FLASH

SCB EIC

SCB EIC anticipates another MPC rate hike to the Terminal rate at 2.5%.

2 August 2023

SCB EIC anticipates another MPC rate hike to the Terminal rate at 2.5%.

KEY POINTS

The MPC voted unanimously to raise the policy rate by 25 basis points from 2% to 2.25% per annum. Thailand's economic recovery stayed intact, whereas external demand saw a slowdown but will likely regain footing. Inflation has subsided and is expected to hover within the target range amid upside risks. Based on the MPC assessment, as Thailand's economy bounced back to its potential, the monetary policy should stabilize inflation within the target range and propel long-term economic and financial stability by preventing the buildup of financial imbalances—brought by a prolonged period of low interest rates. The Committee also strives to secure monetary policy spaces to address higher uncertainties ahead. For further rate hikes, MPC will consider the pace that fits well with the economic and inflation outlook as well as risks.

MPC forecasts continued economic growth backed by the tourism sector and private consumption. In contrast, Thai merchandise exports will witness a short-term contraction, owing to China's economic slowdown and subdued global electronics cycle—which should regain traction in line with an upbeat global economic outlook. Yet, Thailand still faces rising uncertainties as an export rebound could fall behind the forecast while the domestic political situation remains highly unstable.

MPC expects the headline inflation to accelerate in 2H/2023. Headline inflation has cooled down thanks to falling energy prices, cost-of-living subsidies, and high-base effects from the previous year. Still, the headline inflation will likely escalate in 2H/2023 after those temporary effects peter out. Core inflation has subsided but will stay above the past readings, given upside inflationary pressures from food costs—especially in case El Nino's damages on agriculture are larger than anticipated. Such circumstances would accelerate cost pass-through from producers to consumers as the economy continues to rebound.

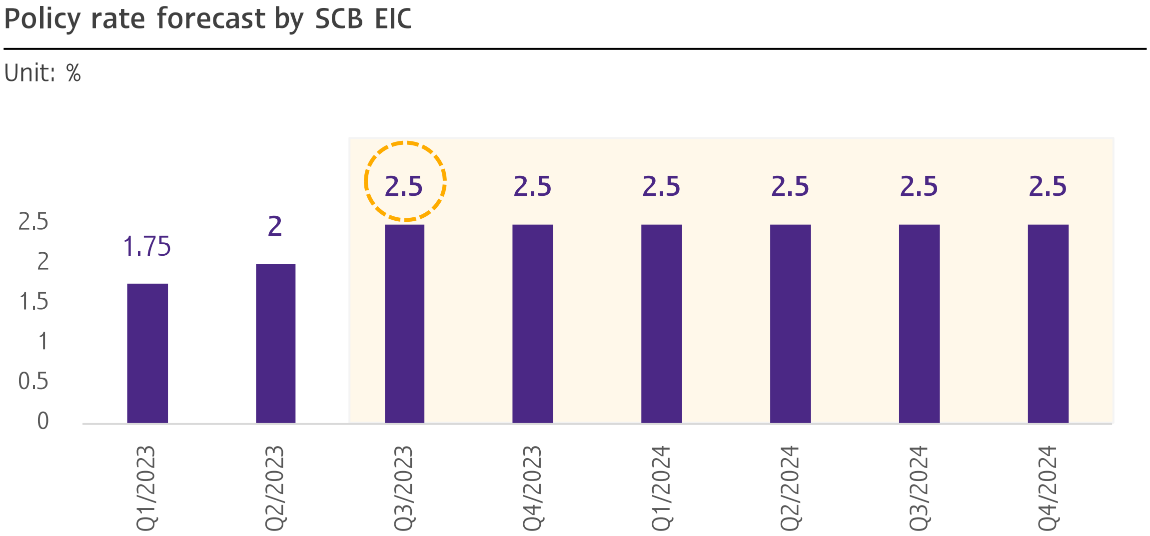
Based on MPC's press release, the financial system remained resilient with easing financial conditions. Thailand's overall financial system was in good shape, as evident in robust funds and capital buffers among commercial banks. Yet, high debt burden and somber income outlook continued to impair SMEs and fragile households' debt service ability—thus worsening overall credit quality. Therefore, MPC has consistently supported debt restructuring and targeted policy measures to assist the vulnerable group in sustainable debt resolution—including responsible lending. The financial condition has been decreasingly accommodative yet remained favorable for economic rebound and fund mobilization by the private sector. Borrowing costs for the private sector will likely increase alongside the policy rate. The recent slowdown in private credit growth was partly attributed to normalization after rapid growth during the COVID-19 crisis. Meanwhile, key factors affecting the Thai baht movement include the US monetary policy direction, China's economic outlook, and Thailand's political uncertainties.

