SCB EIC expects MPC to start the policy rate cut in Q4

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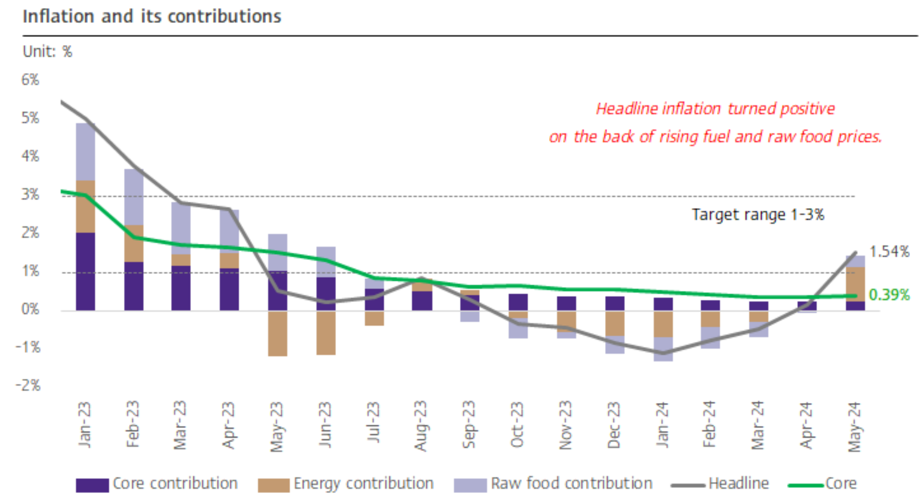
The MPC voted 6 to 1 to maintain the policy rate at 2.5%. One MPC member voted to cut the policy rate by 0.25 percentage point. The communication at the latest meeting thus displays a more hawkish stance compared to the previous meeting in April which resulted in a 5-to-2 vote. The majority of MPC members deems the current policy rate to be consistent with the economy converging to its potential, as well as conducive to safeguarding macro-financial stability. Meanwhile, one member deems the lower policy rate to reflect Thailand's lower potential growth as a result of structural challenges and partly alleviates debt burden for borrowers. As for the Thai economic outlook, the MPC retains its previous economic growth projections at 2.6% and 3.0% in 2024 and 2025, respectively driven by domestic demand, tourism recovery, and acceleration in government disbursement. Meanwhile, MPC expects exports and the manufacturing sector to recover slowly due to structural headwinds. However, MPC assesses that growth of the industrial production has bottomed out. As for the inflation outlook, the MPC also maintains its previous projections, forecasting headline inflation to be 0.6% and 1.3% in 2024 and 2025, respectively. The forecast reflects an upward trend in energy and fresh food prices. The MPC anticipates headline inflation to gradually return to the target range in the fourth quarter of 2024, while medium-term inflation expectations remain consistent with the target.

IMPLICATIONS

SCB EIC expects the MPC to start the policy rate cut in Q4. This will coincide with rising economic pressures stemming from tightening financial conditions, while both households and businesses remain largely vulnerable. Moreover, looking ahead, downside risks to the Thai economy are projected to increase. In the short term, SCB EIC observes that Thailand's economic development since the beginning of the year has been consistent with MPC projections. Headline inflation temporarily exceeded the lower bound of the target range in May, partly due to the base effect of energy subsidies provided by the government in the previous year. Additionally, several commercial banks have announced special six-month reductions in their minimum retail rate (MRR) for the vulnerable group, partially alleviating the debt burden of these vulnerable households and businesses. Consequently, the MPC is expected to maintain the policy rate for the time being. However, the resurgence of headline inflation in May does not signal robust economic growth, as it is primarily driven by rising energy and food prices following the government's gradual reduction of retail fuel subsidies. However, when considering core inflation, which excludes energy and raw food prices, it remains subdued at 0.39%. (Figure 1)

