

### *3. Monetary Conditions and the Exchange Rates*

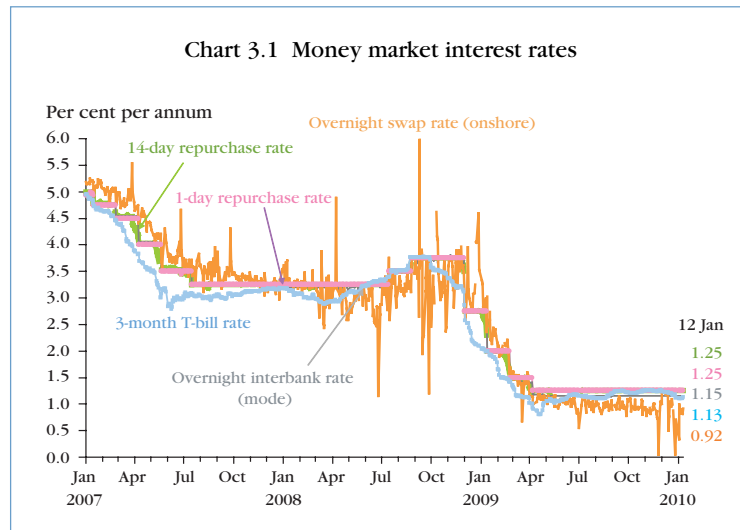
Following the release of the previous *Report*, the MPC convened in the meetings on 2 December 2009 and 13 January 2010, and currently holds a collective judgment that the global economy continues to improve. However, risks to economic recovery in the period ahead remain, especially for the major industrialized economies. The Asian economies are likely to recover sooner, giving rise to policy differentials which may lead to more volatile capital flows going forward. The Thai economy continues to recover, supported by improvements in domestic and foreign order books, business sentiment, farm income, employment conditions as well as the tourism sector. The MPC judges that the economic recovery is likely to continue at a gradual pace, with some need for policy support. The rise of inflation in December owed mainly to oil prices, but the overall demand pressure on inflation remains low. The MPC's view is that inflation is likely to be higher this year, due to effects from oil prices, the end of the government's subsidy measures, and the firmer economic recovery. The MPC will continue to closely monitor inflation and economic developments. In both the December and January meetings, the MPC thus decided to maintain the policy interest rate at 1.25 per cent per annum.

#### *Money market conditions*

##### *Money market*

In 2009 Q4, short-term money market interest rates for both collateralized and uncollateralized

*Short-term money market rates remained unchanged in line with the policy interest rate.*

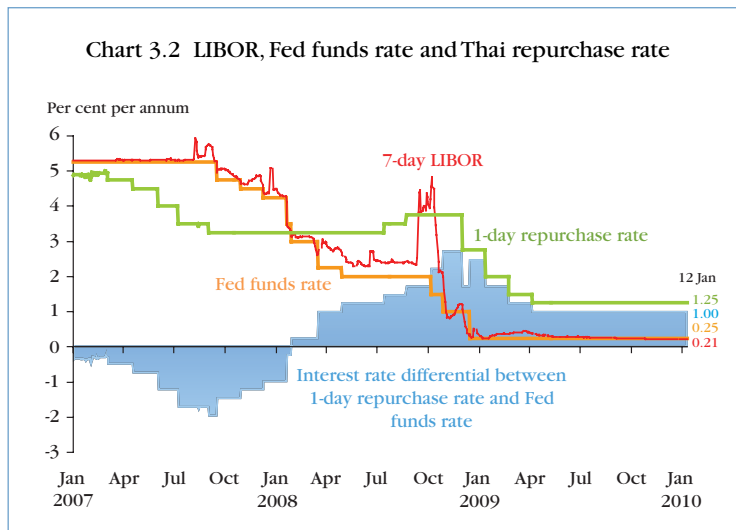


Source: Bank of Thailand

lending in the Thai baht were broadly consistent with the policy interest rate. The 1-day repurchase rate and the overnight interbank rate averaged over the quarter at 1.25 and 1.15 per cent per annum respectively, close to the averages in the previous quarter, following the MPC's decisions to maintain the policy interest rate.

The overnight swap rate, which represents the cost of borrowing the Thai baht using the US dollar as collateral, was lower than the policy interest rate throughout the quarter. This was due to the fact that there was demand for US dollars by foreign investment funds as well as exporters seeking to hedge their foreign exchange exposure. The onshore overnight swap rate declined from the average of 0.97 per cent per annum in the previous quarter to the current average of 0.81 per cent per annum.

As of the end of 2009 Q4, the difference between the Thai and the US policy interest rates remained unchanged at 1.0 per cent per annum, following the decisions in both Thailand and the US to maintain policy interest rates at 1.25 and 0.0-0.25 per cent per annum respectively.

