

### 3. Monetary Conditions and the Exchange Rates

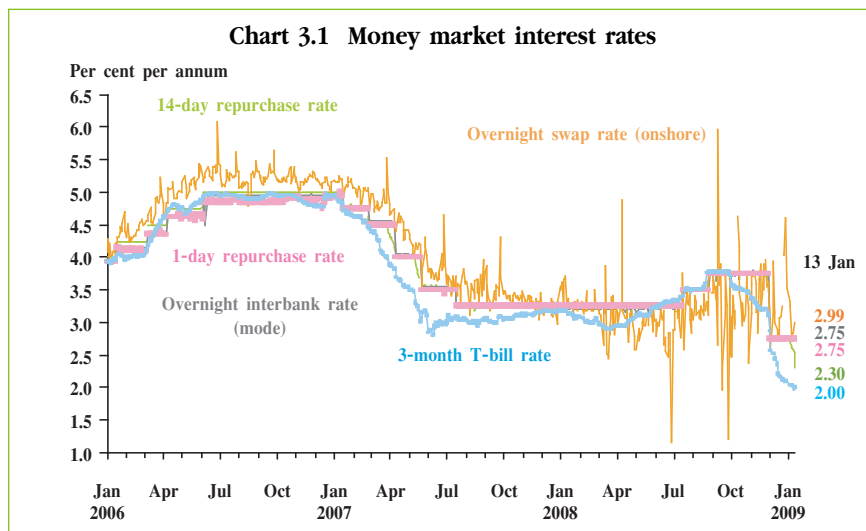
Following the release of the previous *Report*, the MPC met on 3 December 2008 and assessed that the impact of the global financial crisis on the Thai financial sector remained limited. However, the larger-than-expected growth slowdown in industrial economies would have an adverse impact on the export sector. In addition, domestic political problems were likely to delay the impact of fiscal stimulus. Going forward, risks to growth to the Thai economy increased significantly, whilst risks to inflation decreased markedly and were likely to remain low throughout 2009. Given the significant shift in the environment, the MPC assessed that monetary policy could be eased to help support economic recovery, particularly as the economy faced numerous negative risks, both on the domestic and external fronts. The MPC therefore decided to lower the policy interest rate by 1.00 per cent per annum, from 3.75 per cent per annum to 2.75 per cent per annum.

Subsequently, during the meeting on 14 January 2009, the MPC assessed that even though the domestic political situation, which began to stabilize, should help enable the implementation of economic stimulus measures, risks to growth increased markedly as a result of severe recession in industrial economies. Given the fact that risks to inflation remained low, the MPC was of the view that monetary policy could be eased further and decided to lower the policy interest rate by 0.75 per cent per annum, from 2.75 per cent per annum to 2.00 per cent per annum.

#### **Money market conditions**

In Q4 2008, short-term money market interest rates for both collateralized and uncollateralized lending in Thai baht moved closely in line with the policy rate. Following the reduction of the policy interest rate in December, short-term money market interest rates adjusted in the same direction and magnitude. As a result, the 1-day repurchase rate and the overnight interbank rate averaged at 3.46 and 3.45 per cent, respectively, a decrease from an average of 3.56 and 3.54 per cent per annum in the previous quarter.

