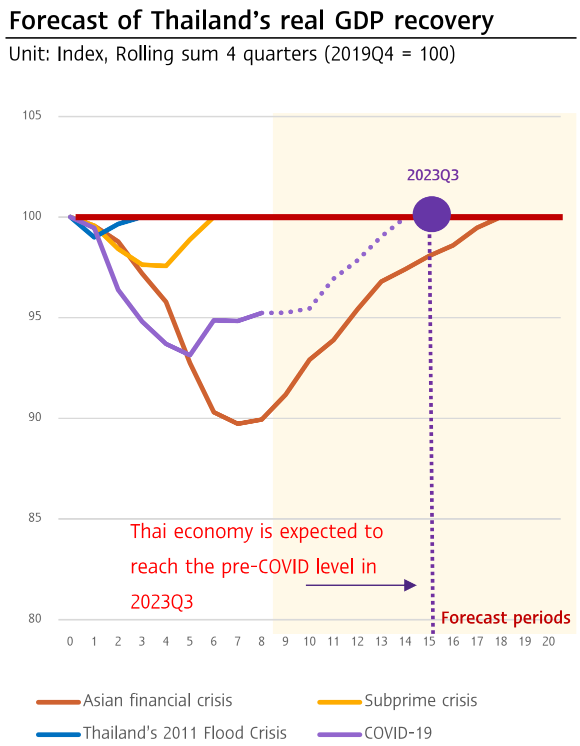
The MPC continued to put emphasis on supporting the economic recovery, under the monetary policy framework with objectives of maintaining price stability, supporting sustainable and full-potential economic growth, and preserving financial stability. The MPC will closely monitor key factors affecting the economic and inflation outlook, namely, global energy and commodity prices, higher cost pass-through, and geopolitical risks that could elevate and pose uncertainties in the period ahead. The Committee stands ready to use appropriate monetary policy tools if necessary.

IMPLICATIONS

EIC expects the MPC to leave policy rate at 0.5% throughout 2022 due to the followings:

1) **The MPC is expected to put emphasis on domestic economic conditions, which remain fragile and where growth is still lower than pre-covid level.** (Figure 1) The Thai economy in 2021 only expanded 1.6% and EIC has revised down growth forecasts for 2022 to 2.7% (from previously 3.2%) due to declining households' purchasing power given a surge in inflation. Meanwhile, an increase in energy and raw material prices led to rising costs of businesses, thereby reducing profit margin and potentially slowing investment. Moreover, the number of tourists will likely recover slower than the previous forecast. This is because 1) Russia-Ukraine war will reduce the number of tourists visiting from Russia and Europe, and 2) some tourists may delay their travels due to inflation and consumption that will be affected. EIC has thus revised down its forecast of foreign tourists in 2022 from 5.9 million to 5.7 million. On scarring effects to the economy, umployment, income, and household debt continue to hinder the Thai economic recovery.

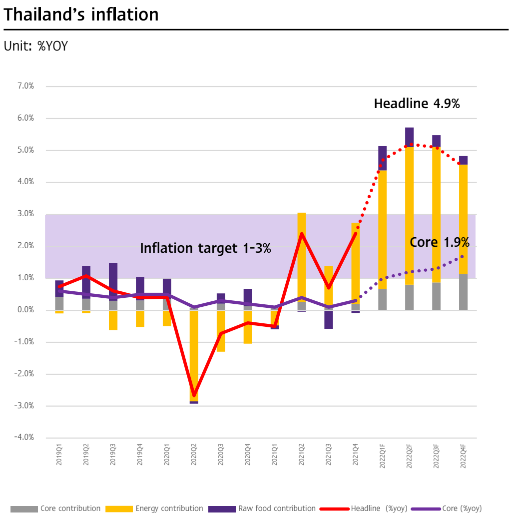
Figure 1: The Thai economic recovery remains fragile and growth is still lower than pre-covid levels.



Source: EIC analysis

2) **A surge in Thailand's inflation was mostly due to supply-side factors, while demand pressures remain weak. In addition, inflation is expected to remain high for just a period of time and will return to target next year.** Although EIC expects Thailand's annual average headline inflation to accelerate to the highest level in 14 years at 4.9% (Figure 2), the increase was largely due to a sharp rise in energy and commodity prices. Meanwhile, demand pressures have not accelerated much although there was somewhat a gradual pass-through of higher costs to consumer prices. Moreover, EIC expects Thailand's inflation to decline and return to the target range of 1-3% next year. In addition, inflation expectations did not increase much and remain anchored within the target with the latest 1-year ahead inflation expectation of households recording 2.6% (as of February 2022) and that of businesses recording 2.8% (as of March 2022). Meanwhile, 5-year ahead inflation expectation of professional forecasters is at 1.9% (Oct 21). Therefore, a recent surge in inflation will not be a factor prompting the MPC to quickly raise the policy rate this year.

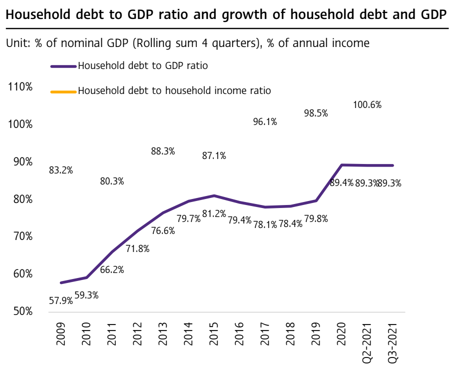
Figure 2: A surge in Thailand's inflation was mostly due to supply-side factors, where an annual average headline inflation could accelerate to the highest level in 14 years at 4.9%.