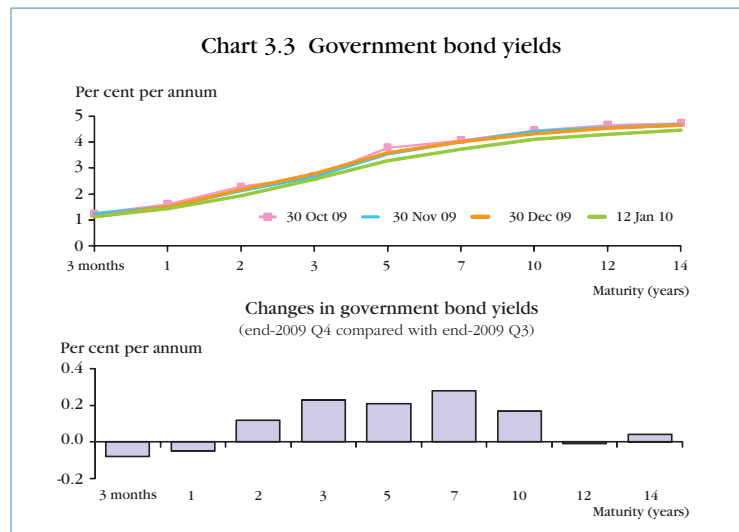


Source: Bank of Thailand

### *Bond market*

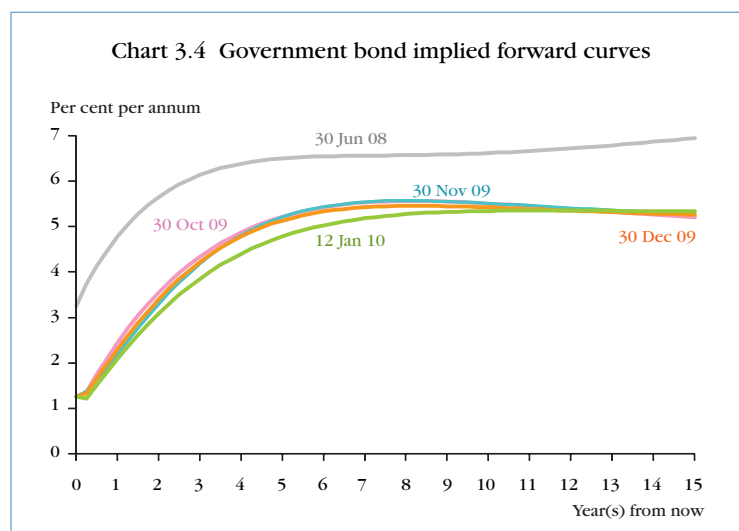
Government bond yields in 2009 Q4 increased slightly from the previous quarter. During the early part of the quarter, government bond yields increased continually, especially in the middle part of the yield curve. The upward adjustment reflected a more buoyant confidence given positive developments of the global and Thai economies, with the SET index also making a new high for the year. In addition, some central banks such as the Reserve Bank of Australia and Norges Bank adjusted their policy interest rates upward sooner than the market had previously anticipated, weighing on the international and Thai bond markets. Nevertheless, towards the middle of the quarter, investor confidence was dented by concerns over the sustainability of the global and Thai economic recovery as well as ongoing domestic political uncertainty. The resulting pickup in demand for government bonds pushed the government bond yields down somewhat.

*The yields on government bonds, especially with medium-term maturities, increased slightly following a more upbeat confidence in the outlook for the global and Thai economies.*



Source: Bank of Thailand

The short end of the implied forward curve shifted upwards slightly, as investors priced in a higher chance of an increase in the policy interest rate in the next 1-2 years. Meanwhile, the long end of the implied forward curve did not change significantly from the third quarter, suggesting that long-term inflation expectations remained well anchored.

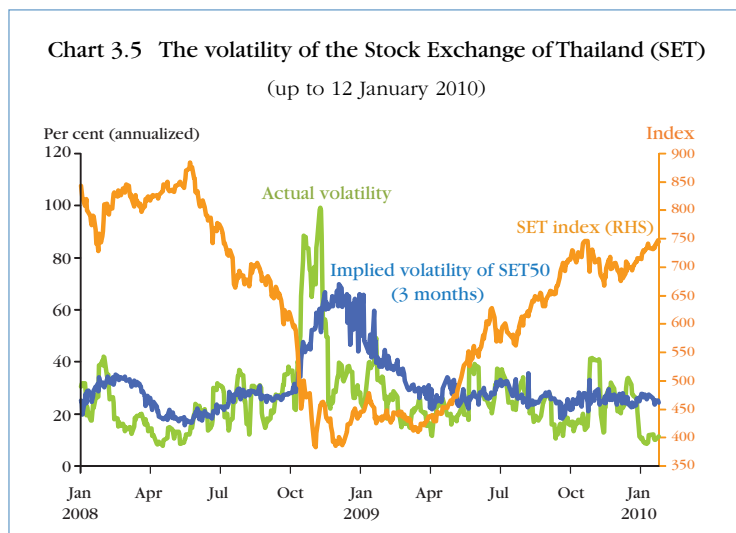


Source: Bank of Thailand

## Equity market

In 2009 Q4, the SET Index was relatively stable after a rapid climb in the previous quarter. In November, the index was under some pressure due to (1) the political uncertainty, (2) the Dubai World debt postponement and (3) the suspension of investment projects in the Map Ta Phut industrial area. Nevertheless, the SET index adjusted upward in December, supported by some easing in the concerns and year-end demand from Long Term Equity Funds (LTFs) and Retirement Mutual Funds (RMFs).

*In 2009 Q4, the SET regained some stability after climbing rapidly in the previous quarter.*



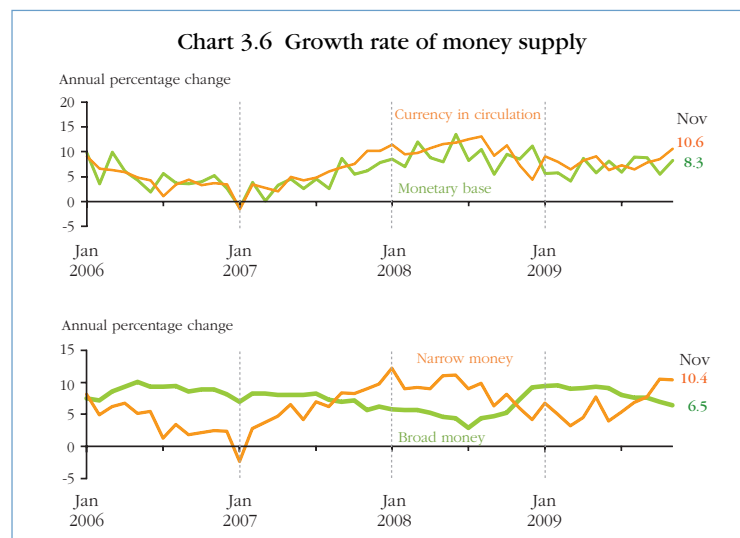
Source: Stock Exchange of Thailand, calculations by the Bank of Thailand

Going forward, the SET index volatility is expected to remain moderate, reflected by a low 3-month implied volatility of the SET 50 index.