IMPLICATIONS

SCB EIC anticipates another MPC rate hike in the September meeting. The policy rate will likely hit the Terminal rate of 2.5% and stay steady throughout the rest of 2023.

SCB EIC expects the MPC to stay the course on monetary policy normalization to a level consistent with long-term economic growth. Thailand's neutral rate is 2.5%, based on our assessment. It is the level consistent with Thai economic growth to its potential strength, while keeping inflation within the 1-3% target range set by the Bank of Thailand. Besides, as the monetary policy normalization proceeds, the real interest rate should turn positive and resume its pre-pandemic level, after falling negative since the advent of COVID-19 outbreaks. Such backdrop would buttress Thailand's economic and financial stability in the long term by preempting the accumulation of financial imbalances triggered by the low-for-long interest rate, whilst helping secure monetary policy spaces to quell uncertainties ahead.

Figure 1: SCB EIC expects MPC to raise the policy rate to 2.5% in Sep and hold it steady.

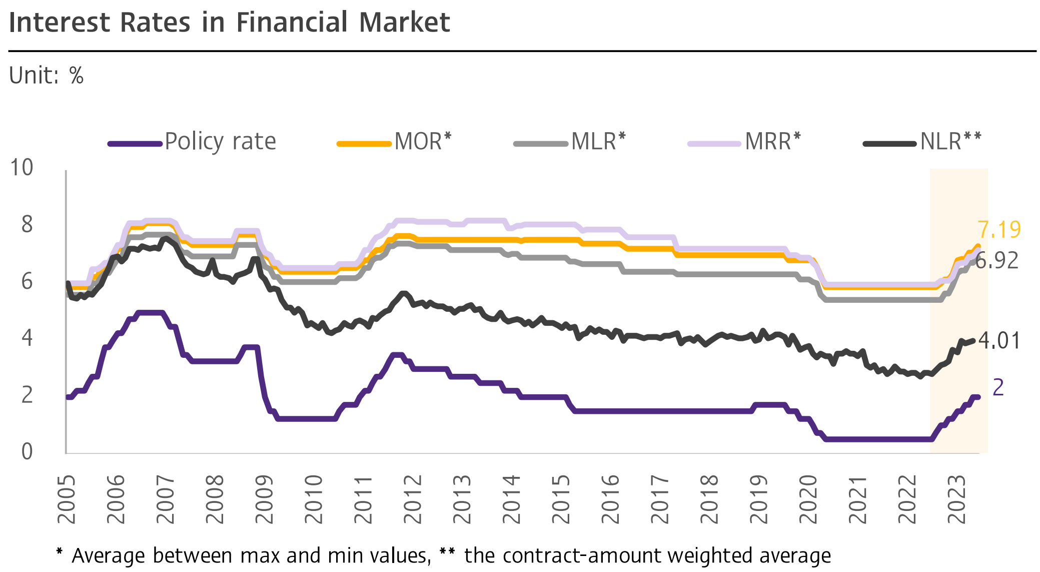


Source: SCB EIC analysis

The past MPC rate hikes have fueled funding costs in Thailand's credit market.

Funding costs in Thailand's credit market have been rising alongside the policy rate (Figure 2). From the first hike in August 2022 to June 2023, MPC has raised the policy rate by 1.5%. As a result, the average minimum loan rate (MLR), minimum overdraft rate (MOR), new loan rate (NLR), and minimum retail rate (MRR) rose by 1.1%, 1.0%, 0.8%, and 0.7%, respectively. The transmission rates to each lending rate were 73%, 68%, 54%, and 47%, respectively (excluding the impact of the FIDF fee).

