FLASH

SCB Economic Intelligence Center

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29 March 2023

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KEY POINTS

The MPC voted unanimously to raise the policy rate 0.25% from 1.5% to 1.75%.

The Thai economy should continue to expand, driven mainly by tourism and private consumption. Exports of goods are recovering and expected to gain strength in the second half of this year. However, the global economic uncertainty has increased, in part from persistent inflationary pressures and episodes of banking stresses in advanced economies. Headline inflation would likely return to the target range in the middle of the year, but core inflation remains elevated with upside risks from higher cost pass-through and demand pressures. A continuation of gradual policy normalization is thus appropriate in light of the growth and inflation outlook.

The MPC projects the Thai economy to continue expanding at 3.6% and 3.8% in 2023 and 2024.

The Thai economy should continue growing on the back of foreign tourists that have been increasing in almost all nationalities. This should promote employment and labor income, in turn sustaining private consumption. Meanwhile, merchandise exports in the first quarter show signs of rebounding after contracting the previous period, and should gather momentum in the second half of this year.

The MPC expects headlind inflation to be 2.9% and 2.4% in 2023 and 2024.

Headline inflation would likely return to the target range by mid-2023 thanks to easing supply-side pressures notably from electricity and oil prices. Meanwhile, core inflation is projected to decline from 2022 to 2.4% in 2023 before gradually falling to 2% in 2024. However, persistently high inflation remains a risk, as producers could pass on higher costs absorbed in the past and demand-side pressures could pick up as the recovery gains traction. The Committee will continue to closely monitor price developments.

The MPC assesses that the overall financial system remains resilient. Recent banking stresses in some advanced economies have not had a significant impact on the Thai financial system, as Thai financial institutions and corporations have limited linkages with the troubled banks and risky assets. Moreover, financial institutions maintain high levels of capital and loan loss provision. As for households and businesses, the ongoing economic recovery has improved debt serviceability. Financial fragilities nonetheless remain for some SMEs and certain households exposed to rising living costs and higher debt burden. The Committee agrees that financial institutions should continue to press ahead with debt restructuring and deems it important to have in place targeted measures and sustainable debt resolution for vulnerable groups. Overall financial conditions remain accommodative, tightening somewhat from higher private sector funding costs consistent with the policy interest rate. On balance, financial conditions are supportive of the ongoing recovery and mobilization of funds by the private sector. The baht continues to fluctuate against the US dollar, driven by the Federal Reserve's uncertain policy outlook and financial market volatility induced by banking stresses in advanced economies.

SCB EIC assesses that the Thai economy in 2023 will likely expand more than expected driven by tourism and private consumption as the Chinese economy recovers faster and stronger than expected. SCB EIC has revised up its growth forecast this year to 3.9% from 3.4% (figure 1) and the forecast of foreign tourists in 2023 from 28 to 30 million. This will support the labor market and private consumption to continue recovering. Moreover, domestic demand has improved in line with business and consumer confidence. Labor market has also recovered with many indicators returning to near pre-COVID levels. Although there remains some fragilities in the labor market, these will likely improve in line with the economic recovery and employment in the tourism sector.

Figure 1: SCB EIC revised up its growth forecast for 2023 to 3.9% from 3.4%

Gross Domestic Product (GDP) Forecasts

Economic projections (base case)	Unit	2021	2022	2023F Nov 2022	2023F Mar 2023
GDP	%YOY	**1.6**	**2.6**	**3.4**	**3.9**
Private consumption	%YOY	0.6	6.3	3.0	3.9
Government consumption	%YOY	3.7	0.0	-1.0	-1.5
Private investment	%YOY	3.0	5.1	2.5	3.0
Government investment	%YOY	3.4	-4.9	2.4	2.2
Goods export value (USD BOP basis)	%YOY	19.2	5.5	1.2	1.2
Goods import value (USD BOP basis)	%YOY	27.7	15.3	3.2	0.9
Number of foreign tourists	million people	0.4	11.2	28.3	30.0
Headline inflation	%YOY	1.2	6.1	3.2	2.7
Core Inflation	%YOY	0.2	2.5	2.7	2.4
Brent crude oil price	USD/Bbl.	70.5	100.9	84.7	77.8
Policy interest rate (end of year)	%	0.5	1.25	2.0	2.0
Thai baht per US dollar (end of year)	THB/USD	33.2	34.6	34.5-35.5	32-33

Source: SCB EIC analysis based on data from NESDC and CEIC

Headline inflation in 2023 is expected to moderate and will return to the BOT's target range of 1-3% this year. SCB EIC expects headline inflation to fall to 2.7% due to a decline in global energy prices and continuing domestic energy subsidies. Meanwhile, core inflation will likely fall to 2.4% this year. Looking ahead, core inflation may not decline fast given the gradual cost passthrough and demand pressures in line with the economic recovery.