## Monetary base and money supply

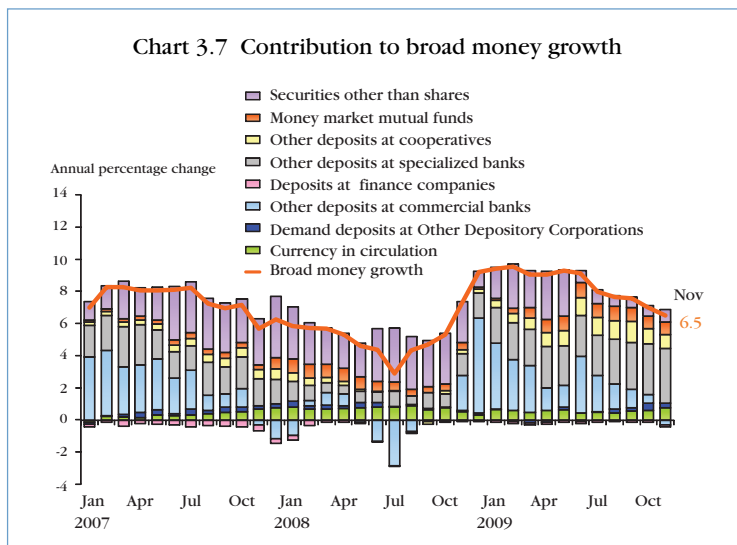
*Monetary base expanded in line with economic activities, while broad money grew at a slower pace, owing to a high base effect last year.*

In October and November 2009, the monetary base picked up its pace to expand from the same quarter last year by an average of 7.0 per cent, following an increase in private expenditure and economic activities.



Source: Bank of Thailand

Broad money expanded at an average rate of 6.7 per cent during the October-November period, a deceleration from 2009 Q3 in which broad money grew by 7.7 per cent on average. The deceleration owed mainly to a high base effect last year, which saw a significant shift to safe and low-duration assets such as deposits with financial institutions. On the other hand, broad money outstanding continued to increase from the previous month, particularly the deposits with specialized financial institutions (SFIs) which rose as a result of the mobilization of deposits in accordance with the government's policy to accommodate more credit expansion in the period ahead.



### *The banking system*

Following the MPC's decision to hold the policy interest rate unchanged at 1.25 per cent per annum since the end of 2009 Q2, most commercial banks had maintained their reference rates for lending throughout the last two quarters of 2009. In some exceptional instances, several big commercial banks lowered their reference rates<sup>1/</sup> for 3-to-12-month time deposits with an amount less than 3 million baht in order to offset earlier increases. These moves were however largely motivated by the banks' internal liquidity and cost management strategies rather than their views about the likely path of future policy interest rates. Overall, the average 3-, 6- and 12-month time deposit rates of the four largest commercial banks at the end of the quarter stood at 0.70 per cent per annum.

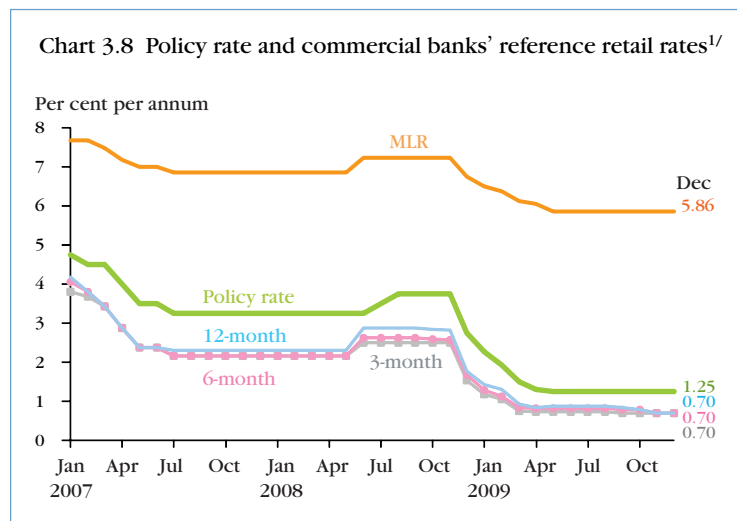
*Commercial banks' deposit rates dropped slightly after a previous pickup, while MLR remained unchanged.*

<sup>1/</sup> The average between minimum and maximum rates of the four largest commercial banks.

Unit: Per cent per annum	2007	2008		2009				
	Dec	Sep	Dec	Mar	Jun	Sep	Nov	Dec
Policy rate	3.25	3.75	2.75	1.50	1.25	1.25	1.25	1.25
Average reference retail rates of the 4 largest banks								
Savings	0.75	0.75	0.75	0.50	0.50	0.50	0.50	0.50
3-month	2.16	2.50	1.54	0.75	0.73	0.70	0.70	0.70
6-month	2.16	2.63	1.68	0.84	0.82	0.79	0.70	0.70
12-month	2.31	2.88	1.78	0.94	0.88	0.84	0.70	0.70
24-month	2.50	3.59	2.50	1.25	1.44	1.44	1.44	1.44
MLR	6.87	7.25	6.75	6.13	5.86	5.86	5.86	5.86

Note: <sup>1/</sup> Policy rate is the rate at end-period; Reference retail rates are the average of minimum and maximum rates.

