

EIC expects a steady policy rate at 0.5% through next year if the outbreak does not become more severe and triggers a nation-wide lockdown

23 December 2020

Key summary

- The MPC voted unanimously to maintain the policy rate at 0.5% and projected that the Thai economy would contract 6.6% in 2020, before expanding 3.2% and 4.8% in 2021 and 2022, respectively.
- EIC expects the MPC to hold policy rate steady at 0.5% through 2021. This is due to 1) a gradual and uneven Thai economic recovery with greater downside risks and uncertainties, 2) rising debt burden among households and businesses, and 3) low inflationary pressures in 2021.
- However, the BOT is expected to ease implemented financial measures by introducing other measures to distribute high level of liquidity in the financial system to the affected businesses and households. The measures include, for example, relaxing soft loan measure, credit guarantee scheme to curb credit risks, and encouraging financial institutions to expedite debt restructuring to have a broader impact, and maintaining BSF and MFLF.
- As Thailand is now included in the US Treasury's monitoring list of currency manipulating countries, the BOT could face limitations in managing the baht in the period ahead. However, the new wave of the COVID-19 outbreak in Thailand poses greater downside risk to the Thai economic growth, EIC thus expects the baht against the USD to stay within the range of 29.5-30.5 at the end of 2021.

■ Key points

The MPC voted unanimously to maintain the policy rate at 0.5% and projected that the Thai economy would contract 6.6% in 2020, before expanding 3.2% and 4.8% in 2021 and 2022, respectively. At the Monetary Policy Committee (MPC) meeting on 23 December 2020, the MPC voted unanimously to maintain the policy rate at 0.5% and assessed that the Thai economy continued to recover but downside risks and uncertainties remained high. In the short term, the recovery would depend on the situation of the new wave of the COVID-19 outbreak and corresponding containment measures. At a longer horizon, it would depend on the recovery in foreign tourist figures, efficacy and coverage of COVID-19 vaccination, labor market situation in which numbers of unemployed and underemployed workers remained high. The MPC thus voted to maintain the policy rate to preserve the limited policy space in order to act at the appropriate and most effective timing.

- **The Thai economy would contract 6.6% in 2020, which was better than the previous assessment of 7.8% contraction**, thanks to improvement in private consumption which would contract less at -1.4% (from previously -3.5%), merchandise exports which would drop 7.4% (from previously -8.2%), and foreign tourist figures that would register 6.7 million people. The projection of headline and core inflation was maintained at -0.9% and 0.3%, respectively.
- **The Thai economy would expand at 3.2% in 2021, down from the previous forecast of 3.6%. For 2022, the Thai economy would grow at 4.8%.** The downward revision of 2021 growth forecast was primarily driven by the downward revision of foreign tourist figures to 5.5 million people (from previously 9 million), but strong recover of foreign tourist figures was expected in 2022 at 23 million people. The Thai economy would then grow at a high rate that year. Economic activities would then return to the pre-COVID level in the second half of 2022. Headline inflation was projected to return to the target in the middle of 2021 at 1% and would stay close to the lower bound of the target range through the forecast period.
- **Nonetheless, the economic forecasts were based on the following assumptions.**
 - The government will be able to contain the recent spread of COVID-19 and implement partial lockdown measures.
 - Vaccine coverage in advanced economies will be higher than 30% of population in the second quarter of 2021, while 20% of the Thai population will be vaccinated in the fourth quarter of 2021.
 - Thailand's re-opening for vaccinated foreign tourists (with vaccination and infection test certificates) will commence, with no quarantine requirements, in the second quarter of 2021.
 - Most countries including Thailand will achieve herd immunity in the second half of 2022 and will re-open the country for foreign tourist with no vaccination and quarantine requirements.

