FLASH

SCB EIC

SCB EIC Expects MPC to Begin Rate Cuts in Q4

21 August 2024

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The MPC voted 6 to 1 to maintain the policy rate at 2.50%. One MPC member voted to cut the policy rate by 0.25 percentage point, consistent with the previous meeting. The overall Thai economy is expanding in line with MPC's projections, while headline inflation decreased slightly more than expected due to supply-side factors and is anticipated to return to the target range of 1-3% by the end of this year. However, **SCB EIC observes that the MPC's communication in this meeting is more dovish** due to: 1) MPC assesses that **domestic demand carries increased downside risks going forward**, with private consumption expected to slow, and it remains to be seen how temporary the sharp contraction in private investment in Q2 would be; 2) **MPC places greater emphasis on uneven recovery across sectors**, particularly in the manufacturing sector where credit for the automotive and electronics industries contracted; and 3) **MPC is beginning to focus on monitoring the linkage between economic developments and financial conditions**, reflecting growing concerns that tighter financial conditions might impact the economy moving forward, particularly through deteriorating credit quality, which could lead to stricter lending standards by financial institutions and potentially impact economic activity.

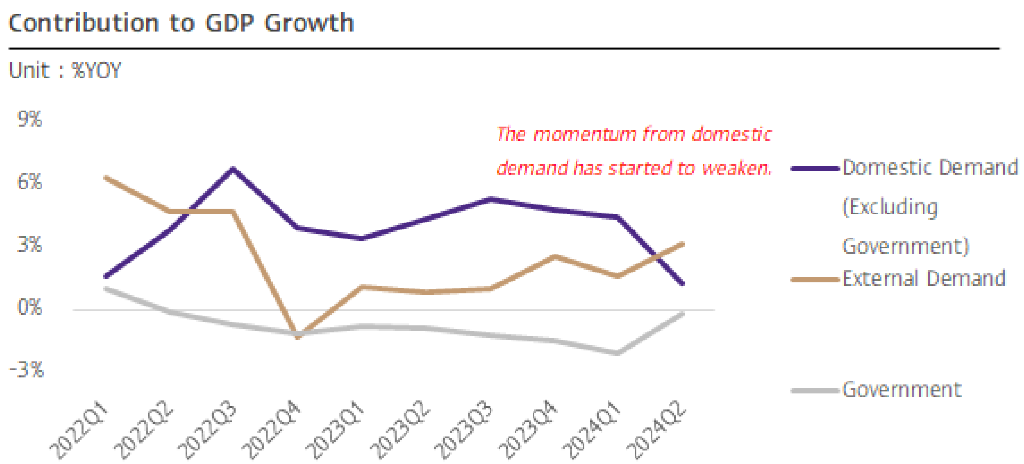
IMPLICATIONS

SCB EIC anticipates two MPC rate cuts to 2.25% in late 2024 and 2% in early 2025 to help ease domestic financial conditions, which have tightened significantly recently, coupled with existing financial fragilities in the business and household sectors. These factors are expected to further dampen the momentum of domestic demand, which will become more evident towards the end of this year. Additionally, the Thai economy next year will continue to face uncertainties both domestically and externally, necessitating a greater role for monetary policy in supporting Thailand's economic momentum going forward.

SCB EIC observes that the recent economic developments are consistent with the MPC's assessments, **as reflected in the Q2 GDP growth figures, which were close to market expectations. However, when examining the components of growth, signs of weakening domestic demand are starting to emerge** (Figure 1), indicating that domestic demand may no longer be the main driver of the economy as it has in the past. Meanwhile, headline inflation remains below the target range, and when the base effects and temporary factors from energy and fresh food prices are excluded, core inflation has remained low, reflecting continued weak domestic demand pressures. These signals of slowing domestic demand lead SCB EIC to believe that the Thai economy in 2025 may grow at a slower pace than previously anticipated.