Source: Bank of Thailand



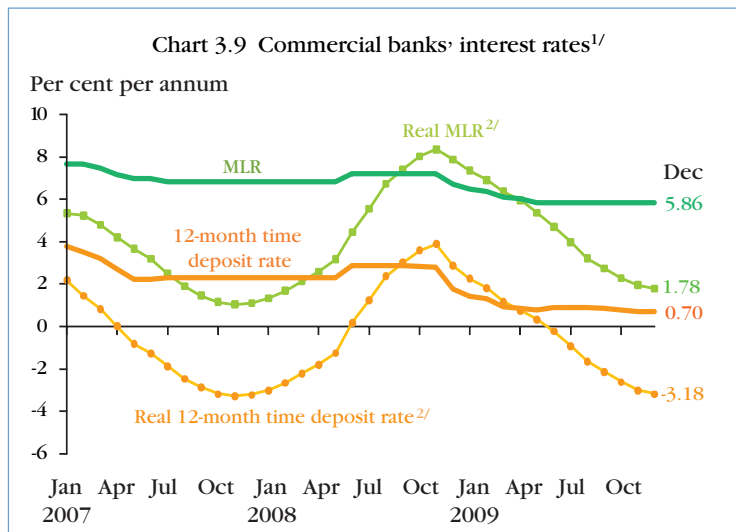
Note: <sup>1/</sup> Average rate of the 4 largest commercial banks at end-period and the average of minimum and maximum

Source: Bank of Thailand

Meanwhile, the minimum lending rates (MLR) of the four largest commercial banks remained unchanged on average at 5.86 per cent per annum. The real MLR<sup>2/</sup> and the real 12-month time deposit rate<sup>3/</sup> dropped to

Note: <sup>2/</sup> Real MLR = MLR - average forecasted inflation 12 months ahead

<sup>3/</sup> Real 12-month deposit rate = 12-month deposit rate - average forecasted inflation 12 months ahead



Note: <sup>1/</sup> Average rate of the 4 largest commercial banks  
<sup>2/</sup> Real interest rates are calculated from the compounded interest rate formula  
Source: Bank of Thailand

1.78 and -3.18 per cent per annum respectively at the end of the quarter, on account of a pickup in projected inflation over the next 12 months.

Deposits of Other Depository Corporations (ODCs)<sup>4/</sup> in October and November expanded on average at a decelerating rate of 7.1 per cent from the same period last year. The deceleration followed a strong surge in ODC deposits last year due to heightened risk aversion during the global financial crisis, which induced investors to shift investment away from higher-yielding assets. However, when compared to the end of the third quarter, the outstanding ODC deposits as of the end of November grew by a robust amount of 260 billion baht. The pickup was due to the mobilization of deposits by both SFIs, in accordance with the

*Deposits of ODCs decelerated from the previous quarter but expanded noticeably compared to the previous month.*

<sup>4/</sup> Other Depository Corporations consist of domestically registered commercial banks, branches of foreign banks, international banking facilities, finance companies, Specialized Financial Institution (including Government Savings Bank, Government Housing Banks, Bank of Agriculture and Agricultural Cooperatives, Export-Import Bank of Thailand, Small and Medium Enterprise Development Bank of Thailand, Islamic Bank of Thailand), saving cooperatives, and money market mutual funds.

Chart 3.10 Other Depository Corporations' deposits and private credits

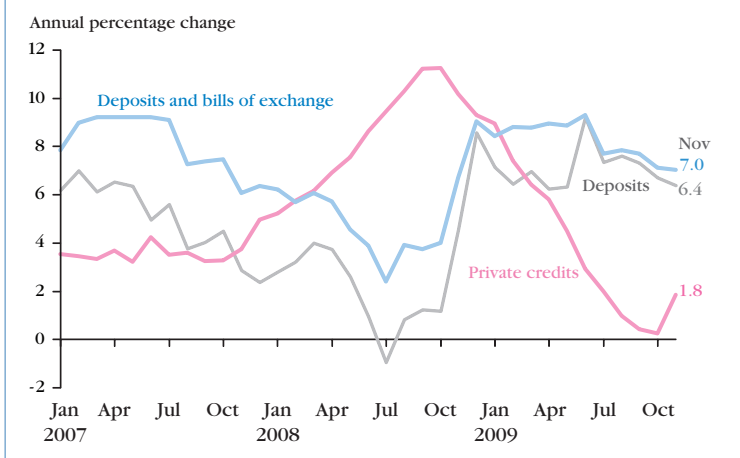
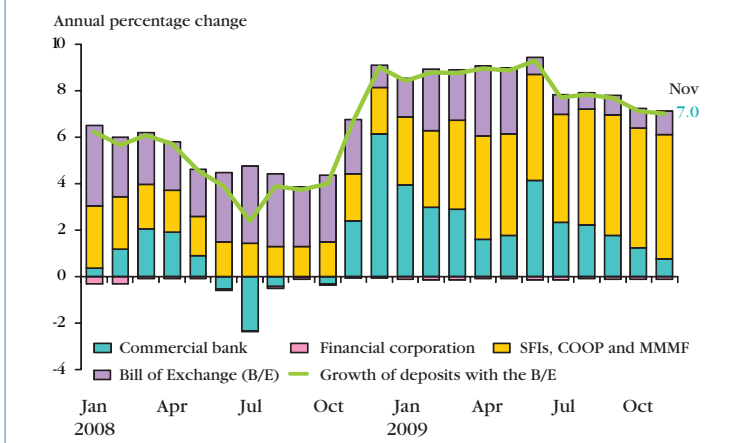


Chart 3.11 Deposits of Other Depository Corporations by financial institutions (with B/E)

