SCB Economic Intelligence Center

# Flash by EIC

20 June 2018

## MPC holds policy rate as Thailand's growth continues while assessing sustainability of inflation

### Key point

- **At the Monetary Policy Committee (MPC) meeting on 20 June 2018 at the Bank of Thailand, the Committee voted to maintain policy rate at 1.50%.** At the meeting, the majority of MPC (5 members) viewed that the current accommodative monetary policy remained conducive to the continuation of economic growth and should support the rise of headline inflation toward target in a sustainable manner. Nevertheless, one member voted to raise the policy rate 25 bps, from 1.50% to 1.75%. One member was unable to attend the meeting.

### Details

- The MPC assessed that the Thai economy continued to gain further traction and would achieve higher growth than previously assessed. Export and tourism, driven by global economic growth, would remain key growth drivers along with stronger growth of domestic demand. The MPC revised up the forecast of Thailand's growth in 2018 from 4.1% to 4.4% and in 2019 from 4.1% to 4.2%. Forecasts of private consumption and investment were also upgraded. Growth of private consumption was revised up from 3.3% to 3.7% and 3.6% in 2018 and 2019, respectively, and that of private investment from 3.0% and 3.6% to 3.7% and 2.2% in 2018 and 2019, respectively.

  However, the MPC viewed that Thailand's growth outlook would face downside risks from uncertainty driven by global trade war and concerns on household purchasing power. Household debt remained elevated and economic recovery had yet to benefit household income and employment in a broad-based manner.

- **MPC's forecast of inflation was revised upward slightly and remained below the policy target.** Higher domestic demand growth and rising oil prices would push headline inflation. However, demand-pull inflationary pressures would only be gradual and boost inflation slightly. Moreover, the MPC stated that low inflation was partly resulted from structural factors such as e-commerce businesses and price competition. In all, the MPC revised forecast headline inflation for 2018 from 1.0% to 1.1% and maintained the forecast for 2019 at 1.2%. Forecast of core inflation in 2019 was also revised up from 0.8% to 0.9%.

- **MPC assessed that overall financial conditions remained accommodative while the baht depreciated.** The baht weakened against the US dollar due to external factors. Looking forward, the exchange rate would experience fluctuations. Other aspects of financial conditions were rather unchanged: high liquidity in the financial system, low real interest rates, and higher loan growth. Also, financial stability remained sound but there continued to be a need to monitor yield-searching behavior.

## Implication

### EIC expects the MPC to keep the rate unchanged throughout 2018

- EIC expects the MPC to hold policy rate at 1.5% during the remainder of 2018. This would support economic growth to be more robust and bring inflation back to target in a sustainable manner. While the growth forecasts were upgraded at this meeting, the MPC still stated downside risks to the outlook, especially risks from intensifying anti-trade incidents recently. The direct impact on Thailand would be in fact limited because affected products in the supply chain only account for a small share of total export value. However, trade retaliatory measures would undermine global trade outlook and in turn affect Thailand's trading partners' growth and Thailand's exports in the period ahead. In addition, the marginal upward revision to the forecast still projects inflation to be below the target and there remain downside risks to the forecast. As a result, a "sustainable" recovery of inflation remains to be seen. Thus, the MPC is in no rush to raise policy rate this year.

- EIC keeps an eye on inflation and the MPC's communications on financial stability as two determinants of the pace of policy rate hikes. The MPC's assessment reveals that higher global oil prices (projections of this year's price raised from 62.4 to 69.2 USD/barrel) would not significantly affect inflation this year. However, should oil prices increase further or demand-pull inflationary pressures accelerate, headline inflation would trend up and remain at a sustainable level. In fact, these are key conditions for the MPC to raise policy as indicated in their communications. In addition, the MPC's stance on financial stability remains under a close watch after risks could heighten in the prolonged low interest rate environment. In particular, the MPC would likely raise policy rate to reduce systemic risks which cannot be contained by risk-specific macroprudential policy.

- Monetary policy stance in major advanced economies and concerns on global trade war would induce capital flows and impact exchange rates in the short term. However, they would not impact Thailand's overall economic stability due to the country's strong economic fundamentals. The MPC mentioned monetary policy stance of major advanced economies as well as impact from global trade war as factors which weakened the baht recently and drove up volatility. Path of policy rate hikes of the Fed and changes in guidance toward the Eurozone's first interest rate hike would affect investor confidence and international capital flows. In EIC's views, investors tend to move from emerging markets with periods high uncertainty. However, EIC expects limited impact on Thailand's economy and stability due to diversification of its export destinations. Moreover, public investment would help boost domestic demand and strong external financial position could cushion against heightened volatility. Going forward, capital flows would likely return to Asia due to its high growth potential and strong economic stability, relative to countries in Latin America. Strength of each country's economy is probably a key determinant for investment, as reflected by the effects on exchange rates in emerging economies now and during the Taper Tantrum in 2013 (Fig 1).