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



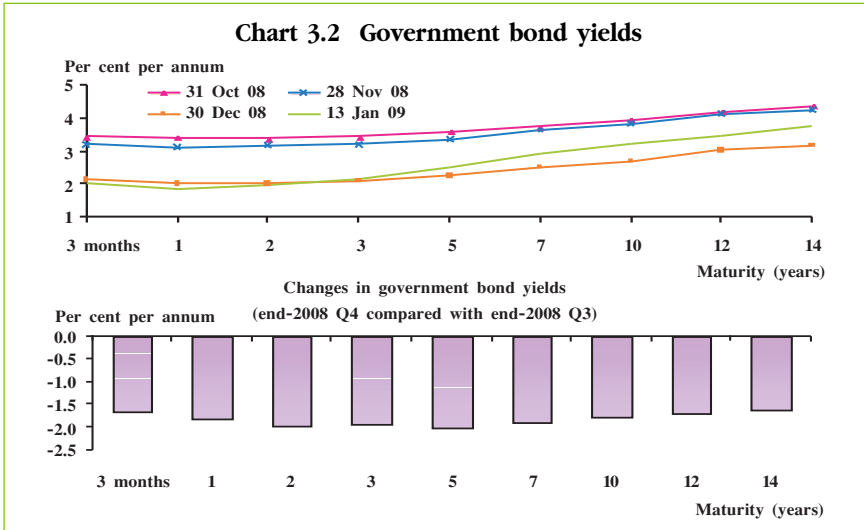
Source: Bank of Thailand

Nevertheless, the overnight swap rate, which reflected the cost of borrowing Thai baht using US dollar as collateral, still fluctuated somewhat. This was due to the tightening of USD liquidity during some periods following the shortage of USD in global money markets. The overnight swap rate averaged at 3.31 per cent per annum, a slight increase from the average of 3.24 per cent per annum in the previous quarter.

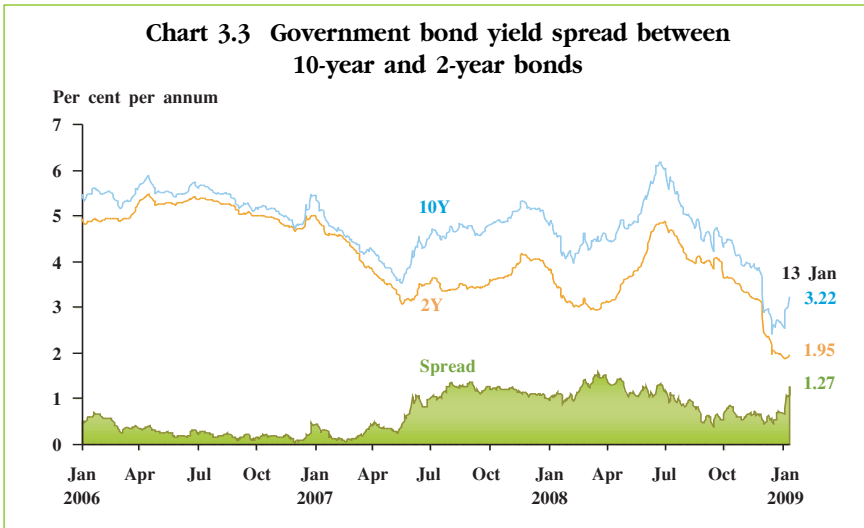
*The yields on long-term government bonds declined in line with inflation expectation and the policy interest rate.*

Government bond yields declined on average this quarter, in tandem with investors' expectation of a downward trend for the Thai economy and the resulting decline in inflation and the policy interest rate since the beginning of the quarter. Additionally, risk aversion prompted investors to divert their investment from the stock market into the bond market, which was considered a safer option. This in turn led government bond yields to decline further.

The aforementioned change in investors' expectation caused the implied forward curve, which reflected future short-term rates anticipated by the market, to decline throughout the last quarter of 2008. The short-term interest rate ten years from now decreased in tandem with lower inflation expectations in the medium term, whilst short-term interest rates 1-2 years from now continued to decline to a