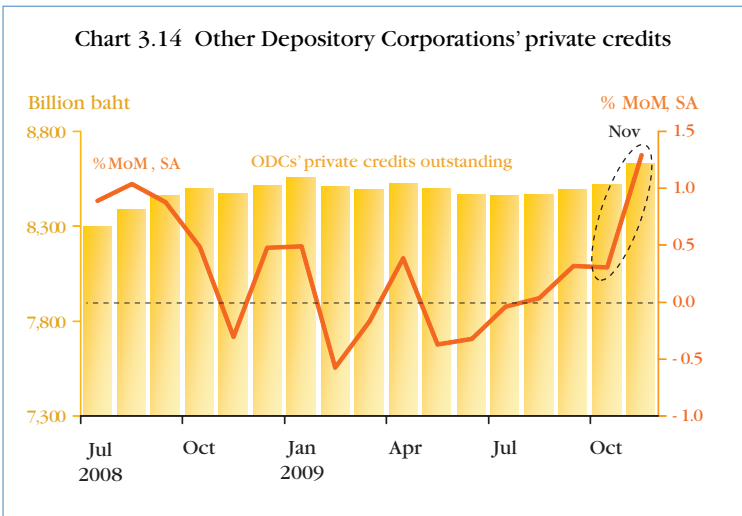
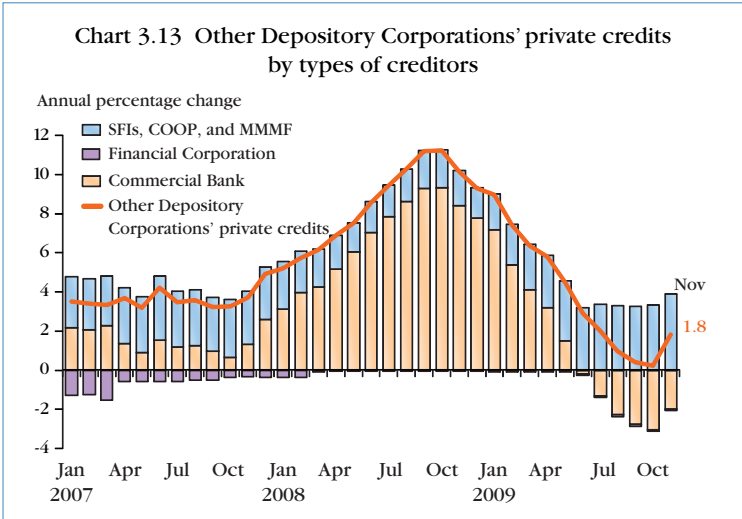
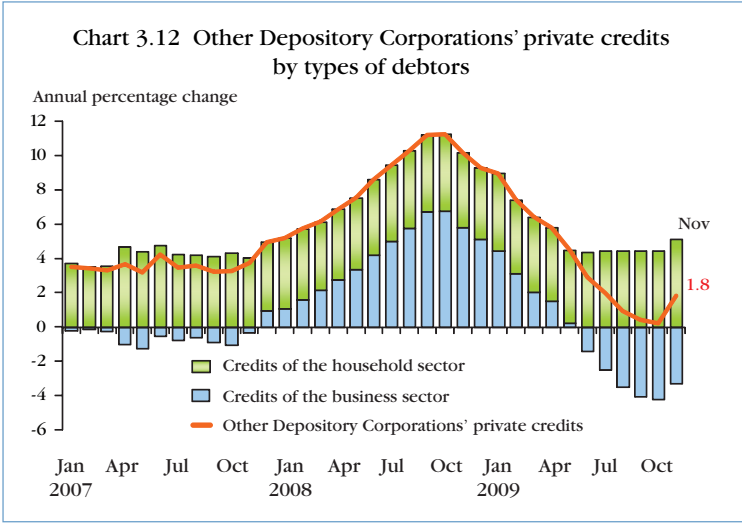


Source: Bank of Thailand

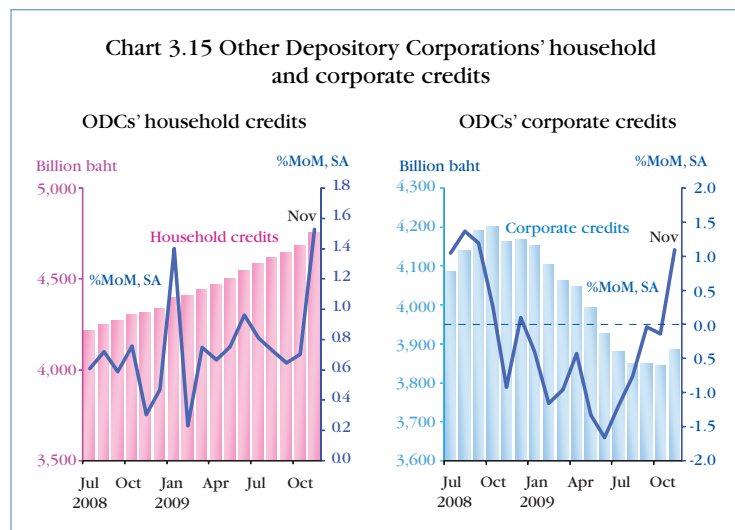
government's policy, and commercial banks in anticipation of greater credit expansion going forward especially in personal consumption loans. Additionally, a number of Bank of Thailand and government saving bonds had reached their maturities.

*Private credits, especially those extended to the household sector, accelerated.*

Private credits of ODCs in October decelerated from the previous quarter, growing at an average rate of 0.2 per cent per annum from the same period last year. However, private credits in November grew at an accelerating rate of 1.8 per cent per annum, largely



