MPC cut the policy rate by 25 bps at its special meeting

24 March 2020

Key summary

- **The MPC voted unanimously at its special meeting to cut the policy rate to 0.75% as the impact of the COVID-19 outbreak would be more severe and prolonged than previously expected and in order to reduce interest burdens of borrowers affected by the COVID-19 outbreak and alleviate liquidity strain in the financial markets.**
- **EIC expects another 25 bps rate cut by the MPC at the meeting on 25 March 2020 or at the latest by the end of the second quarter of this year. This is due to 1) the Thai economy would likely experience a larger contraction than previously expected, and 2) although measures to support liquidity and stability of the bond market were already in place, the MPC might have to cut the policy rate further to ensure sufficient liquidity, support debt restructuring, and build confidence among market participants, especially amid highly volatile global financial markets.**
- **In the period ahead, the MPC may introduce additional measures, such as a more intensive use of forward guidance to signal a low-for-long interest rate until the economy clearly recovers, and targeted soft loans.**
- **Eyes on risks in Thailand's corporate bond market, liquidity condition in the financial markets, and dollar funding.**

Key points

The MPC voted unanimously at its special meeting to cut the policy rate to 0.75% as the impact of the COVID-19 outbreak would be more severe and prolonged than previously expected and inorder to reduce interest burdens of borrowers affected by the outbreak and alleviate liquidity strain in the financial markets. On 20 March 2020, the MPC held a special meeting, the first special meeting since 2003. At the meeting, the MPC voted unanimously to cut the policy rate from 1.00% to 0.75% due to the followings.

- The impact from the COVID-19 outbreak would be more severe and prolonged than previously expected. This would severely affect the Thai economy, as well as liquidity and the functioning of Thai financial markets. However, the MPC has yet to publish the economic forecast at this special meeting, where the forecast was scheduled to be published at the meeting on 25 March 2020.
- The purposes of the policy rate cut at this time were not only to reduce interest burdens of borrowers affected by the outbreak, but also to alleviate liquidity strain in the financial markets. The MPC urged the Bank of Thailand (BOT) to ensure sufficient liquidity and the well-

functioning and stability of the financial markets. On this, EIC views that the MPC would like to communicate to build confidence among market participants as there has been turbulence in the bond market with higher risk of liquidity shortages in the recent period. This was reflected in acceleration of yields for both government and corporate bonds, and redemption of investment units from some bond mutual funds. (figure 1)

- Moreover, the MPC also stated that the policy rate cut at this meeting would reforce fiscal measures already implemented and forthcoming. The MPC also urged the BOT to closely monitor each financial institution's assistance to borrowers, especially SMEs and households. The MPC viewed that financial institutions should play active roles in addressing liquidity problems of borrowers in order to enhance benefit of the policy rate cut to the economy.

The BOT, in collaboration with the Ministry of Finance and the Stock and Exchange Commission, implemented measures to address liquidity problem in the financial markets. In the past week, yields of government bond and corporate spread rose sharply (figure 1). The three institutions then implemented measures to curb liquidity problem in the financial markets on 22 March aiming to ensure sufficient liquidity for 1) bond mutual funds (money market mutual funds and open-ended fixed income funds), 2) corporate bonds, and 3) government bonds (details of measures as in table 1). Following the announcement, on 23 March, government bond yields declined, where yields on 1, 5 and 10-year bonds dropped by 15 bps (to 0.85%), 18 bps (to 1.15%), and 20 bps (to 1.49%) respectively.