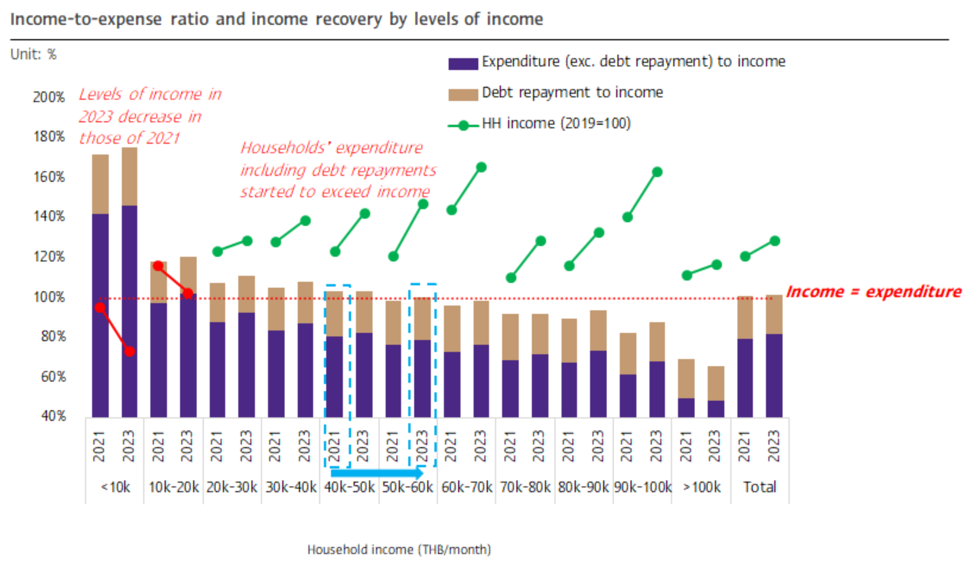
Figure 1: Headline inflation returned to the target range in May, while core inflation remains subdued.



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

Moreover, SCB EIC emphasizes on the fragility in the Thai economic recovery, especially within the household sector. According to the latest Household Socio-Economic Survey (SES) conducted by the National Statistical Office in 2023, indebted households are facing heightened vulnerabilities. This stems primarily from income-expenditure imbalances, with low-income households experiencing a decline in income (compared to 2021) while middle-income households struggling to meet their debt obligations (Figure 2).

Figure 2: Debt-laden households are becoming more vulnerable, particularly low-income households experiencing income decline, while middle-income households are struggling to meet debt obligations



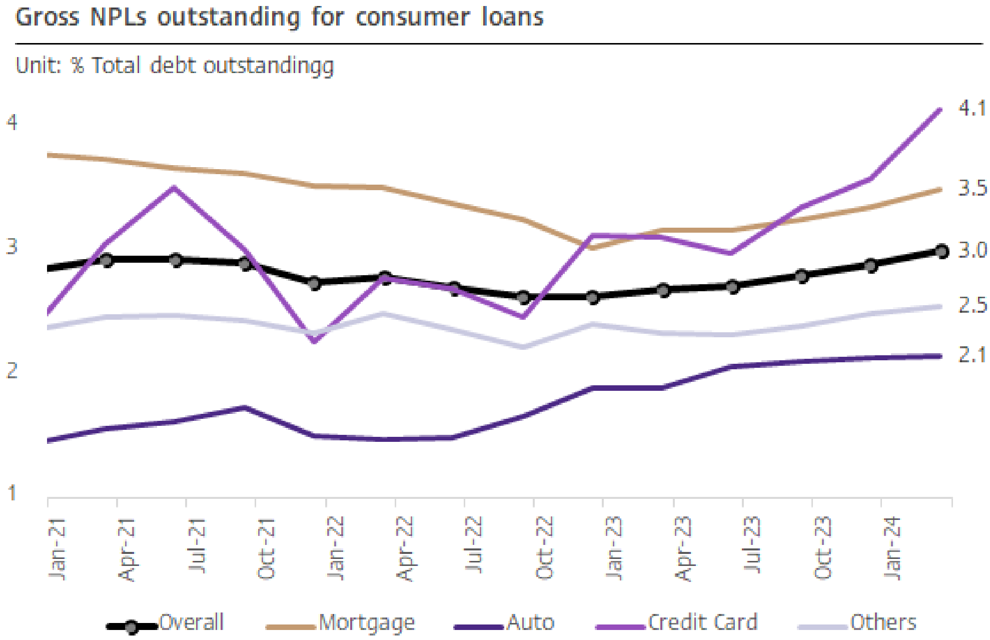
Note: Data on household income, expenditure, and debt payments only includes indebted households.