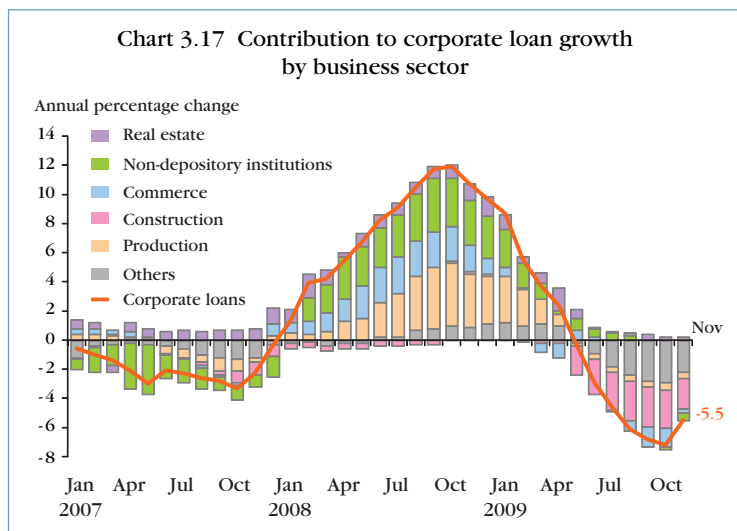
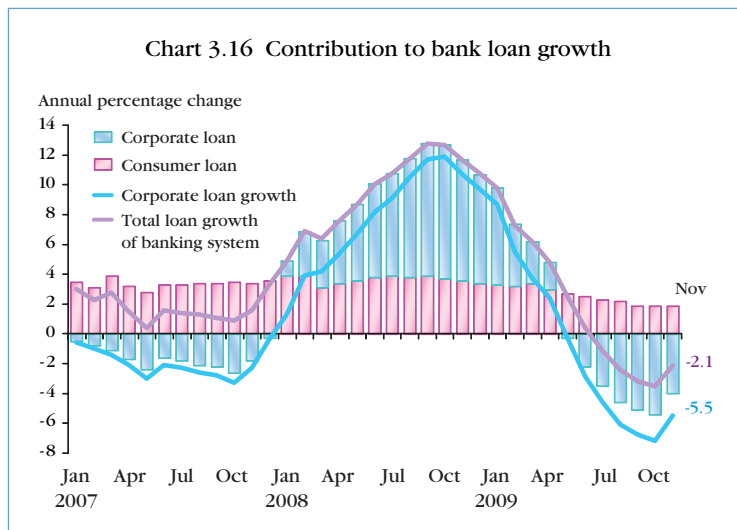
Source: Bank of Thailand



Source: Bank of Thailand

attributable to household credit extension. Notably, the SFIs continued to expand credits in accordance with the government's policy, especially to the housing sector which was deemed to be less risky compared to corporate credits due to its collateralized nature. Meanwhile, corporate credits in November expanded from the previous month for the first time in 11 months, partly because of rising demand for credits in view of an ongoing economic recovery.

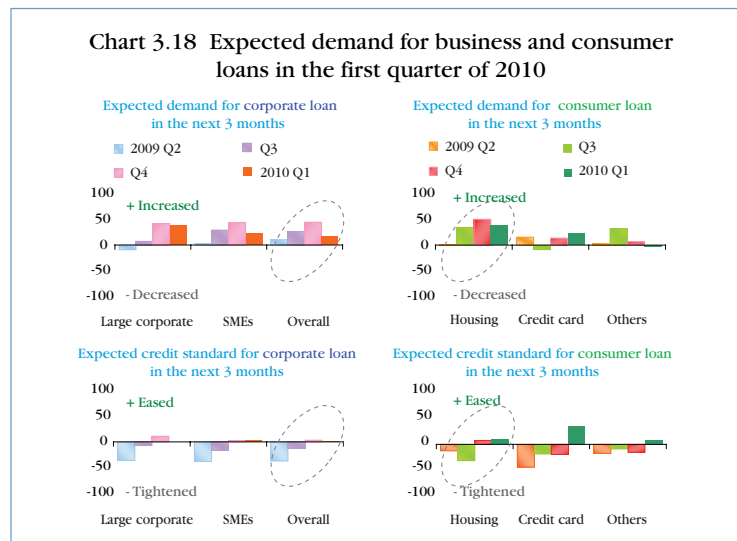
Commercial banks' private credits in October and November 2009 shrank by 7.2 and 5.5 per cent respectively from the same period last year. The deceleration of the contraction in November was mainly attributable to some improvements in corporate credits, especially for hire-purchase and public-utility credits such as electricity production. Meanwhile, household credits, especially for housing and vehicles, continued to expand.



The credit outlook for 2010 Q1, according to the Senior Loan Officer Survey, is expected to benefit from higher demand for credits from household and business sectors, particularly in housing credits, as well as a continued easing in credit standards set by financial institutions in tandem with the economic recovery. However, the overall growth rate of credits is likely to decelerate from the previous quarter.

*Demand for credits is expected to increase both for business and household credits, while credit standards set by financial institutions will likely ease further.*

**Chart 3.18 Expected demand for business and consumer loans in the first quarter of 2010**



Source: Senior Loan Officer Survey conducted in the 4<sup>th</sup> quarter of 2009

### Exchange rates

*The Thai baht continued to appreciate against the US dollar from the previous quarter.*

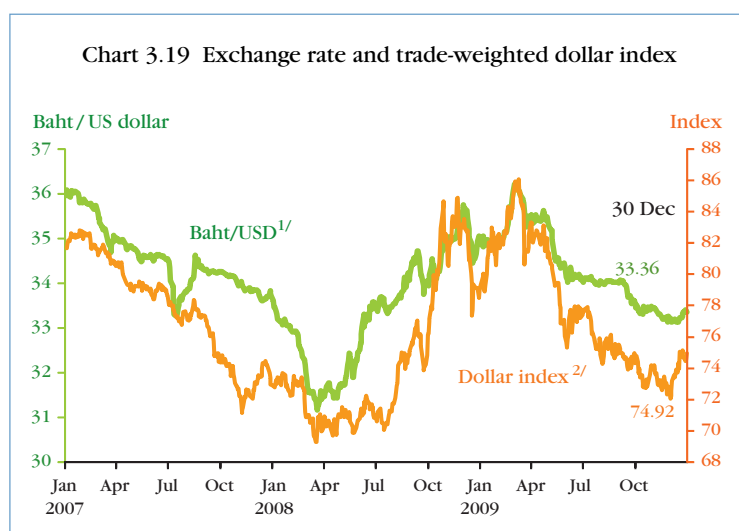
In 2009 Q4, the baht appreciated 2.0 percent from the previous quarter's average to 33.31 baht per US dollar. The appreciation of the baht in the earlier part of the quarter largely resulted from the US dollar selling by foreign investors who sought to reduce their US dollar exposure, as well as commercial banks and exporters amidst concerns of continued baht strength.