Table 1 : Summary of measures to support liquidity in the Thai bond market

Measures	Key detail	Expected Effective date
Money Market/Daily Fixed Income Fund Liquidity Facility:	• Set up lending facilities for commercial banks to purchase money market/daily fixed income funds' units, which can be used as collaterals under repurchase agreement with BOT • BOT's lending capacity: THB 1 tn	• Tuesday March 24, 2020
Corporate Bond Liquidity Stabilization Fund	• TBA, GSB, Insurance companies, and GPF to set up bridge financing facility to facilitate (top up) the rollover of investment grade corporate bonds due over 2020-21 • Fund size: THB 70-100 bn (vs 378 bn of corporate bond outstanding maturing in 2Q20; of which 353 bn with investment grade)	• April 2020
Government bond purchase	• Continue to provide liquidity to short-term and long-term government bond markets	• Ongoing process

Source : compiled by EIC

Implication

EIC expects the MPC to cut the policy rate further by 25 bps at the meeting on 25 March 2020 or at the latest by the end of the second quarter of this year. There may also be other additional measures in the period ahead. Reasons for EIC expectation of another policy rate cut are as follows.

1. **The Thai economy would likely contract by more than previously expected, while downside risks to both global and Thai economies rose tremendously as the latest**

situation on the COVID-19 outbreak in Thailand started to be more severe. EIC expects the Thai economy in 2020 to drop by more than the forecast under worse case scenario at -2.0%YOY, a much larger contraction than previously anticipated.

2. **Financial conditions continued to tighten. Thailand's financial conditions became more tightened recently due to several factors,** be they a rise in real interest rate (due to a faster decline in headline inflation relative to the decline in nominal interest rate, as a result of a drop in energy prices and a slowing domestic demand), fundraising that has been postponed or become harder in both the bond and stock markets, as well as credit slowdown. EIC thus expects the MPC to cut the policy rate further to ease financial conditions.

3. **Despite measures to support liquidity and stabiliy in the bond market already implemented, the MPC may have to cut the policy rate further to ensure sufficient liquidity, suport debt restructuring, and build confidence among market participants, especially highly volatile global financial markets.** Although government bond yields declined somewhat on 23 March, EIC still expects another policy rate cut by the MPC in order to pressure Thai government bond yields to continue falling and to pressure a cut in interest rates offered by commercial banks to support debt restructuring for both Thai businesses and households in the period ahead.

   Risks in the Thai corporate bond market heightened somewhat, as reflected by rising corporate spread. The set-up of Corporate Bond Stabilization Fund is expected to help reduce some dificulties for corporates having to rollover their maturing bonds. EIC found that corporate spread has been rising in the recent periods, especially that of BBB-rated corporate bonds which faced a sharp rise reflecting higher risk in response to outlook of the Thai economic contraction. (**Figure 1, RHS**) EIC used data from the Thai Bond Market Association to study roll-over risk and observed that a total of THB 5.59 trillion corporate bonds will be matured from the second to fourth quarter of 2020[1], including THB 1.47 trillion corporate bonds with BBB or lower credit ratings. (**Figure 2**) Nevertheless, EIC views that the set-up of Corporate Bond Stabilization Fund will likely help mitigate this risk to some extent, particularly when investors lose confidence and increase demand for corporate bonds (especially those with lower credit ratings). However, risks of higher volatility in the corporate bond market must be carefully monitored.