Figure 2: CPI growth in February 2023 classified by product

Consumer price index classified by product's type

%YoY	Share	2022	Dec-22	Jan-23	Feb-23
Total	100%	6.1%	5.9%	5.0%	**3.8%**
Food and Non-Alcohol	40.4%	6.9%	8.9%	7.7%	**5.7%**
fresh food	20.6%	6.8%	8.9%	7.3%	7.1%
- Meats	3.5%	21.1%	19.9%	-1.1%	2.1%
- Prepared Food: at Home	8.7%	7.5%	9.9%	9.2%	**5.0%**
- Prepared Food: Food Away From Home	6.7%	7.0%	9.3%	8.6%	**4.4%**
Apparel & Footwears	2.2%	0.0%	0.3%	0.2%	**0.3%**
Housing & Furnishing	23.2%	4.7%	3.5%	3.1%	**3.1%**
Electricity, Fuel, Water Supply	5.5%	20.8%	13.0%	11.2%	11.2%
Medical & Personal Care	5.7%	1.1%	1.8%	1.9%	**2.0%**
Transport & Communication	22.7%	9.1%	5.7%	4.3%	**2.4%**
Recreation, Reading, Education and Religion	4.5%	0.2%	1.4%	1.4%	**1.4%**
Tobacco & Alcoholic Beverages	1.4%	2.0%	1.3%	1.0%	**1.1%**
Core Consumer Price Index	67.1%	2.5%	3.2%	3.0%	1.9%

Source : SCB EIC analysis based on data from the Ministry of Commerce

IMPLICATIONS

1. SCB EIC's recent assessment of Thailand's neutral rate is 2.5% where the MPC would be able to gradually increase the policy rate toward the level consistent with long-term sustainable growth on 2 conditions: (1) The Thai economy could continue to expand in the period ahead, and (2) a continuation of policy normalization would help tame inflation back to the target range this year as the MPC has previously assessed.

SCB EIC has conducted the assessment of neutral rate or the rate of interest that is consistent with the economic growth at its long-term potential and general goods and services prices at its long-term stability in line with the inflation target. This is the interest rate that reflects neutrality of monetary policy stance (not too tightened or accommodative). In this assessment, Taylor's rule equation was applied in the analysis together with the consideration of Central bank's loss function[1] in order to find the appropriate policy normalization path to the neutral rate that could narrow the inflation and output gap paths of the economy as much as possible.

The recent assessment suggests that Thailand's neutral rate is at 2.5% which is the level consistent with the economy growing at its potential and inflation in line with the BOT's inflation target of 1-3%. Monetary policy stance also becomes more neutral as reflected in the real interest rate becoming less negative and closer to zero. Therefore, SCB EIC expects the MPC to increase the policy rate to the level consistent with the long-term economic growth where the normalization path to the terminal rate of 2.5% could occur in 2 cases (figure 3) as follows.

1. <u>**Base case :**</u> **The MPC will increase the policy rate to 2% in May and hold it steady throughout this year** in order to assess the situation in the second half of the year where the global economy could slow down given downside risks stemming from the lag effect of global monetary policy tightening and uncertainty surrounding banking stresses in some major economies. Moreover, this will allow for a more broad-based recovery of the Thai economy amid tightening financial conditions which can be seen from the income recovery of vulnerable businesses and households. The MPC could then decide to increase the policy rate to the terminal rate of 2.5% in the first half of 2024.
2. <u>**Better case :**</u> **Should the Thai economy continue to expand in the second half of this year and inflationary pressures increase in line with the economic recovery, the MPC will likely continue hiking the policy rate 25 bps at each meeting to the terminal rate of 2.5% in Q3/23 and then hold it steady** so that the monetary policy transmission to the economy could take place.

Figure 3: Monetary policy should be normalized to the level consistent with long-term economic growth where SCB EIC's recent assessment suggests the neutral rate to be 2.5%

Thailand's policy rate forecast by SCB EIC

Unit : %

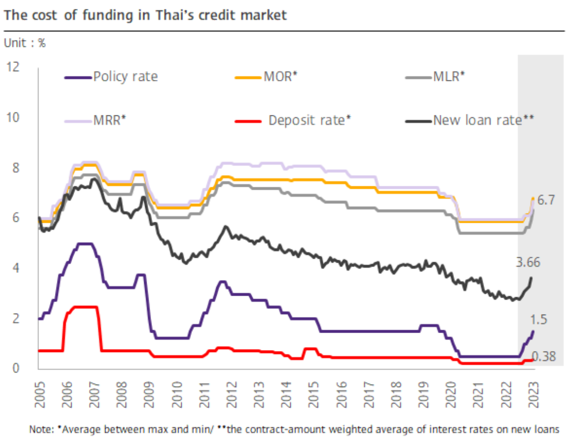
	2023F				2024F			
Scenario	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Base line	1.75	2	2	2	2.25	2.5	2.5	2.5
Better	1.75	2	2.5	2.5	2.5	2.5	2.5	2.5

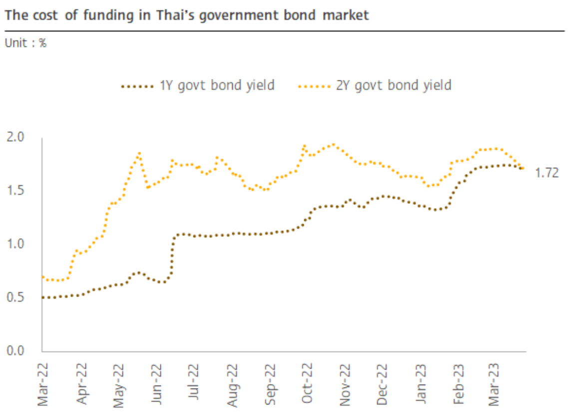
Source: SCB EIC analysis

[1] Loss Function is calculated from the chosen weights to closing the inflation gap and output gap. The neutral rate is then estimated from simulations of policy rate adjustments where the model that provides the lowest central bank's loss function will be chosen.