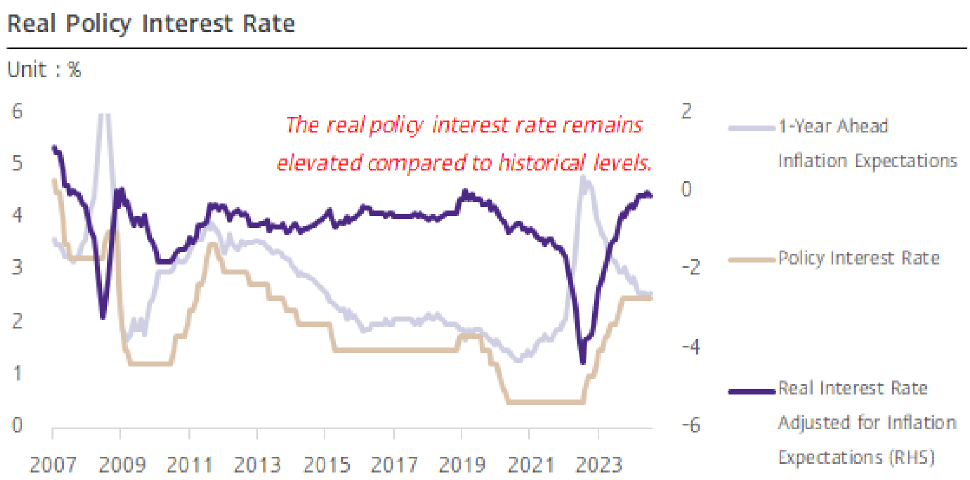
Thailand's financial conditions remain tight, as reflected by the real policy rate (Figure 2), which has increased more rapidly than in the past. Additionally, households may face more severe financial tightening than other sectors due to the stricter household lending standards by financial institutions, particularly commercial banks, which continue to tighten (Figure 3). As a result, households are now able to incur significantly less debt than in the past. In this juncture, **the rate cut is not expected to spur excessive debt accumulation and is not seen as an obstacle to the debt deleveraging process**. Furthermore, **the economic environment towards the end of the year is expected to provide a suitable timing for a rate cut**, given the anticipated easing of global financial conditions in line with the Federal Reserve's monetary policy trajectory. In addition, Thailand's economy next year will face heightened uncertainty from U.S. trade policies following the upcoming elections and increased uncertainty in domestic economic policy. **SCB EIC thus expects the MPC to cut the policy rate once at the end of this year to 2.25% and again in Q1 next year to 2%.**

Figure 1: Signs of Weakening Domestic Demand Emerged



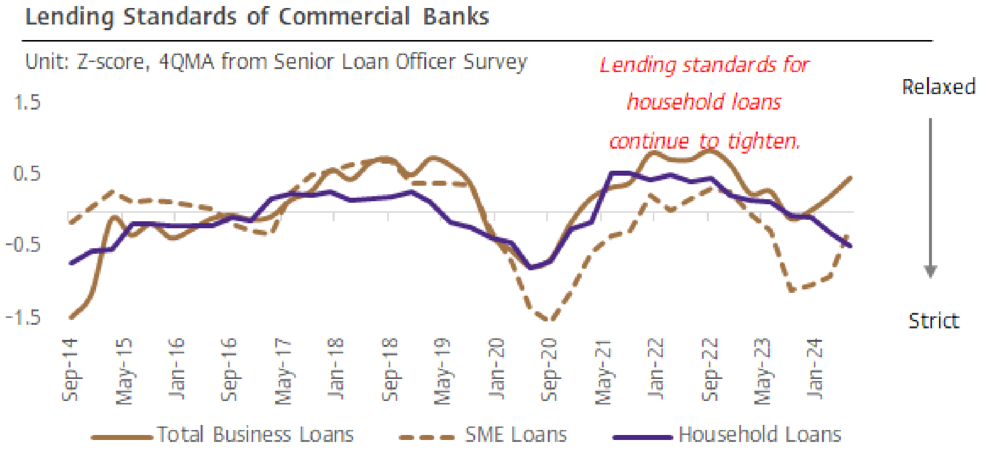
Source: SCB EIC analysis based on data from the National Economic and Social Development Council (NESDC).

Figure 2: Real Policy Rate Has Increased Rapidly



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

Figure 3: Households Face Severe Financial Tightening Due to Stricter Lending Standards



Note: Weighted average based on outstanding household loans as of Q1 2024

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

Author

NOND PRUEKSIRI (nond.prueksiri@scb.co.th)

SENIOR ECONOMIST

MACROECONOMICS 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 MACROECONOMICS RESEARCH

POONYAWAT SREESING, Ph.D.

SENIOR ECONOMIST

NOND PRUEKSIRI

SENIOR ECONOMIST

VISHAL GULATI

SENIOR ECONOMIST

NATHAPONG TUNTICHIRANON

ECONOMIST

PUNN PATTANASIRI

ECONOMIST

PAWAT SAWAENGSAT

ECONOMIST