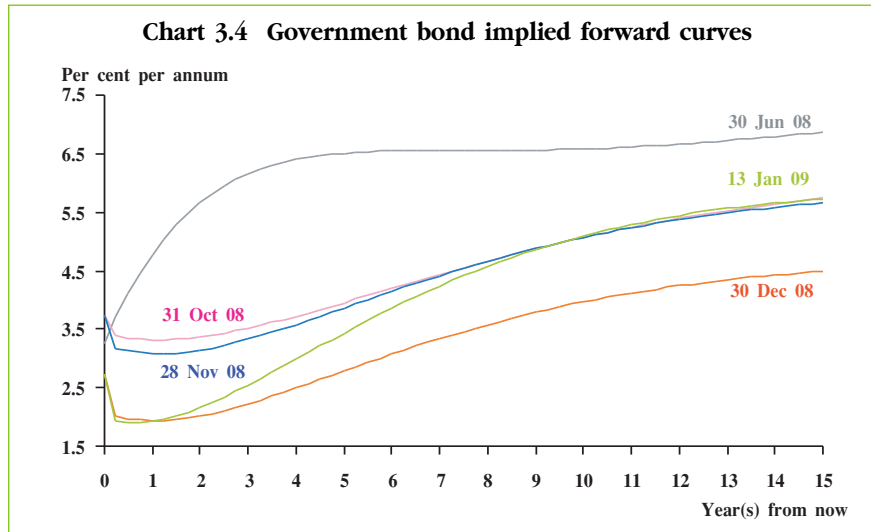


Source: Bank of Thailand



Source: Bank of Thailand

level lower than the policy rate, especially during the latter part of the quarter. This reflected market expectation of further policy interest rate cuts to support economic recovery, given that risks to inflation remained low.



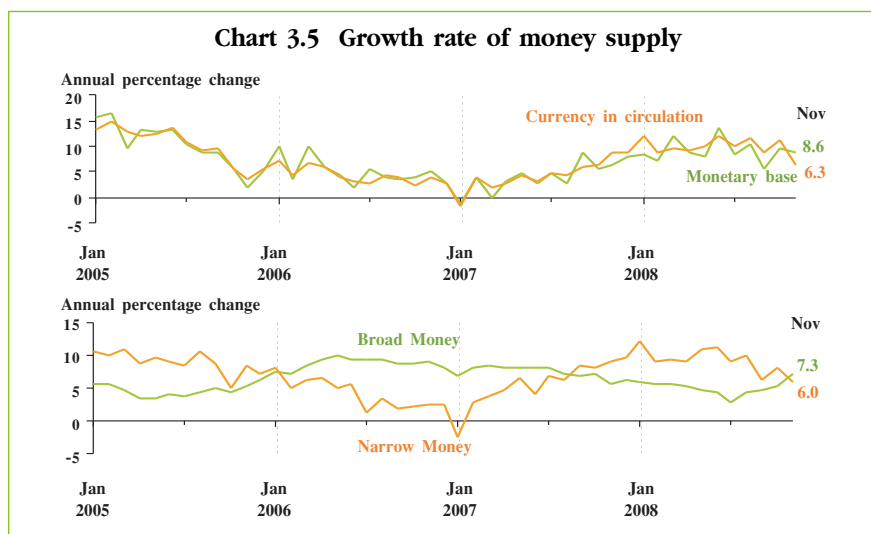
Source: Bank of Thailand

### Monetary base and money supply

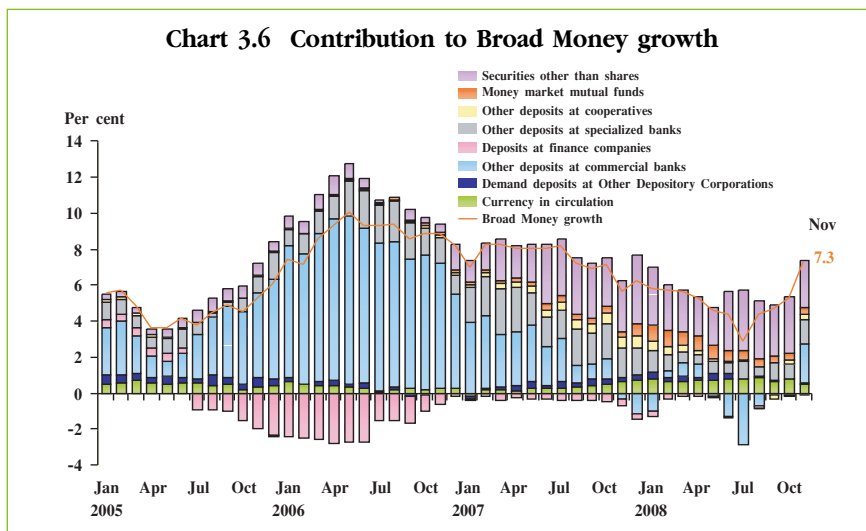
*The monetary base slowed down in line with decelerating economic growth and inflation.*

In October and November 2008, the monetary base expanded by 9.1 per cent compared to the same period of the previous year. However, since the middle of 2008, monetary base and currency in circulation exhibited a decreasing trend. This was reflected in the moderation of economic activities and softer inflation in the previous period.

