SCB
Economic Intelligence Center

Flash by EIC

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MPC kept the rate on hold and revised down its growth forecasts. EIC expects steady rate throughout the year.

Key point

- **At the Monetary Policy Committee (MPC) meeting on 26 June 2019 at the Bank of Thailand, the Committee voted unanimously to maintain the policy rate at 1.75%.** The Committee assessed that the Thai economy would expand at a slower pace that the previous assessment mainly due to merchandise and services exports. The Committee viewed that the current accommodative monetary policy stance contributed to the continuation of economic growth and was appropriate given the inflation target. The Committee thus voted to keep the policy rate unchanged at this meeting.

Analysis

- **MPC assessed that the Thai economy was expected to expand at a slower rate than previously assessed, where key factors were from lack of improvement in merchandise exports and a slower-than-expected growth outlook of tourism.** Considering press statement of the MPC meeting and forecasts of key economic figures for this meeting suggested that MPC expected "the Thai economy to expand at a slower rate than previously assessed". Nevertheless, MPC revised down GDP growth in 2019 from 3.8% to 3.3%. Key factors included merchandise exports that would grow at a "significantly" slower pace than the previous assessment and tourism that was expected to expand at lower rate than previously estimated mainly due to Chinese tourists. Forecast for value of merchandise exports was revised down from 3.0% to 0.0%, as a result of impacts of a slowdown of trading partners economies and global trade volume following intensifying trade tensions. Meanwhile, a number of foreign tourists was forecasted to fall from 40.4 to 39.9 million persons. With regard to domestic demand, MPC assessed that public and private investment was expected to slow down. In particular, public investment was revised down considerably from 6.1% to 3.8%. This was due to an expected delay in the enactment of the Annual Budget Expenditure Act, B.E. 2563 and postponement of some state-owned enterprise investment. Furthermore, forecast of private investment was not revised down to a large extent, 4.4% to 3.8%, as there was still support from the relocation of production base to Thailand. With regard to inflation, MPC maintained its forecast at 1.0% this year, while core inflation was estimated to be 0.7%, falling from the previous assessment of 0.8%.

  With regard to forecasts for 2020, MPC revised down its forecast of Thailand's growth for

2020 to 3.7% from 3.9%, where value of merchandise exports would resume growth of 4.3%. Public investment would grow at 7.2% and private investment that expanded 5.0% would be key economic driver next year.

- **MPC assessed that financial conditions were at an accommodative level and expressed concerns on the baht appreciation which might not be consistent with economic fundamentals.** MPC stated that "financial conditions over the previous period had been accommodative and conducive to economic growth", as reflected by financing by the private sector that continued exoanding. Nevertheless, MPC has clearly expressed greater concerns on the fast appreciation of the baht, stating that "the baht appreciation might not be consistent with economic fundamentals". Moreover, the baht "outperformed regional currencies". The Committee would continue to "closely" monitor developments of exchange rates and capital flows.

  With regard to financial stability, MPC still assessed that financial stability remained sound overall but there were still concerns over search-for-yield behavior. Apart from the macroprudential measures, MPC also mentioned microprudential measures to be implemented in conjunction with the policy rate in order to address financial stability risks in the period ahead.

Implication

EIC expects the MPC to hold rate steady this year but keeps an eye on downside risks to growth, baht appreciation and capital flow outlook.