The MPC assessed that liquidity in the financial system remained ample but was not distributed evenly, and also expressed concerns over the baht strength. The MPC assessed that some businesses, especially SMEs, and households in need of liquidity have not gained access to credits. The movement of the baht against the US dollar was volatile in line with regional currencies. The Committee expressed concerns over potential rapid appreciation of the baht owing to risk-on sentiment in financial markets and the weakening outlook of the US dollar. The Committee would closely monitor developments in foreign exchange markets, consider the necessity of implementing additional appropriate measures, as well as continue to expedite new foreign exchange ecosystem.

Government measures and policy coordination among government agencies would be critical to support the economic recovery going forward. Monetary policy must remain accommodative. Financial and credit measures should expedite liquidity distribution to the affected groups in a targeted and timely manner, for instance, through credit guarantee schemes in order to curb credit risks, while financial institutions should accelerate debt restructuring to have a broader impact. Fiscal measures must continue to sustain the economy. In particular, the government should expedite budget disbursement under the restoration plan and simultaneously implement supply-side policies to

support business restructuring and upskilling of labor, which would help support sustainable economic recovery in the long term.

The Committee continued to put emphasis on supporting the economic recovery. Under the monetary policy framework with objectives of maintaining price stability, supporting sustainable and full-potential economic growth, and preserving financial stability, the Committee would monitor the adequacy of the government measures and various risks, especially the new wave of the domestic outbreak in deliberating monetary policy going forward. The Committee would stand ready to use additional appropriate monetary policy tools if necessary.

■ Implication

EIC expects the MPC to hold policy rate steady at 0.5% through 2021. This is due to the followings.

- 1. The Thai economic recovery will be gradual and uneven with greater downside risks and uncertainties.** The MPC projected that the Thai economy will grow only 3.2% with greater downside risks. In addition, EIC views that the economic scars will weigh on the Thai economic recovery outlook, as reflected by fewer business openings but higher business closures, and fragile labor market driven by high unemployment, low working hours, and larger informal workers. Given such backdrop, the recovery is expected to be slow.
- 2. Debt burden of households and businesses rose following the crisis, where household debt in the second quarter of 2020 recorded a historical high rate of 83.8% to GDP.** The IIF data also pointed to rising debt of businesses. Going forward, weaker balance sheets of households and businesses would need to be repaired, resulting potentially slow recovery of spending and investment. Thus, low policy rate will remain necessary in alleviating interest burden of the economic system.
- 3. Inflationary pressures will remain low in 2021, resulting from continuation of below the target inflation until the middle of 2021.**

Nevertheless, the BOT is expected to ease financial measures by intruding other measures as follows.

- **The relaxation of soft loan measure will incentivize financial institutions to extend more loans.** At present, numbers of those with access to soft loan measure are relatively low. The latest data reports the credit approval amount of only THB 120 billion out of the total credit line of THB 500 billion. In particular, those with low credit lines have relatively lower access to soft loan measure. Furthermore, SME credits continues to drop, partly as financial institutions do not have enough incentives to extend credits. Thus, the BOT is likely to issue the new soft loan decree to ease limitations of the previous measure, where examples of regulations that could be amended are as follows.
 - Raising the cap of lending rates that financial institutions could offer to business from the current rate of 2%
 - Co-lending with commercial banks to extend loans for SMEs

- Expanding the credit limit from the previous cap of 20% of loan outstanding
- Raising TCG's gurantee limit
- **The Corporate Bond Stabilization Fund (BSF) and the Mutual Fund Liquidity Facility (MFLF) should be maintained** as these measures are backstop measures that help strengthen investor confidence, especially in the current situaton where the COVID-19 outbreak has returned. Furthermore, if investors are panic and rapidly sell off assets, leading to lack of liquidity in financial markets, such measures will be important tools to preserve financial stability for both businesses and mutual funds.
- **However, the possibility to establish the Asset Management Company (AMC) and implement warehousing measure becomes lower at the current juncture.** The governor of the BOT stated that at present, commercial banks were still able to manage their NPL ratios, although non-perform loans increased in line with the economic conditions. In addition, the BOT views that measures to assist affected borrowers implemented earlier this year were more targeted in addressing the problems, as reflected by outstanding loans of commercial banks whose customers are now able to repay debts following the end of debt-holiday period in October rose to 66% of total outstanding loans. Meanwhile, 32% is now in the process of individual debt restructuring with only 2% that banks are still unable to contact. The BOT has urged commercial banks to get in touch and assist these customers promptly.