- EIC expects the upward cycle of policy rate to commence next year and continue gradually. The MPC would be cautious about raising policy rate in order to limit the impact on economic recovery and market confidence. This is particularly the case amid high household debt and ongoing key structural changes in the Thai economy.

**Press release by Bank of Thailand (Current meeting compared to the previous one.**

| Issues | Previous meeting (16 May 2018) | This meeting (20 June 2018) |
|---|---|---|
| **Thai Economy** | The Thai economy as a whole continued to gain further traction, driven particularly by continued improvements in merchandise exports and tourism, thanks to global economic growth. Although employment saw signs of improvement, private consumption growth remained moderate. This was partly because the economic recovery had yet to benefit household income and employment in a broad-based manner while household debt remained elevated. Private investment picked up further with the improved economic outlook and was projected to continue expanding with additional support from government projects. Meanwhile, public expenditure would be a driver of growth but there remained risks of delays in budget disbursement. Furthermore, Thailand's growth outlook was still subject to external risks that continued to warrant monitoring, including uncertainties pertaining to US economic and foreign trade policies, retaliatory measures from trading partners of the US, and geopolitical risks. | The Thai economy as a whole continued to gain further traction, driven by merchandise exports and tourism which continued to improve in tandem with global economic growth, and by stronger momentum from domestic demand. In particular, private consumption continued to expand, although elevated household debt and the economic expansion had yet to benefit household income and employment in a broad-based manner, resulting in a gradual improvement in purchasing power. Private investment was projected to continue expanding. Meanwhile, public expenditure would be a driver of growth but there remained risks of delays in budget disbursement. Furthermore, Thailand's growth outlook was still subject to external risks that continued to warrant monitoring, especially US foreign trade policies and retaliatory measures from trading partners of the US, and geopolitical risks. |

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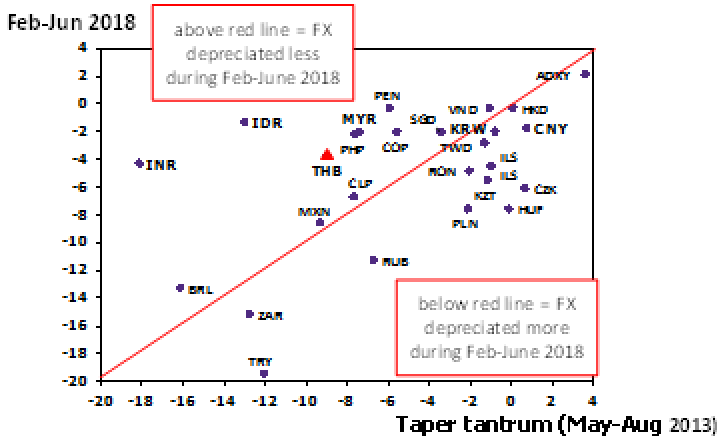
| **Inflation Conditions** | Headline inflation edged up at a gradual pace as previously expected on the back of the expansion of domestic demand and the increase in oil prices. However, headline inflation was projected to rise gradually as fresh food prices remained low. Demand-pull inflationary pressures remained low, while structural changes would still affect inflation. Meanwhile, the public's inflation expectations broadly increased. | Headline inflation was projected to rise at a slightly faster pace than previously assessed toward target on the back of increases in oil prices. Core inflation was projected to edge up given gradual build-up in demand-pull inflationary pressures. Moreover, structural changes, such as an expansion of e-commerce and rising price competition, still warranted monitoring as they might contribute to more persistent inflation than in the past. Meanwhile, the public's inflation expectations were largely unchanged. |
| **Key Risk Factors** | 1. US economic and foreign trade policies, and retaliatory measures from trading partners of the US<br>2. Geopolitical risks<br>3. Debt serviceability of SMEs<br>4. Search for yield behaviors<br>5. Monetary policy of major economies | 1. US economic and foreign trade policies, and retaliatory measures from trading partners of the US<br>2. Geopolitical risks<br>3. Debt serviceability of SMEs<br>4. Search for yield behaviors<br>5. Monetary policy of major economies |
| **Policy Interest Rates** | Unanimous vote to maintain the policy rate at 1.50%. (One committee member was absent) | 5:1 votes to hold policy rate at 1.50% (One committee member was absent) |
| **Policy Deliberations** | The Thai economy as a whole was projected to continue to gain further traction, particularly on the back of external demand. However, the strength of domestic demand recovery and the sustainability of the return of inflation to target remained to be monitored. Hence, the Committee viewed that monetary policy should remain accommodative to support economic growth. | The Thai economy continued to gain further traction and would achieve higher growth than previously assessed, driven by stronger momentum from both domestic and external demand. Headline inflation was projected to rise slightly more than the previous assessment. |

For most Asian currencies, the recent depreciation episode (during Feb-Jun 18) has been milder than that during the 2013 taper tantrum. However, other EM currencies have depreciated more during Feb-Jun 18, owing to the economic fragility in the region.

Change in EM currencies

unit: %




Source: EIC analysis based on data from Bloomberg (data as of 19 June 2018)



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