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FLASH

SCB
Economic Intelligence Center

SCB EIC expects policy rate
hike to continue to hit 2.5% in Q3/23

31 May 2023

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KEY POINTS

The MPC voted unaminously to raise policy rate by 0.25% from 1.75% to 2.00%.

The Thai economy should continue to expand, driven mainly by tourism and private consumption. Mechandise exports are expected to recover gradually. While headline inflation slows, core inflation remains elevated. Inflationary risks stem from greater demand pressures amid expanding economic activity and higher cost pass-through from supply pressures. The Committee deems a continuation of gradual policy normalization to be appropriate in light of the growth and inflation outlook.

The MPC projected the Thai economic growth to be 3.6% and 3.8% in 2023 and 2024.

A key impetus is the broad-based recovery in tourism, which should promote employment and labor income, in turn sustaining private consumption. Merchandise exports are recovering broadly consistent with expectation, and should improve in line with a moderate expansion in the global economic activity. The Committee recognizes upside risks to domestic growth, in part owing to forthcoming government economic policies. At the same time, there is a need to monitor the uncertain economic and monetary policy outlook of major economies.

The MPC projected headline inflation to be 2.5 and 2.4 percent in 2023 and 2024.

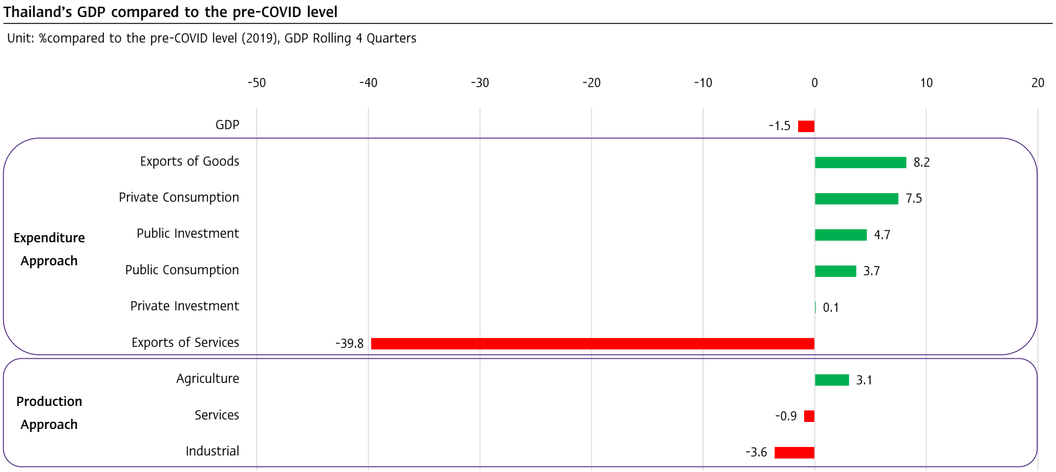
Inflation should continue to decline at a gradual pace. Headline inflation returned to the target range due to easing electricity and oil prices. Moreover, core inflation is projected to stabilize at 2.0 percent in 2023 and 2024, an elevated level relative to the past. Upside inflationary risks exist from greater demand pressures amid expanding economic activity and higher cost pass-through from supply pressures, in part contingent on government economic policies looking ahead. As a result, there is a need to monitor the price-setting behavior of businesses.

The MPC assessed that the overall financial system remains resilient, while financial conditions turned somewhat less accommodative. The overall financial system remains resilient. Financial institutions maintain high levels of capital and loan loss provision. Debt serviceability of households and businesses has improved in tandem with the economic recovery. Nevertheless, financial fragilities remain for some SMEs and households that are exposed to rising living costs and higher debt burden. Overall financial conditions turned somewhat less accommodative owing to higher private sector funding cost consistent with the policy interest rate. Current financial conditions nonetheless remain supportive of the ongoing recovery and mobilization of funds by the private sector. The baht depreciated against the US dollar, in part influenced by the Federal Reserve's monetary policy outlook, the renminbi depreciation and domestic political uncertainties.