Broad money in October and November 2008 grew at the rate of 5.1 and 7.3 per cent, respectively. This expansion was mainly due to



Source: Bank of Thailand



Source: Bank of Thailand

an increase in commercial banks' deposits and securities issued by commercial banks. Risk aversion also prompted investors to divert more of their investments to markets with lower risk. Moreover, some investments in securities abroad which reached maturity gradually returned into the banking system. It should be noted that in this *Inflation Report*, the definition of broad money had been revised to include bills of exchange, money market mutual funds as well as deposits at savings cooperatives. This change of definition was intended to ensure consistency of the measure of broad money with international standards for compilation of financial statistics.

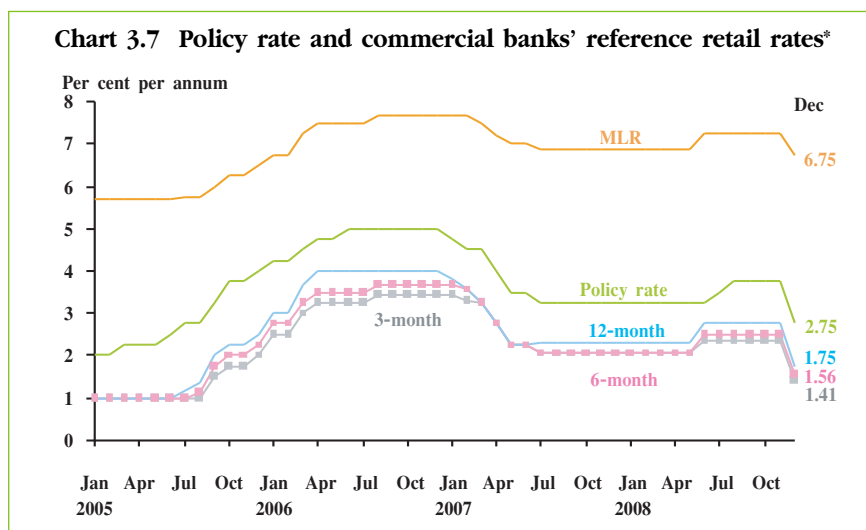
### **Adjustments of the banking system**

After the MPC decided to lower the policy interest rate by 1.00 per cent per annum on 3 December 2008, most commercial banks gradually adjusted their reference interest rates downward for both deposits and loans. As a result, the 3-month and 12-month time deposit rates of the 4 largest commercial banks at the end of 2008 Q4 averaged at 1.41 and 1.75 per cent per annum, respectively, while the MLR of the four largest commercial banks averaged at 6.75 percent per annum. Nevertheless, real interest rates continued to rise from the previous quarter as inflation declined at a faster rate than the fall in reference interest

*Most commercial banks adjusted their time deposit rates and MLR downwards alongside the fall in the policy interest rate. In contrast, the real interest rates edged up as the decrease in inflation outweighed the interest rates fall.*

Table 3.1 The policy rate and banks' reference retail rates*								
Unit: Per cent per annum	2006	2007				2008		
	Dec	Mar	Jun	Sep	Dec	Oct	Nov	Dec
<b>Policy rate</b>	5.00	4.50	3.50	3.25	3.25	3.75	3.75	2.75
<b>Average reference retail rates of the 4 largest banks</b>								
Savings	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
3-month	3.44	3.25	2.25	2.06	2.06	2.37	2.37	1.41
6-month	3.69	3.25	2.25	2.06	2.06	2.50	2.50	1.56
12-month	4.00	3.25	2.25	2.31	2.31	2.75	2.75	1.75
24-month	4.69	3.69	2.50	2.50	2.50	3.50	3.50	2.50
MLR	7.69	7.50	7.00	6.87	6.87	7.25	7.25	6.75