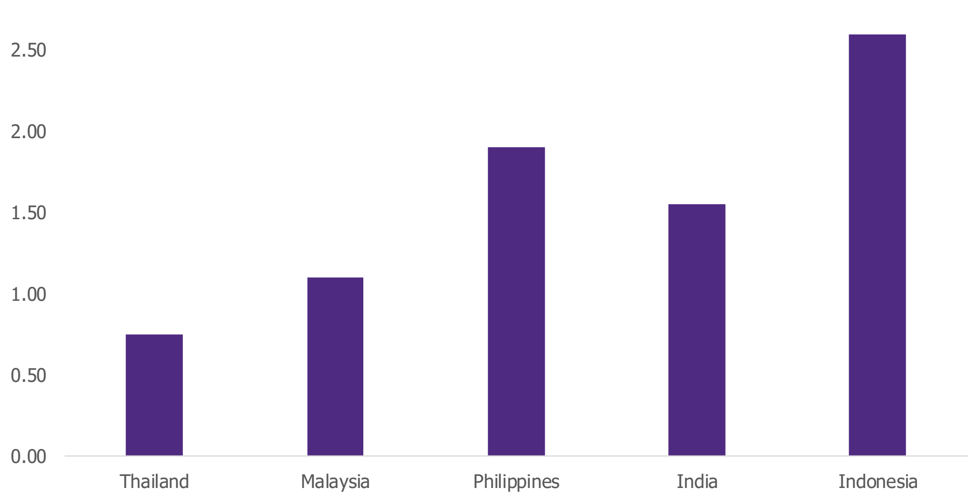
- **EIC expects the MPC to keep the policy rate unchanged throughout this year, despite a downward revision of economic figures.** This is because 1) **MPC still expects the economy to recover in 2020,** although the MPC assessed that the Thai economy would continue to slow down, as reflected by a downward revision of Thailand's GDP from 4.0% at the meeting in December 2018 to 3.8% at the meeting in March 2019, and recently to 3.3%. However, EIC views that such growth level is not considerably lower than Thailand's potential GDP. Moreover, MPC still expects the Thai economy to resume growth of 3.7% next year. Thus, the MPC is not in a rush to cut the policy rate this year. 2) **EIC views that the MPC still places emphasis on financial stability.** According to MPC press statement for this meeting, MPC still stated about concerns over financial stability, both on debt accumulation of households (auto-related loans), risks of saving cooperatives, and leverages of large corporates. Moreover, MPC also stated that there was a need to use a combination of tools, including the policy rate, to address such risks. 3) **Thailand's real policy rate is currently at 0.75% which is still low relative to regional countries.** Thus, ability and necessity for the MPC to cut the policy rate in order to boost growth is not as much as other countries whose real rates are high. (Figure 1)

- **Conditions for MPC to consider lowering the policy rate in the period ahead: Thailand's GDP falls below 3%, the baht strengthens at a fast pace, or capital inflows continue.** Although EIC expects the policy rate to be kept on hold at 1.75% throughout this year, change in the policy rate can occur given high uncertainties of global growth. EIC believes that conditions that might prompt the MPC to cut the policy rate include **1) Thailand's GDP that falls below 3%**. This may occur due to a lower-than-expected contraction of merchandise exports from a slowdown of the global economy and US-China trade war which affects Thailand's supply-chain. Furthermore, a slowdown of tourism given a strengthening baht should be carefully watched, as it may cause spending of tourists to decline. 2) T**he baht continues to strengthen from the current level.** The baht appreciated at a fast pace in the recent period as a result of trade war that heated up once again in the past May. Investors then returned to hold safe haven assets, including the baht given Thailand's strong external stability. In addition, the US FOMC meeting in the past week is also another factor resulting in a fast appreciation of the baht, as the dollar index weakened after the Fed signaled to cut the policy rate in the period ahead. The MPC has clearly expressed concerns over this issue. Although the MPC has never lowered the policy rate in the past in order to weaken the baht, if the baht continues to strengthen, this may impede competitiveness and income from merchandise and services exports in terms of the baht. Hence, a cut in the policy rate may be increasingly needed. 3) **A large volume of capital inflows continues.** Since May 2018 until 21 June 2019, there were capital inflows into the Thai stock and bond markets as high as 87 billion baht. Hence, the MPC stated that it would monitor such development closely. Nevertheless, EIC assesses that if capital inflows continue in the period ahead, this may pressure the Bank of Thailand (BOT) to implement measures to curb short-term speculative flows into Thai assets. One of the measures that the BOT can implement swiftly is to cut the policy rate in order to lower the carry yield. Other measures that the BOT could consider include a decrease in supply of the Thai government bond to make it harder for investors to speculate via the bond market. This measure was last implemented in April 2017.

Figure 1 : Thailand's real policy rate has been lower than regional countries.

Real policy rate of selected countries

Unit: %



Source: EIC analysis based on data from Bloomberg.

Summary of the Press Statement by Bank of Thailand compared to the previous meeting

Issue	Previous meeting (8 May 2019)	This morning (26 June 2019)
Thai economy	The Thai economy was expected to expand at a slower pace than previously assessed owing to merchandise exports and investment. Merchandise exports would grow at a slower pace than previously assessed due to the global economic slowdown, a down cycle of electronic products as well as impacts from trade protectionist measures between the US and China. Tourism would continue to gain traction. Regarding domestic demand, private consumption was expected to continue expanding. Nevertheless, private consumption was restrained by elevated household debt and the overall employment that started to flatten out, with signs of moderation in employment in the construction and export-related manufacturing sectors. Private investment was expected to expand at a slower pace. However, the	The Thai economy was expected to expand at a slower pace than previously assessed. Merchandise exports would grow at a significantly slower pace than the previous assessment due to the slowdown of trading partner economies and global trade, which were affected by intensifying trade tensions, particularly between the US and China. Tourism would grow at a lower rate relative to the previous assessment due mainly to Chinese tourist figures. Regarding domestic demand, private consumption was expected to continue expanding. Nevertheless, private consumption would be restrained by elevated household debt, with signs of moderation in earnings and employment in the export-related manufacturing sectors. Private investment was projected toslow down. However, the relocation of production base to Thailand and public-private partnership projects for