However, should the recent spread of COVID-19 in Thailand result in a more severe economic contraction than the MPC latest assessment, there is a possibility that a policy rate will be cut once (0.25%). For the base case, EIC expects the COVID-19 spread to remain at a controllable level. Consequently, the government does not have to impose lockdown measures as strict as in the second quarter. The Thai economy would not shrink as much as during that period. The MPC is thus expected to keep the policy rate steady to preserve the policy space to cushion against future downside risks which could potentially arise from, such as, a more-severe outbreak or a less-than-expected efficacy and coverage of vaccination. Nevertheless, if the outbreak situation does not subside and thus warrants a stricter and nation-wide lockdown, this will cause the Thai economy to recover more slowly than the MPC and EIC projected in the base case. Consequently, the MPC could consider cutting the policy rate one more time (0.25%).

The US Treasury has labelled Switzerland and Vietnam as currency manipulators, while Thailand is now included in the monitoring list. Switzerland and Vietnam have met all the 3 criteria set by the US Treasury as follows.

1. A bilateral trade surplus with the US of over USD 20 billion during a 1-year period
2. A current account surplus of over 2% to GDP during a 1-year period
3. Central bank's net foreign exchange purchases of over 2% to GDP and persistency of the intervention of more than 6 out of 12 months.

Countries that have met 2 out of 3 criteria will be included in the US Treasury's monitoring list. In the lastest report, the US Treasury has added Thailand, India, and Taiwan into the list from the

previous list that includes China¹, Japan, South Korea, Singapore, Malaysia, Germany, and Italy. In the case of Thailand, from the end of the second quarter of 2019 to the the second quarter of 2020, Thailand registered a trade surplus with the US worth USD 22 billion, a current account surplus of 6.3% to GDP, and persistent foreign exchange intervention of more than 6 months. However, net foreign exchange purchases recorded 1.8% to GDP, Thailand thus met only the first 2 criteria and was not labelled as a currency manipulator. (Table 1)

Table 1 : Currency manipulation evaluation criteria

	1) Bilateral trade surplus of over USD 20 billion	2) Current account surplus of over 2% to GDP	3) Net foreign exchange purchases		Monitoring List	
			Over 2% to GDP	Over 6 out of 12 months	Jan 2020 Report	Dec 2020 Report
China	310	1.1	-0.1	Less than 6 months	X	X
Germany	62	6.8	-	-	X	X
Vietnam	58	4.6	5.1	Over 6 months	X	Currency Manipulator
Japan	57	3.1	0.0	Less than 6 months	X	X
Ireland	55	-5.5	-	-	X	X
Switzerland	49	8.8	14.2	Over 6 months	X	Currency Manipulator
Italy	30	3.0	-	-	X	X
Malaysia	29	2.5	1.1	Over 6 months	X	X
Taiwan	25	10.9	1.7	Over 6 months	X	X
Thailand	22	6.3	1.8	Over 6 months	X	X
India	22	0.4	2.4	Over 6 months	X	X
South Korea	20	3.5	-0.6	Over 6 months	X	X
Singapore	-1	16.1	21.3	Over 6 months	X	X

Note: X = Countries included in the US Treasury's monitoring list

Source: Report on Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States

Countries that were labelled as currency manipulator will be at risk of facing retaliatory trade measures by the US. Although Thailand has yet to be labelled as currency manipulator, risk of being labelled as currency manipulator in the next report is higher (normally published every 6 months), where the US may impose retaliatory measures to currency manipulators as follows.

- If those countries fail to correct the undervaluation within one year after being labelled, the US will adjust terms on trade policies and limit access to funding.
 1. Limiting access to funding from The Overseas Private Investment Corporation, which is the US government agency responsible for helping developing countries
 2. Limiting access to procurement contracts on goods and services with the US

¹ Although China met on the first criteria, China's bilateral trade surplus with the US was highest among countries in the monitoring list.