The major factors contributing to the depreciation of the US dollar during the first two months of the quarter were (1) the rising appetite for risky assets as investors grew more confident in the economic recovery, (2) the action by the Reserve Bank of Australia (RBA) to raise its policy interest rate earlier than expected during the beginning of the quarter, (3) a string of positive economic releases in the US, Japan and euro area, as well as strong corporate earning announcements, (4) news about continued foreign reserves diversification away from the US dollar, and (5) the expectation that

the Federal Reserve would maintain the policy interest rate (Fed funds rate) at a low level for an extended period.

However, towards the end of November, concerns regarding the possible default of Dubai World on its debt disrupted the stock markets worldwide and induced a safe haven flight to the US dollar. This reversal led to a temporary depreciation of the Thai baht and other regional currencies, which was short-lived due to their limited exposure to Dubai World. Moreover, the concerns were alleviated after the UAE had provided the liquidity assistance to the affected commercial banks in Dubai.

Towards the end of the quarter, the Thai baht weakened once again, owing to year-end demand for US dollars by foreign investors and financial institutions in preparation for the long holiday. Moreover, the recent better-than-expected US economic data also led the market to price in an earlier Fed funds rate hike.

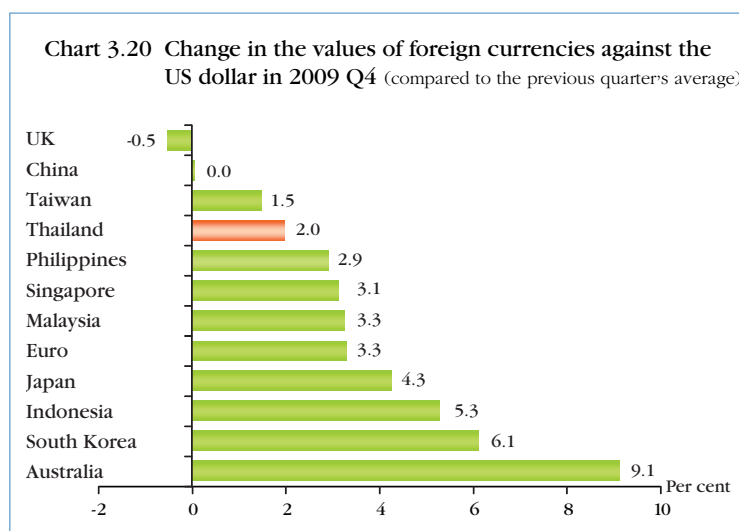


Sources: <sup>1/</sup> Bank of Thailand  
<sup>2/</sup> Bloomberg

*Most currencies appreciated against the US dollar amidst a resumption of risk appetite.*

Other major and regional currencies also appreciated against the US dollar in 2009 Q4, due to the aforementioned surge in risk appetite. The gain was largest for the Australian dollar, which was supported by a comparatively positive outlook for recovery in Australia as well as a brisker pace of policy normalization. The Korean won also appreciated markedly, due to a positive trade balance, improved economic data, and an expectation that the Bank of Korea may raise the policy rate sooner than expected. The pound sterling was volatile, with some short-term upswings in response to positive economic releases, but overall depreciated from the previous quarter from the worries on the country's fiscal deficit, its fragile economic recovery, and concerns about the impact of Dubai World's default on British commercial banks.

Similarly, the euro and the yen rose against the US dollar from the previous quarter's average. The yen was initially under pressure early in the quarter from greater demand for risky assets, but strengthened subsequently as investors turned to the US dollar as a

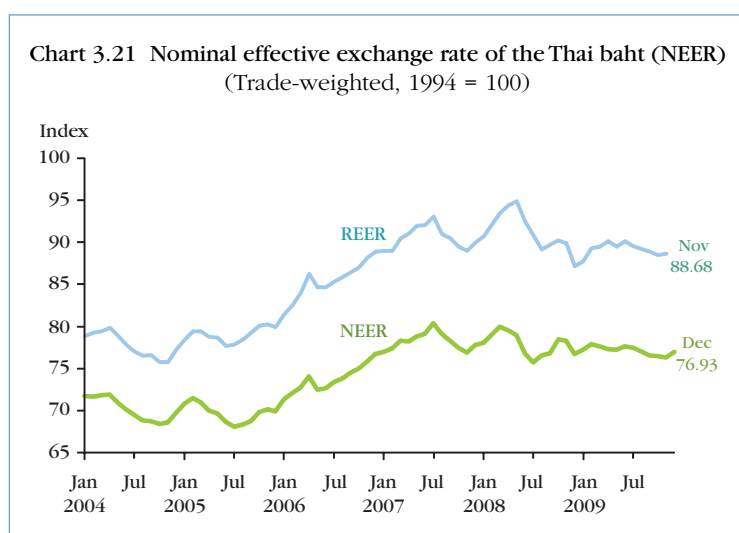


Source: Bank of Thailand

funding currency. Strong Japanese economic data and a bout of risk aversion from the Dubai World problems also contributed to an appreciation in the yen. The euro also appreciated against the US dollar, benefiting from an improvement in economic data as well as the demand by various central banks seeking to diversify their foreign reserves.