	relocation of production base to Thailand and public-private partnership projects for infrastructure investment would support investment in the period ahead. Meanwhile, public expenditure would grow at a slower pace than previously assessed, which was partly due to delays in some public investment projects. The Committee would monitor external risks from both trade protectionist measures between the US and China, as well as the economic outlook of China and advanced economies, which could affect domestic demand. Furthermore, the Committee would monitor domestic uncertainties, including policy implementation of the new government and public expenditure, as well as the progress of major infrastructure investment and its knock-on effects on private investment, which could affect momentum of economic growth in the period ahead.	infrastructure investment would support investment in the period ahead. Meanwhile, public expenditure would grow at a slower pace than previously estimated due to the expected delay in the enactment of the Annual Budget Expenditure Act, B.E. 2563 (A.D. 2020) as well as postponement of some state-owned enterprise investment. The Committee would monitor external risks from trade tensions, the economic outlook of China and advanced economies that could affect domestic demand, as well as geopolitical risks. Furthermore, the Committee would monitor policy implementation of the new government and public expenditure, as well as the progress of major infrastructure investment and its knock-on effects on private investment, which could affect the momentum of economic growth in the period ahead.
Inflation conditions	The annual average of headline inflation would be largely unchanged from the previous projection. The increase in energy prices since the previous meeting offsetted lower-than-expected increase in fresh food prices. Nevertheless, there remained risks to inflation due to the impact of drought. Meanwhile, core inflation would remain broadlyunchanged from the previous projection. The Committee viewed that structural changes contributed to more persistent inflation than in the past. Such changes included the expansion of e-commerce, rising price competition, and technological development which reduced costs of production.	The annual average of headline inflation would be largely unchanged from the previous projection, although fresh food prices were expected to increase from the previous meeting. Meanwhile, core inflation would be mostly in line with the previous projection. The Committee viewed that structural changes contributed to more persistent inflation than in the past. Such changes included the expansion of e-commerce, rising price competition, and technological development which reduced costs of production.
Key risk factors	1. Trade protectionist measures between the US and China 2. Economic outlook of China 3. Progress of major infrastructure investment and its knock-on effects on private investment	1. Trade protectionist measures between the US and China 2. Economic outlook of China 3. Progress of major infrastructure investment and its knock-on effects on private investment 4. Policy implementation of the new government and public

	4. Search-for-yield behavior including rising household debt accumulation driven particularly by auto-related loans, adjustments in the real estate sector, growth in assets held by saving cooperatives, leverage by household and large corporates, and greater emphasis on debt serviceability of borrowers. 5. Exchange rate developments and their impacts on the economy	expenditure 5. Search-for-yield behavior including rising household debt accumulation driven particularly by auto-related loans, adjustments in the real estate sector, growth in assets held by saving cooperatives, leverage by household and large corporates, and greater emphasis on debt serviceability of borrowers. 6. Exchange rate developments and their impacts on the economy
Policy interest rate	Unanimous vote to maintain the policy rate at 1.75%.	Unanimous vote to maintain the policy rate at 1.75%.
Policy deliberations	The Thai economy would expand at a slower pace than the previous assessment. Inflation was projected to be around the lower bound of the inflation target. Overall financial conditions remained accommodative and conducive to economic growth. However, there were risks to financial stability in the future that warranted continued monitoring. The Committee viewed that the current accommodative monetary policy stance had contributed to the continuation of economic growth and was appropriate given the inflation target. In addition, global economic and domestic uncertainties would remain high in the period ahead. The Committee thus voted to keep the policy rate unchanged at this meeting to assess the clarity of impacts from such uncertainties.	The Thai economy would expand at a slower pace than the previous assessment mainly due to merchandise and services exports. Inflation was projected to be in line with the previous forecast. Overall financial conditions remained accommodative and conducive to economic growth. However, there were pockets of risks to financial stability in the future that warranted continued monitoring. The Committee viewed that the current accommodative monetary policy stance contributed to the continuation of economic growth and was appropriate given the inflation target. The Committee thus voted to keep the policy rate unchanged at this meeting.

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