IMPLICATIONS

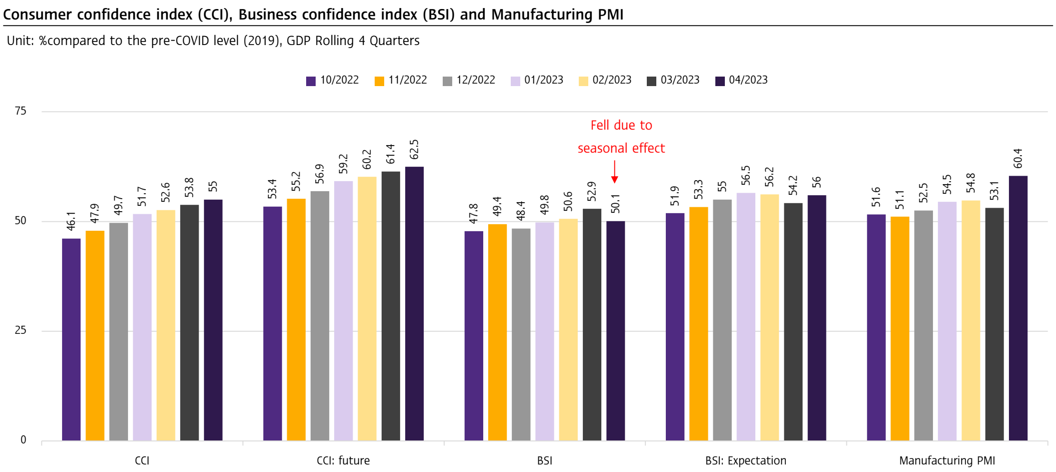
SCB EIC assesses that the Thai economy will return to pre-COVID level in the middle of this year. The overall Thai economy has recovered to the level below pre-COVID level by around 1.5% (Figure 1). However, services sector recovery remains well below pre-COVID level by almost 40%, but is expected to continue during the rest of this year. Moreover, various confidence indices including private consumption, private investment and manufacturing indices continue to rise (Figure 2). Such improvement reflects a positive outlook going forward, which will result in a continuous expansion of the Thai economy this year as supported mainly by tourism and private consumption.

Figure 1: The Thai economy has already recovered to the level below pre-COVID level by around 1.5%



Source: SCB EIC analysis based on data from the NESDC

Figure 2 : Confidence indices, including private consumption, private investment, and manufacturing indices, all reflect this year's positive outlook



Source: SCB EIC analysis based on data from the Band of Thailand, University of the Thai Chamber of Commerce, and S&P Global

SCB EIC expects the MPC to continue hiking policy rate 2 more times, 0.25% at each meeting in August and September, to the terminal rate of 2.5%. **The Thai economy should continue to expand. Meanwhile, inflation** is already within the Bank of Thailand (BOT)'s target range of 1-3%, but there remains upside risks stemming from cost pass-through of businesses which is expected to be high this year. In addition, demand pressures could arise looking ahead on the back of economic recovery and foreign toursist arrivals.

Thailand's monetary policy should continue to be normalized to the level consistent with long-term economic growth. SCB EIC assesses Thailand's neutral rate to be 2.5%, consistent with the economy growing at potential and inflation residing within the BOT's target. Moreover, Thailand's real interest rate is still negative. Too low real interest rate could lead to economic imbalance and build-up of risks to the financial system in the long run.

Therefore, the MPC is likely to continue raising policy rate to the level where monetary policy is more neutral to growth and would then keep it on hold to allow for monetary policy transmission to the economic system. Nonetheless, should the economic and inflation outlook differ from the assessment, the MPC may not be able to continue raising policy rate to the neutral level in this hiking cycle. The MPC may instead have to raise the policy rate to be consistent with evolving economic and inflation outlook.

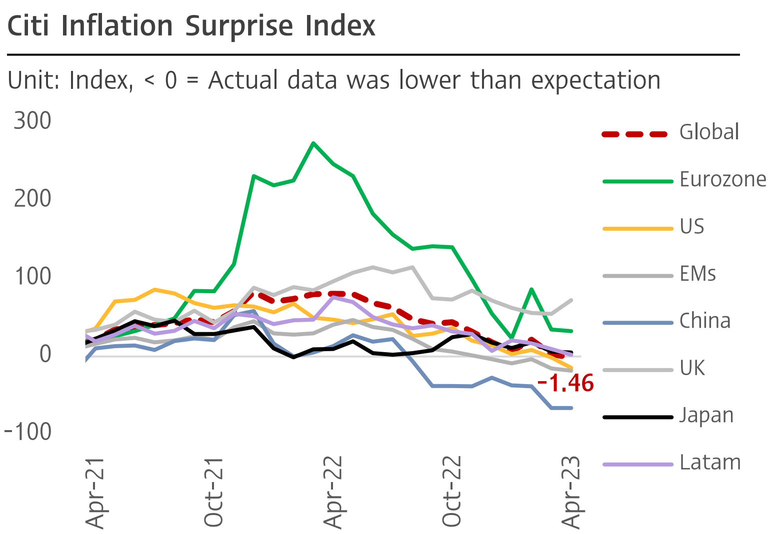
Global tightening cycle is likely to end soon as inflation in many countries has declined more than expected while real interest rates have started to turn positive. Inflation in many countries globally started to fall more than expected in Q2/23, where Citi's global inflation surprise index turned out lower than expected for the first time in 29 months (Figure 3). SCB EIC expects global inflation to slow continuously for the rest of this year in line with energy prices and easing supply bottlenecks and high base effect, while the effect from policy rate hike will be increasingly transmitted to the economic system. In addition, real interest rates in many countries have gradually turned positive after having been largely negative since the start of COVID-19 (Figure 4). SCB EIC expects major central banks to continue hiking policy rate no more than 1-2 times this year.