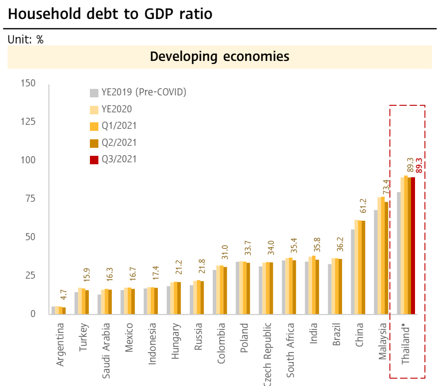


Source: EIC analysis based on data from the Ministry of Commerce

3) **Higher debt, especially Thai household debt, results in a larger impact of policy rate hike on consumption and investment than in the past.** Thailand's household debt to GDP stabilizes at high level of 89.3% in the third quarter of 2021, the highest level among developing countries (Figure 3) and EIC expects Thailand's household debt in 2022 to continue growing 3-5% in line with household demand for liquidity amid slow recovery of income. However, household debt to GDP is expected to fall slightly at the end of 2022 in line with the Thai economic recovery, registering the range of 88%-90%.

Figure 3: Thailand's household debt to GDP stabilizes at high level of 89.3% in the third quarter of 2021, the highest level among developing countries.





Note: * Thailand's household debt to GDP is based on data from the Bank of Thailand, while the ratio of other countries is based on data from the Bank for International Settlements (BIS) (data as of Q2/2021)

Source: EIC analysis based on data from the Bank of Thailand, the National Statistical Office, and BIS

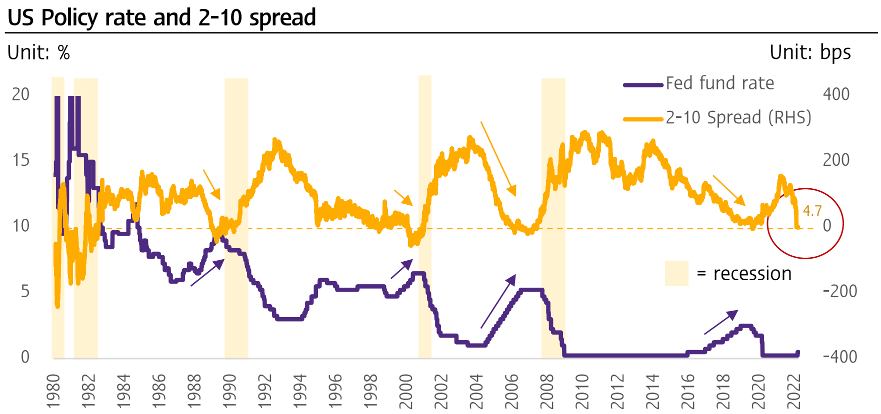
Nevertheless, the fast monetary policy tightening of major central banks (especially the Fed) may lead to global recession risk, which will affect demand and Thai exports going forward.

EIC expects the Federal Reserve (Fed) to hike policy rate in every remaining meetings of this year (totalling 7 times in 2022). At the Federal Open Market Committee (FOMC) meeting in March 2022, the Fed raised the policy rate 25 bps to curb inflation that has accelerated to the highest level in 40 years. For the remaining of this year, EIC expects the Fed to raise its policy rate 6 more times with high probability for the Fed to raise policy rate 50 bps at the meetings in May and June this year. This is because US inflation will likely remain high. For 2023, EIC expects the Fed to raise policy rate once a quarter from the first until the third quarter, causing the terminal rate to peak at 3-3.25%. Moreover, EIC expects the Fed to start the Quantitative Tightening (QT) at the meeting in May with faster pace and larger amount than the previous round given that the Fed currently owns much more assets than in the past. EIC expects the pace of balance sheet reduction to be around USD 100 billion a month including USD 60 billion a month of US treasuries and USD 40 billion a month of mortgaged-backed securities (MBS) respectively. **The Fed's fast monetary policy tightening to curb inflation may increase risk of the US economic recession** through rising borrowing costs and interest burden of both businesses and consumers. This will affect consumption, investment, and economic recovery through the following channels.

1) **Higher borrowing costs of both businesses and consumers** Higher interest rates and corporate spread will cause investment and consumption to decline in the future.
2) **Higher debt burden which is already at high level** This will affect income and consumption of households with already high level of debt.
3) **Deteriorating financial positions and profitability of businesses** Higher corporate debt from rising debt burden, coupled with falling profits, could increase default risk.
4) **Falling asset prices such as real estate as well as returns from stock market** This will cause household wealth to decline, affecting consumption and investment through wealth effect.

Fast policy rate hike will cause the 2-10 spread to narrow, which could lead to the situation where long-term government bond yield is lower than short-term one or inverted yield curve. This is often followed by the economic recession. According to past statistics, economic recession often occurs around 1-2 years following the negative 2-10 spread (Figure 4). Nevertheless, in the baseline case, the US recession may not occur next year but the Fed's policy rate hike should be carefully monitored.

Figure 4: According to past statistics, economic recession often occurs around 1 year following the inverted yield curve.



Source: EIC analysis based on data Bloomberg

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