SCB Economic Intelligence Center

# Flash by EIC

11 March 2015

## The Bank of Thailand cut its benchmark interest rate by 0.25% to 1.75%.

### Event

- The Monetary Policy Committee (MPC) voted 4-3 to cut the policy rate by 0.25% from 2.00% to 1.75% in the meeting on March, 11th 2015.

### Analysis

- **The rate cut took markets by surprise.** The majority of the committee members viewed that downside risks from slow growth and low inflation are higher than risks from financial instability. The recovery of private consumption and investment between 4Q2014 and January 2015 was weaker than previously expected. Moreover, fiscal stimulus will take time to materialize. Therefore, a reduction in interest rates could help support economic growth and shore up private sector's confidence.

- **The MPC was aware of financial instability risks.** According to the meeting press release, the MPC says "there is a need to closely monitor the potential risk build-up associated with search-for-yield behavior, amid an extended period of low domestic interest rate environment." The statement means that the rate cut increases the risks of price bubbles for assets that give higher returns than bank deposits, such as real estate and common stocks.

- **EIC expects that the cut will have a limited impact on boosting the economy.** Private consumption is likely to recover slowly due to 1) declining household income in the agricultural sector following the fall in commodity prices, and 2) uncertainty in new tax policies. Furthermore, commercial banks have been tightening their lending to SMEs. Overall credit demand from the private sector has also slowed down. Therefore, domestic consumption should remain sluggish, particularly without further fiscal stimulus. EIC thinks that the pressure for a further rate cut will remain as long as the baht continues to strengthen relatively to other currencies in the region.

### Implication

- **EIC forecasts that the policy rate will stay at 1.75% this year.** The MPC has expressed more concern on the financial stability risk and the low inflation rate is likely to be temporary. Some committee members suggest fiscal stimulus be a key economic driver and that the monetary policy tools should be used only when necessary to be more effective.

**Summary table of BOT's declaration compared to the previous meeting**

| Topic | MPC Meeting on 28 Jan 2015 | MPC Meeting on 11 March 2015 |
|---|---|---|
| **Thai economy** | In 4Q14, the Thai economy continued to expand from improving exports and tourism, which helped to offset slightly weaker-than-expected domestic demand. Looking ahead, the economy should continue to recover and benefit from a decline in energy prices which should strengthen the recovery of domestic demand. | In 4Q2014 and Jan-15, the Thai economy continued to recover slowly, as the economic momentum from private consumption and investment was softer than expected. In the periods ahead, the economy is projected to recover at a slower pace than formerly assessed. Exports of goods are expected to recover at a rate close to the previous projection. Meanwhile, tourism is projected to recover steadily |
| **Inflation** | Headline inflation declined due to a marked fall in energy prices. This increased the probability of breaching the lower bound of the inflation target in 2015, but is not considered deflation. In addition, headline inflation is expected to rebound in the second half of 2015, in tandem with global oil prices. | Inflationary pressure is forecasted to remain at a low level, close to the committee's assessment at the last meeting. |
| **Risks** | 1. Downside risks from global economy (slow recovery in major trading partner economies, lingering political uncertainty, and policy divergence among major central banks)<br>2. Household loan quality<br>3. Asset price movements | 1. A slowdown in trading partners' economies, notably China.<br>2. The potential risk build-up associated with search-for-yield behaviour, amid an extended period of low domestic interest rate environment. |
| **Policy rate** | 5:2 voted to maintain the policy rate at 2.00% (2 voted to cut the policy rate by 0.25%) | 4 to 3 voted to cut the policy rate by 0.25% from 2.00% to 1.75% (3 voted to maintain the policy rate at 2.00%) |
| **Reasons** | 1. The current stance of monetary policy to be sufficiently supportive of the economic recovery.<br>2. To contain risks associated with a prolonged period of low interest rates and increased global financial market volatility | 1. Monetary policy should be eased further to provide more support to economic recovery<br>2. To shore up private sector's confidence |

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