3. Having the US Trade Representative (USTR) to negotiate a bilateral or regional trade agreement again
 4. Allowing the IMF to pursue a more stringent exchange rate policy
- **In addition, the US may consider imposing retaliatory measures through raising import tariffs.** US companies may consider filing petitions to the Ministry of Commerce, claiming that their industries have been affected by dumpings of imported goods as these goods from trading partners are subsidized by the foreign government (The foreign government's intervention to weaken their own currencies is seen as a kind of subsidy.). This could lead the US to raise tariffs on such imported goods. For example, on 5 November 2020, the US Ministry of Commerce raised tariffs on tires imported from Vietnam to 6.23%-10.08% as such goods gained comparative advantage from undervalued dong.

However, the punishment will be finalised by Biden's government which seems to have less harsh stance on international trade policies than Trump.

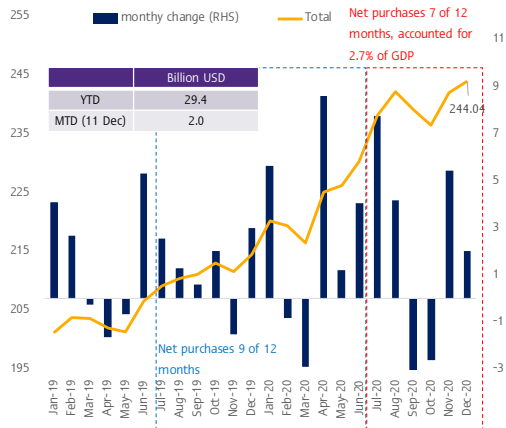
Thailand's inclusion in the US Treasury's monitoring list could cause the BOT to face limitations in managing the baht in the period ahead. After being included in the monitoring list on 16 December 2020, the baht strengthened 0.7% to THB 29.7 per USD on the next day. However, as Thailand's now encountering the new wave of the outbreak, the baht weakened rapidly 1% to around THB 30.2 per USD as end of 23 December 2020. In the next period, EIC assesses that Thailand will face risks of meeting all the 3 criteria of the US Treasury and being labelled as currency manipulator, where the last criteria that has not yet met is the net purchases of the intervention. EIC views that the risk is high for Thailand to meet all the 3 criteria in the next report. Therefore, BOT will face challenges in managing the baht in the period ahead, as well as communicating with the US Treasury.

Nevertheless, the new wave of the COVID-19 outbreak in Thailand resulted in greater downside risks to the Thai economic growth. EIC thus expects the baht to stand within the range of THB 29.5-30.5 per USD at the end of 2021.

Figure 1 : Going forward, BOT will face challenges in managing the baht as well as communicating with the US Treasury as Thailand might meet the criteria of net FX purchases of over 2% to GDP.

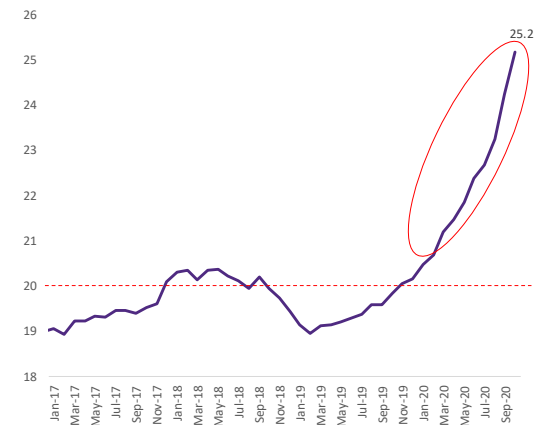
BOT foreign currency reserves

Unit: USD billion (data as of Nov 2020) Unit: USD billion



Thailand's trade surplus with US (data as of Dec20)

Unit: USD billion (12 months cumulative)



Source : EIC analysis based on data from the United States Census Bureau and the BOT

By: 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 PLC.

EIC Online: www.scbeic.com



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