2. Thailand's funding costs have increased in line with the policy rate in both credit and bond markets (figure 4). In addition, SCB EIC finds that the rate of monetary policy transmission to commercial banks' interest rates for this hiking cycle declines relative to past hiking cycles (figure 5). The transmission rate to 12-month fixed deposit appears the highest (62.5%), followed by the transmission to minimum loan rate or MLR (54.5%). Meanwhile, transmission rate to the minimum retail rate or MRR appears lowest (21.5%). This is in line with the BOT's communication in recent periods where the BOT seeked for coorporation from the banking system in giving more focus to the recovery of vulnerable businesses and households. Banks then tried to be more cautious in transmitting the higher costs to vulnerable borrowers whose incomes have yet to sufficiently recovered. Nonetheless, M-rates have been raised 0.4% in January 2023 after the BOT announced the expiry of the temporary FIDF fee reduction to 0.23%, causing all types of lending rates to increase immediate 40 bps.

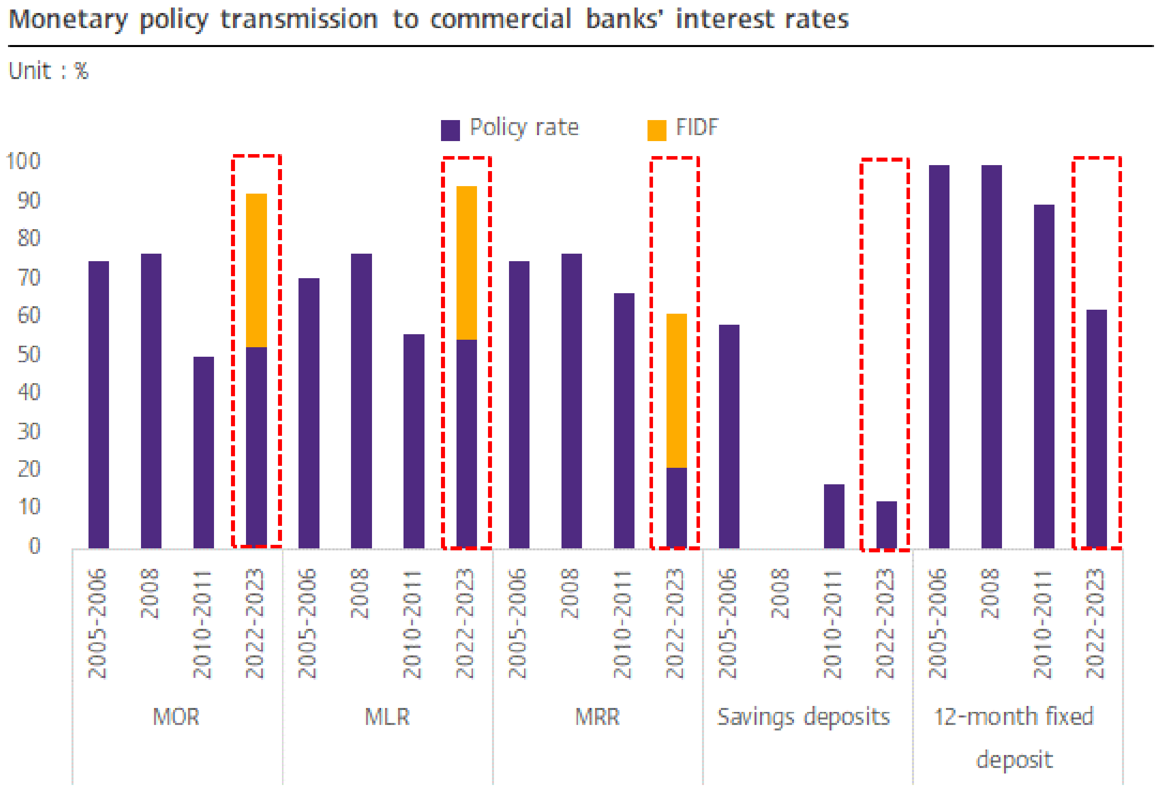
Figure 4: Thailand's funding costs have increased in both credit and bond markets





Source: SCB EIC analysis based on data from BOT

Figure 5: the rate of monetary policy transmission to commercial banks' interest rates for this hiking cycle declines relative to past hiking cycles



Source: SCB EIC analysis based on data from BOT

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