Source: SCB EIC analysis based on data from the National Statistical Office.

Looking ahead, the fragile economic recovery, partly as a result of elevated household debts and deteriorating household credit quality (Figure 3), will prompt financial institutions especially commercial banks to tighten their lending standards for households (Figure 4). Consequently, **overall financial conditions are expected to tighten further in the remaining months of the year, exacerbating economic fragility** amidst ongoing structural headwinds facing certain sectors. SCB EIC projects that the manufacturing sector will continue to exhibit a sluggish recovery due to persistent pressure from China's imports and a protracted decline in domestic demand for durable goods. These economic pressures are expected to be more pronounced in the near future. **This strengthens the case for a policy rate cut in late 2024 particularly during the extra tightened lending standards, while policy rate cut is not expected to raise concern on a surge in household debt as in the past.** Therefore, a reduction in the policy rate is not seen as an impediment to the debt deleveraging process. In addition, **the expected economic environment in late 2024 will be an appropriate timing for the policy rate cut** as it aligns with the anticipated weakening of the US dollar in line with the US Federal Reserve's monetary policy trajectory. Additionally, risks to the Thai economy in 2025 are projected to be higher than the MPC's current assessment. These risks could stem from external factors such as the potential impact of US elections and global trade on exports, as well as domestic factors such as a potential weakening of domestic demand if financial tightening exacerbates household vulnerabilities.

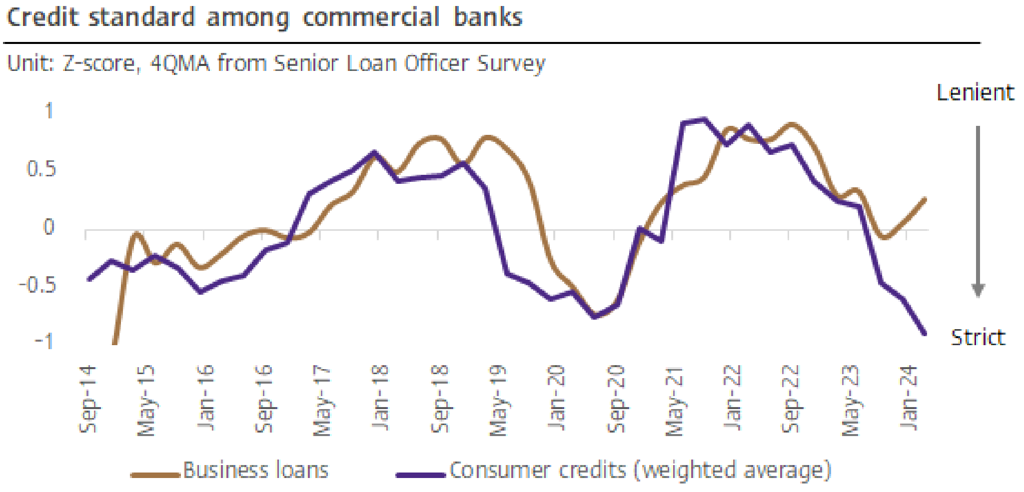
SCB EIC therefore expects the MPC to cut the policy rate once in late 2024 to 2.25% and cut again in early 2025 to 2%, as tightening financial conditions are expected to put more pressure on the economy. Meanwhile, households and businesses will become more vulnerable with risks to the Thai economy in 2025 starting to escalate.

Figure 3: household credit quality continues to deteriorate



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

Figure 4: Commercial banks tightened their lending standards especially for households



Note: weighted average of household outstanding loans as of Q1 2024

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

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