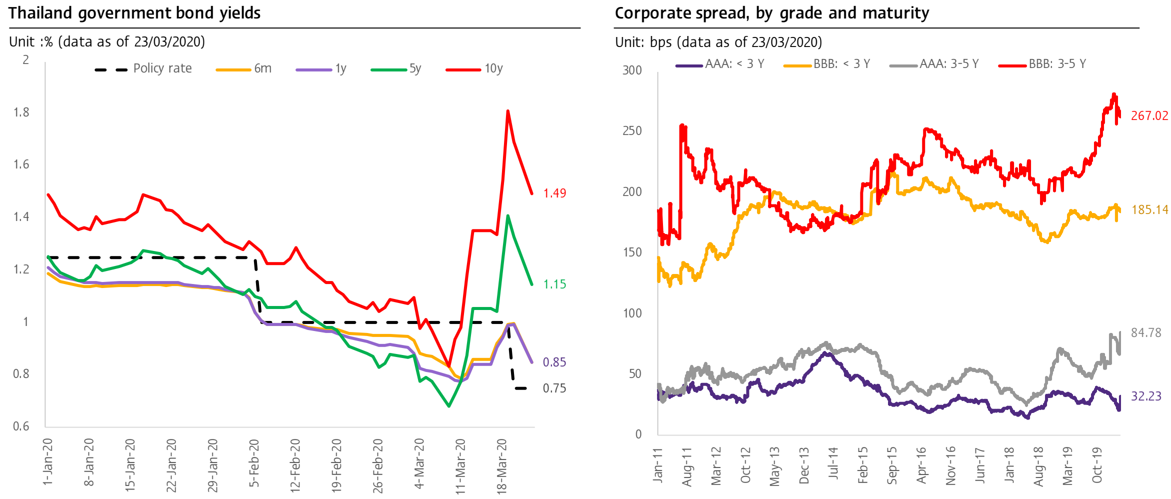
In conjunction with the interest rate policy, the MPC may also introduce other policies to build confidence and boost the economy in the period ahead. Examples include the use of forward guidance to clearly communicate the outlook of monetary policy stances in the period ahead. This may include signaling the effective lower bound of the policy rate as assessed by the MPC or conditions for adjustment in the policy rate by the MPC (both a rise and a cut). In addition, another

[1] Only taking into account bonds that are rated by TRIS

possible measure that the MPC could implement is the targeted soft loan through commercial banks to support lending to businesses and households facing liquidity problems during the COVID-19 outbreak. EIC views that this targeted soft loans will help enhance effectiveness of the policy rate cut, especially during when interest rates are at very low levels. This measure will provide incentives for commercial banks to increase lending (as cost of funding through this measure will be lower than deposit rates in the money market), reducing risk of a halt in the credit system when risk to the economy is high. As for other measures, EIC believes that additional fiscal policy easing will likely play a more active role in offsetting lost revenue and stimulating domestic demand.

Although dollar liquidity in the Thai swap market became tightened, EIC does not see this as a key risk to Thai financial markets as there remains sufficient dollar liquidity, as reflected by large foreign reserves and current account. Another issue to keep an eye on is dollar liquidity in the swap market which became tightened in the past week. The BOT conducted dollar liquidity injection operation after having observed a fall in USDTHB basis swap. However, EIC views that the dollar liquidity shortage in the Thai financial markets is not as severe as in the past and relative to other regional financial markets (**Figure 3**). This is because Thailand has large current account surplus and foreign reserves, while external debt in dollar term is not high. Therefore, dollar liquidity does not become much tightened. Going forward, the BOT is likely to continue its dollar liquidity injection operation into the swap market provided that there are still a tightening sign and a falling basis swap

Figure 1 : A sharp rise in Thai government bond yields and corporate spread was observed in the past week, causing the BOT to implement liquidity support measures