Note: \*Rates at end-period  
Source: Bank of Thailand

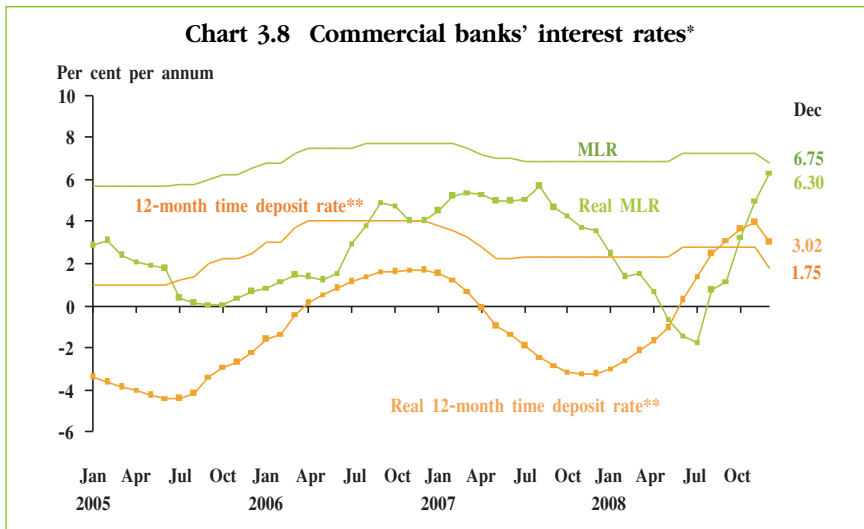


Note: \*Average rate of the 4 largest commercial banks at end-period  
Source: Bank of Thailand

rates. The average real MLR<sup>1/</sup> and real 12-month deposit rate<sup>2/</sup> increased from 0.04 and 2.30 per cent per annum at the end of the previous quarter to 4.83 and 3.56 per cent per annum at the end of this quarter, respectively.

<sup>1/</sup> Real MLR = MLR - contemporaneous headline inflation

<sup>2/</sup> Real 12-month deposit rate = 12-month deposit rate - average forecasted inflation 12 months ahead



Note: \*Average rate of the 4 largest commercial banks  
 \*\*Real interest rates are calculated from the compounded interest rate formula  
 Source: Bank of Thailand

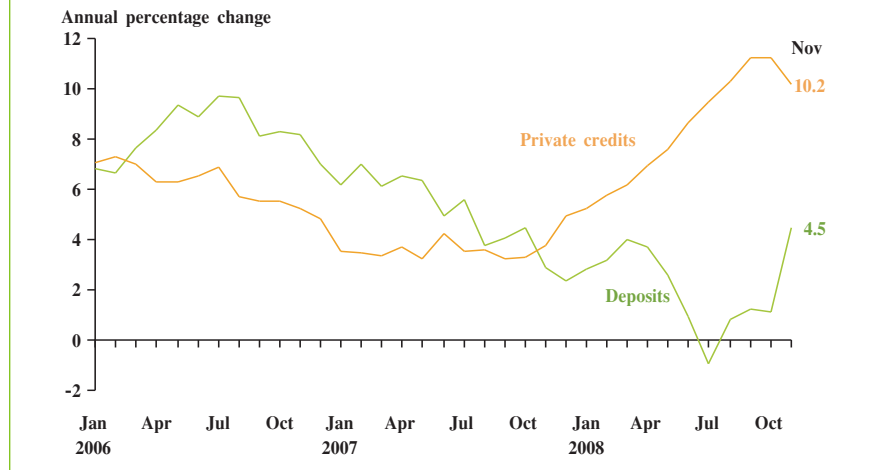
The growth of deposits<sup>3/</sup> of Other Depository Corporations<sup>4/</sup> continued to expand at a low rate but began to show signs of acceleration in the fourth quarter. In October and November 2008, deposits grew by 1.1 and 4.5 per cent from the same period last year, respectively. The acceleration in deposits came about as investors shifted their investment from risky assets, such as foreign securities and bonds, back into deposits. Moreover, the narrower spread between 12-month deposit rate and 1-year government bond yield reflected improving returns on deposits, resulting in an expansion of deposits.