- **The Federal Reserve (Fed) :** Tighter credit and financial conditions, as well as monetary policy lags and real policy rate hitting the restrictive zone, will likely prompt the Fed to keep the policy rate on hold at the Meeting in June (Baseline). However, core PCE, the Fed's favourite gauge, accelerated again in April driven by strong consumer spending. If employment and inflation figures in May accelerate more than expected, this may pressure the Fed to hike the policy rate one more time. SCB EIC expects the Fed to hold the policy rate at a high level throughout this year as inflation is still considerably above the Fed's inflation target of 2%.
- **European Central Bank (ECB) :** The European region has been facing relatively high inflationary pressures. Although headline inflation already slowed rapidly in line energy prices, core inflation is still rising on account of higher wages and low unemployment. This led to high inflation expectations. Moreover, real interest rate is still largely negative. SCB EIC expects ECB and BOE to

hike the policy rates 2 more times, 25 bps at each meeting, to stand at 3.75% and 5%, respectively.

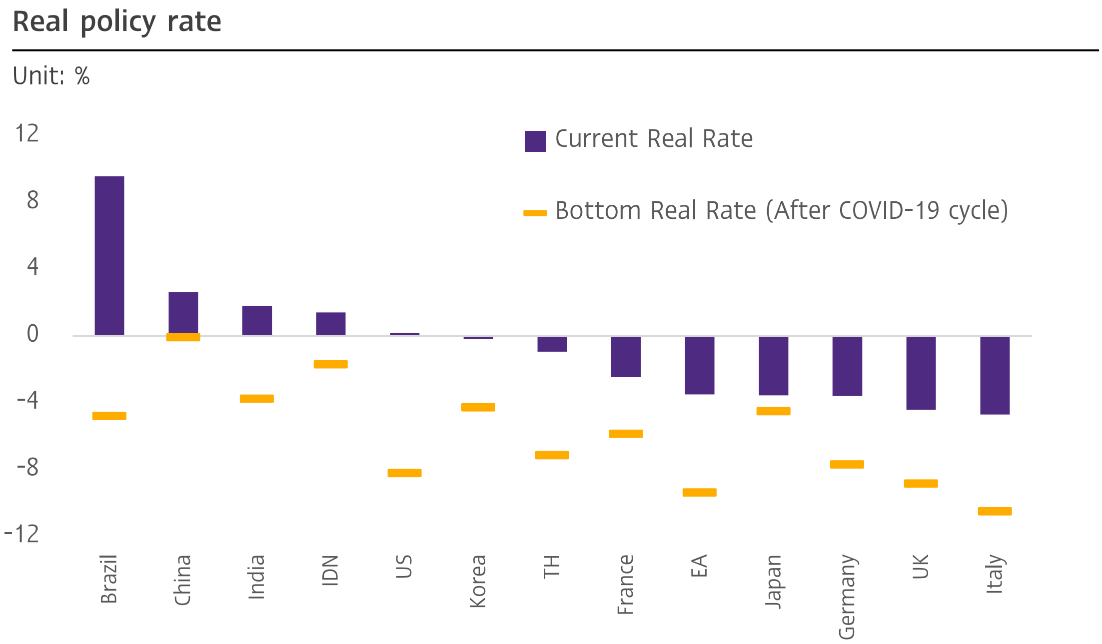
- **Other countries :** Tightening cycle is likely to have already ended in many countries including Bank of Canada and Bank of India. Meanwhile, Bank of Korea is expected not to raise its policy rate further, where the cut is expected during the end of this year as inflation is likely to return to the target range with the economy expanding at a slower pace.

Figure 3: Global inflation began to fall more than expected in Q2/23



Source: SCB EIC analysis based on data from Bloomberg

Figure 4: Real interest rates in many countries have gradually turned positive after having been largely negative since the start of COVID-19



Source: SCB EIC analysis based on data from Bloomberg

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