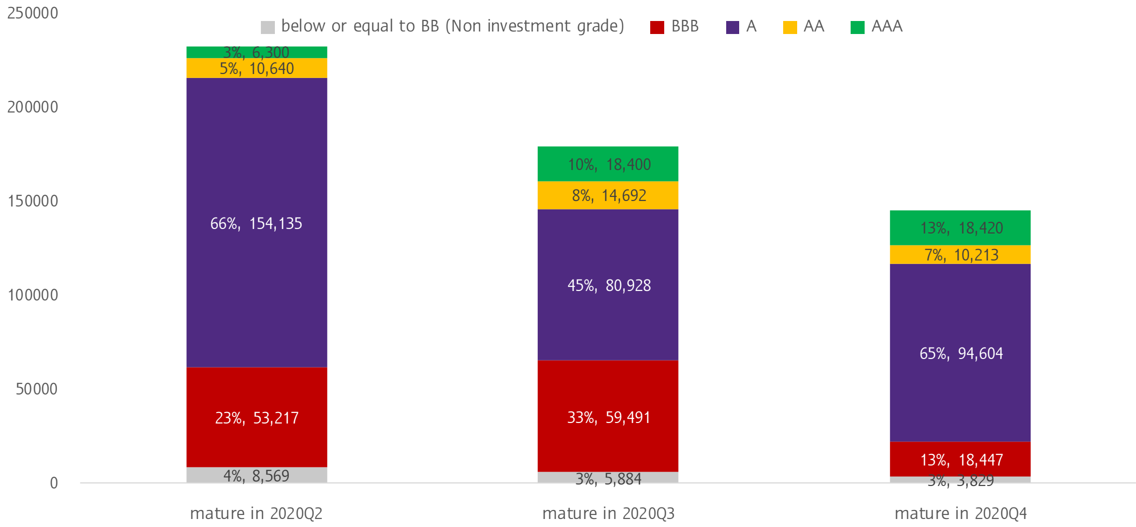


Source : EIC analysis based on data from CEIC and Bloomberg

Figure 2 : This year's maturing corporate bonds are mostly investment grade

Corporate bonds that will mature in 2020, grouped by the credit rating (TRIS)

Unit: million THB (% = Ratio of corporate bond outstanding of that grade to the outstanding that will mature in that quarter)

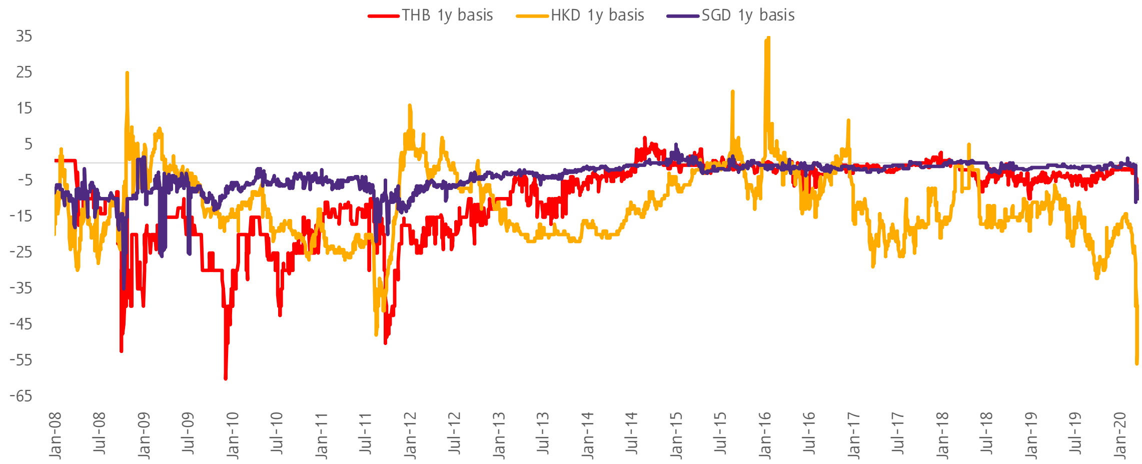


Source : EIC analysis based on data from Thai BMA

Figure 3 : Dollar liquidity shortage in the Thai financial markets is not as severe as in the past and relative to other regional financial markets

Basis swap points of regional currencies

Unit : point



Source : EIC analysis based on data from Bloomberg

By : Yunyong Thaicharoen, Ph.D.

Chief Economist and FEVP

Kampon Adireksombat, Ph.D. (kampon.adireksombat@scb.co.th)

Head of Economic and Financial Market Research

Wachirawat Banchuen (wachirawat.banchuen@scb.co.th)

Senior Economist

Pongsakorn Srisakawkul (pongsakorn.srisakawkul@scb.co.th)

Analyst

Economic Intelligence Center (EIC)

Siam Commercial Bank

EIC Online: www.scbeic.com