*Deposits expanded at a faster rate as investors shifted away from riskier assets.*

<sup>3/</sup> In this *Inflation Report*, the series for deposits and credits of Other Depository Corporations were adjusted by including data for saving cooperatives and money market mutual funds. Additionally, negotiable certificates of deposit (IMF definition) were excluded from the deposit series; as a result, figures on deposits are slightly lower after adjustment.

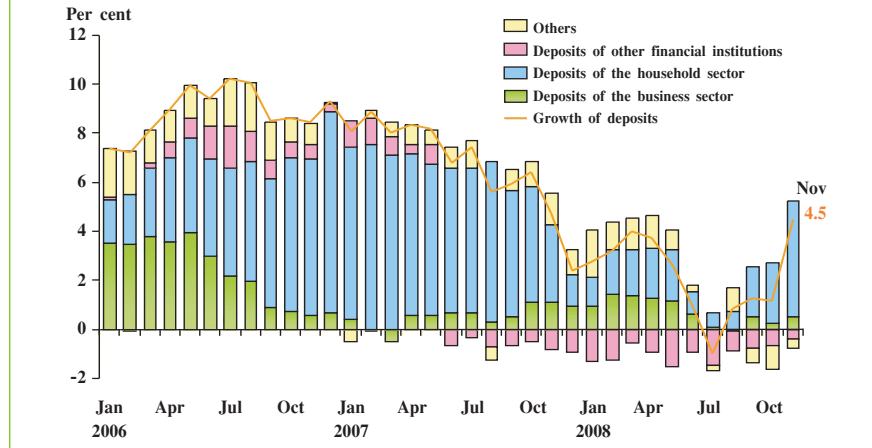
<sup>4/</sup> Other Depository Corporations comprise of domestically registered commercial banks, branches of foreign banks, international banking - facilities, finance companies, Specialised Financial Institutions (including Government Savings Bank, Government Housing Banks, Bank for Agriculture and 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 3.9 Other Depository Corporations' deposits and private credits**



Source: Bank of Thailand

**Chart 3.10 Contribution to growth of deposits of Other Depository Corporations**

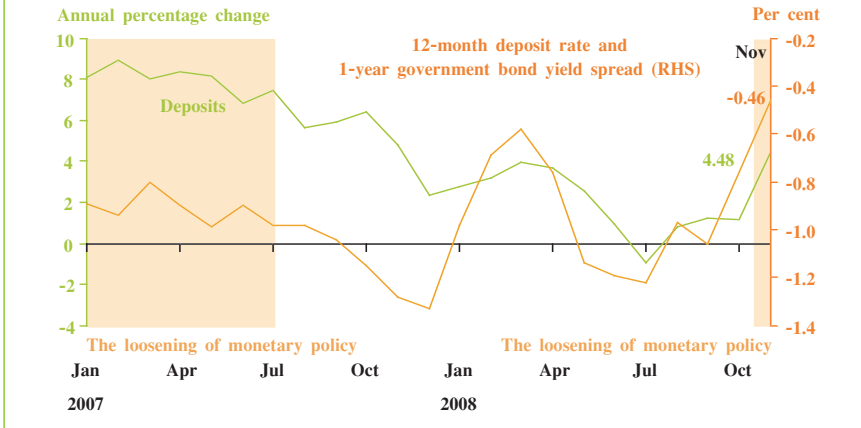


Source: Bank of Thailand

*The growth in private credits began to slow down, mainly as a result of the fall in credits extended to the corporate sector.*

The growth of private credits at Other Depository Corporations began to slow down in this quarter, particularly corporate sector credits, corresponding to weaker economic conditions and lower pressure on the costs of production. This resulted in a remarkable slowdown in the need for more working capital compared to the same period last year. Of total credits extended to the corporate sector, credits extended for use as working capital expanded by 17.4 and 13.2 per cent year-on-year in October and November 2008, respectively, compared to the average