Figure 2: Funding costs in Thailand's credit market rose in line with the policy rate.

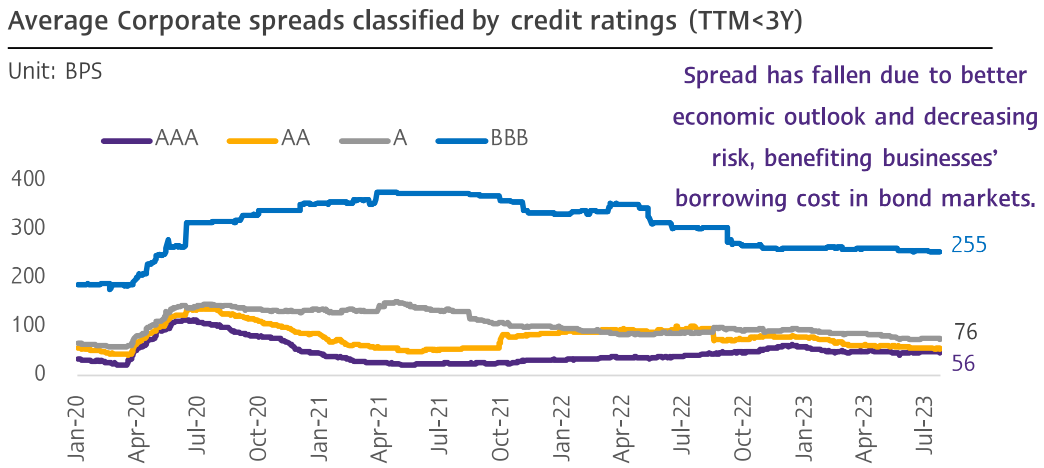


Source: SCB EIC analysis based on data from the Bank of Thailand

Funding costs in the bond market also increased alongside the policy rate.

Thailand's government bond yields in all maturity have risen since MPC kicked off the first hike in Q3/2022. We found that the yields of short-term government bonds (less than 1 year) showed up to 0.8-0.9 correlation with the policy rate. Meanwhile, the corporate spreads—which reflects funding costs by issuing bonds—tended to decline as Thailand's economy gathered steam and the corporate credit spread narrowed (Figure 3). The overall environment is considered accommodative to the funding costs for businesses in the bond market.

Figure 3: Despite MPC's continuous rate hikes, the corporate spreads have narrowed as the Thai economy regained ground amidst subsiding credit risks.



Source: SCB EIC analysis based on data from Bloomberg

Looking ahead, corporate finance via the bond market is poised for a slowdown as many firms already issued corporate bonds over recent months to ensure low interest costs. Investors also became more heedful of bond market investment due to the higher credit risks of some issuers. In 1H/2023, the bond market faced heightening default risks and a growing number of companies that got their ratings or outlook downgraded. These drawbacks have pressured the bond market investment and also fueled rollover risks among the high-yield bonds approaching maturity. Furthermore, rising interest rates could impair the funding and debt service ability of SMEs and fragile households—all of which entail a deteriorating credit quality. Despite swelling growth over recent months, corporate finance via Thailand's bond market will likely lose momentum and result in tightening financial conditions.

Author

NICHANAN LOGEWITOOL (nichanan.logewitool@scb.co.th)

ANALYST

ECONOMIC AND FINANCIAL MARKET RESEARCH

SOMPRAWIN MANPRASERT, Ph.D.

First Executive Vice President, Chief Economist at Economic Intelligence Center (EIC), Siam Commercial Bank and FEVP, Chief Strategy Officer at Siam Commercial Bank.

THITIMA CHUCHERD, Ph.D.

HEAD OF ECONOMIC AND FINANCIAL MARKET RESEARCH

POONYAWAT SREESING, Ph.D.

SENIOR ECONOMIST

ASAMA LIAMMUKDA, Ph.D.

ANALYST

JONGRAK KONGKUMCHAI

ANALYST

NICHANAN LOGEWITOOL

ANALYST

PUNN PATTANASIRI

ANALYST

VISHAL GULATI

ANALYST