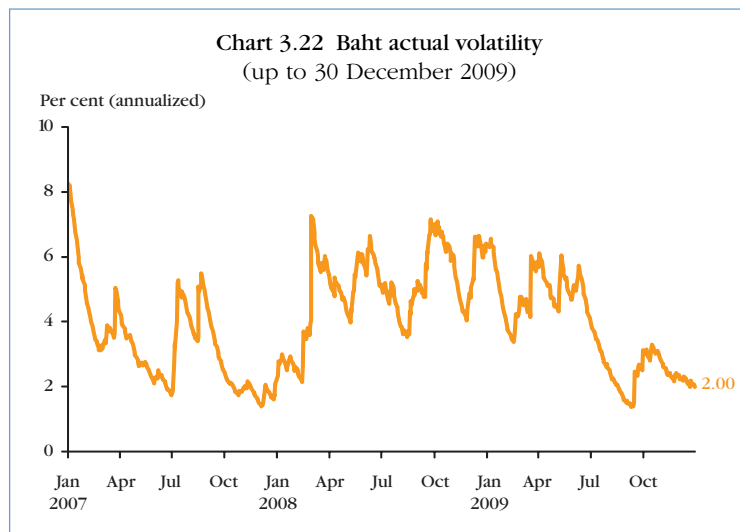
The appreciation of the baht against the dollar was comparatively subdued relative to many other currencies, causing the nominal effective exchange rate (NEER)<sup>2/</sup> to weaken slightly by 0.57 per cent from the previous quarter's average.

The real effective exchange rate (REER), calculated by deflating the NEER by relative inflation rates to reflect the country's price competitiveness, also trended downwards in line with the NEER depreciation. On average, the REER declined from the previous quarter's average by 0.77 per cent in the first two months of 2009 Q4.



Source: Bank of Thailand

<sup>2/</sup> The Thai baht NEER is calculated as a weighted average of bilateral exchange rates between the baht and major trading partners' currencies.



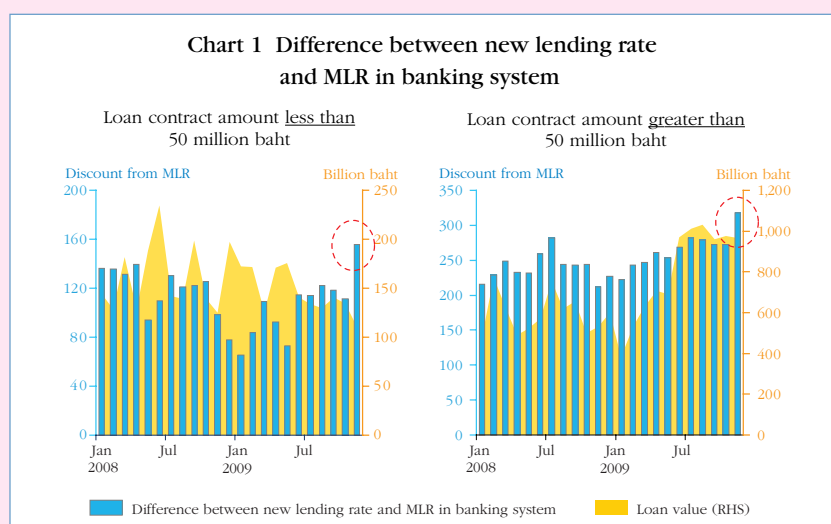
Source: Bank of Thailand

The average volatility of the Thai baht vis-à-vis the US dollar in 2009 Q4 increased from the previous quarter, stemming from relatively active foreign exchange transactions by foreign investors, commercial banks and exporters seeking to reduce their US dollar holding. Towards the quarter end, the pressures from the demand and supply sides were more balanced, and the baht consequently moved within a narrow range with subdued volatility.

## *The role of banks in sustaining the economic recovery*

The rapid eruption of the global financial crisis in the last quarter of 2008 has extensively affected both the global and Thai economies, leading to the deterioration in demand for exports as well as business and consumer confidence. As a result, there had been a drastic decline in credit outstanding of financial institutions since the start of 2008, induced by (1) heightened risk aversion of financial institutions and consequently a drop in loan supply, and (2) weakened demand for loans during the economic slowdown. Nevertheless, the November data suggest that there have been positive developments in the credit market, signaling tentative signs that the banks' deleveraging process may have come to an end:

1. The private credits provided by commercial banks expanded from the previous month in a wide range of sectors, including the business loans that had been falling since the beginning of the year. Household credits also continued to grow, with outstanding household credits in all categories already reaching their pre-crisis levels.



2. Despite leaving the reference loan rates unchanged since mid-2009, some commercial banks had recently been lending at a discount (as shown in chart 1), implying a higher degree of price competition in the loan market.

3. According to the latest survey taken in 2009 Q4, most senior loan officers were of the view that the demand for both business and household loans would continue to grow into the first quarter of 2010. They also expected the credit standards to be eased significantly.

4. Liquidity in the commercial bank system remains ample and sufficient to accommodate the expansion of demand for credits looking ahead.

Another encouraging development in the credit market has been the sign of competition among commercial banks to attract deposits. As most commercial banks did not anticipate an imminent increase in the policy interest rate, they opted against adjusting the deposit rates and instead focused on non-price competition strategies, such as offering special saving products. The small and medium-sized banks were looking to mobilize funds in order to accommodate greater credit expansion expected in the periods ahead, while larger banks engaged in competition mainly to maintain the existing deposit base. SFIs have also launched campaigns to mobilize funds to meet greater credit extension expected as a result of the government policy. Nonetheless, the overall degree of competition in the deposit market remains moderate.

The aforementioned developments point towards an increase in the private demand for loans, and a more accommodative outlook in credit supply. With credit standards continuing to ease and banks charging effective lending rates with greater discount, the noticeable expansion of credit growth in November should have sufficient momentum to continue expanding going forward. Therefore, it is likely that the commercial banks' deleveraging process has come to an end, and the banking system should serve as an important engine for a self-sustaining economic recovery the period ahead.