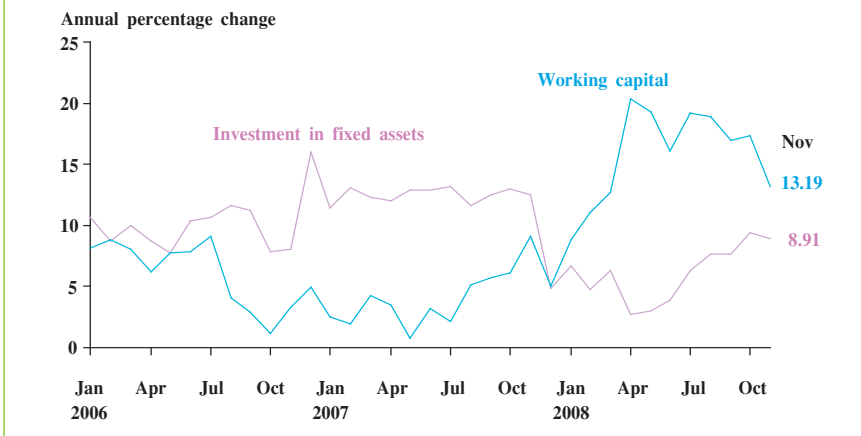
**Chart 3.11 The spread of 12-month deposit rate and 1-year government bond yield, and the growth of Other Depository Corporations' deposits**



Source: Bank of Thailand

expansion of 18.4 per cent in the previous quarter. Moreover, consistent with weakened outlook for the economy and a higher risk perception, the demand for loans for investment in capacity expansion began to decline.

**Chart 3.12 Corporate loan growth rate of commercial banks classified by purpose**



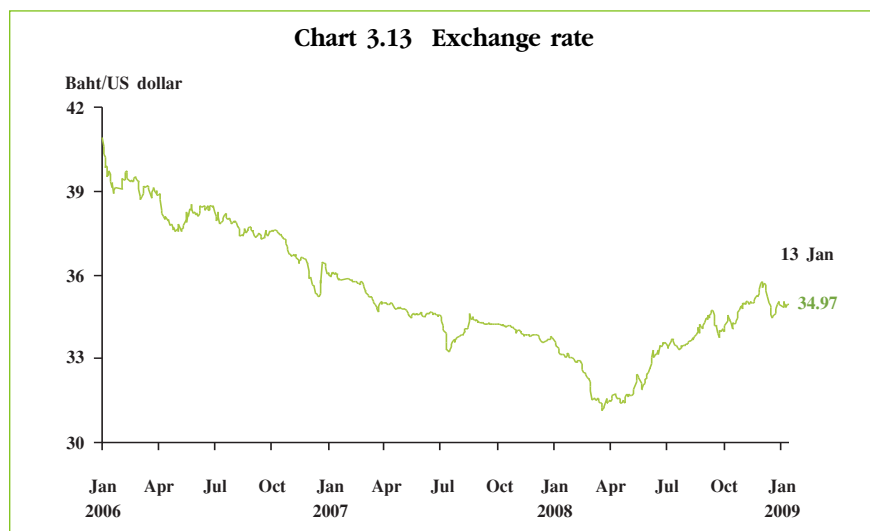
Source: Bank of Thailand

## Exchange rates and capital flows

*The Thai baht continued to depreciate from the previous quarter from both domestic and external factors.*

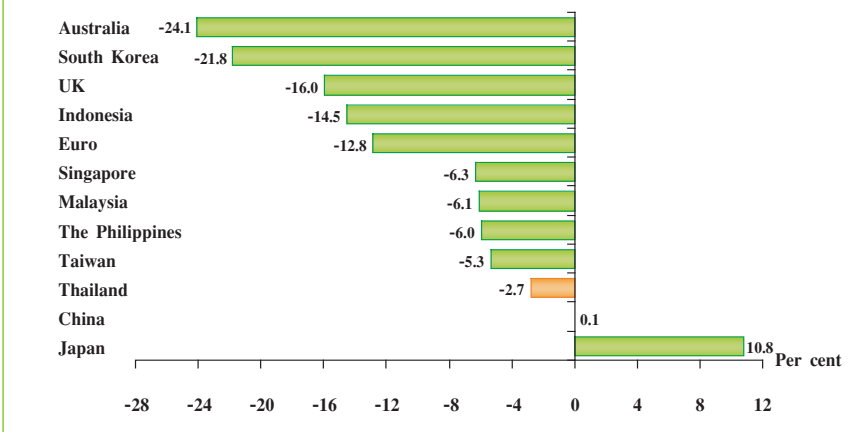
In 2008 Q4, the Thai baht continued to depreciate from the previous quarter. The depreciation that lasted until mid-December was partially due to the strengthening of the US dollar from the risk aversion that moved international investors towards lower-risk assets nominated in the US dollar such as US Treasury bills. Furthermore, between end-November and early-December, the Thai baht was weakened by domestic factors such as political unrest and the closure of Bangkok's international airports. These incidents affected investor confidence as well as the tourism industry, which had been an important source of foreign income.

During the latter half of December, the baht regained some of its strength as global investor confidence improved, as reflected by higher risk appetite as funds left the US for investment in riskier assets in regional capital markets. Moreover, the formation of a new government led markets to view that the fiscal stimulus package could be implemented without any major delay. Nevertheless, towards the end of the year, high demand for US dollar from gold and oil importers before the long holidays induced another bout of Thai baht depreciation. On average, the baht depreciated by 2.7 per cent from the average value in the previous quarter.



Source: Bank of Thailand

**Chart 3.14 Change in the values of foreign currencies against the US dollar**  
(average in 2008 Q4 compared with 2008 Q3)



Source: Bank of Thailand

Despite the weakening of the baht against the US dollar, the Thai baht appreciated against regional peers (except for the yen that recently appreciated from the unwinding of carry-trade transactions) as investors expected that the impact of the crisis on the Thai financial sector would be less than that experienced by others countries in the region. As a result, the Nominal Effective Exchange Rate (NEER)<sup>5/</sup> appreciated significantly from the previous period.

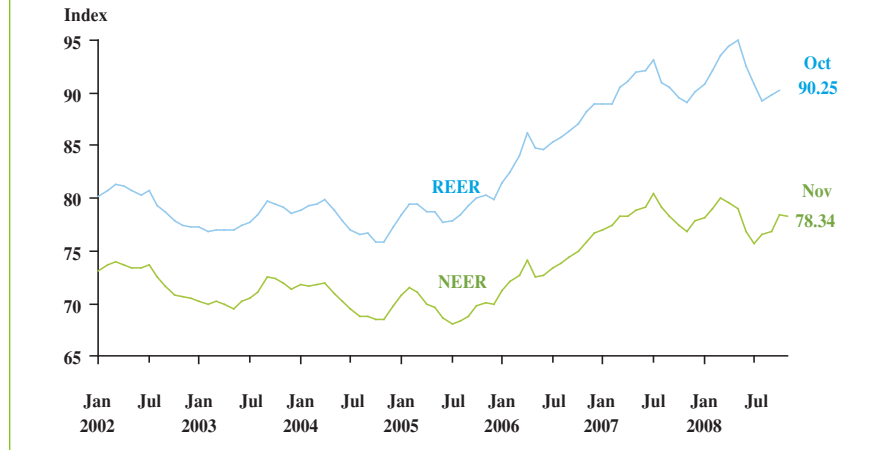
*The nominal effective exchange rate fluctuated during the quarter, but reported a slight appreciation overall from the previous period.*

Nonetheless, the depreciation of the baht exchange rate against most currencies towards the end of November as a result of domestic unrest led the NEER to weaken sharply. On average over the quarter, however, the NEER appreciated slightly by 2.0 percent compared to the previous period.

The Real Effective Exchange Rate (REER), calculated by deflating the NEER by relative inflation in order to reflect the country's price competitiveness, also registered a slight appreciation in October and then a decline in November in tandem with the NEER. The REER was expected to decline in December as a result of a fall in the NEER together with an overall decline in domestic inflation compared to that in major trading partners.

<sup>5/</sup> The Thai baht NEER is calculated as a weighted average of bilateral exchange rates between the baht and major trading partners' currencies.

**Chart 3.15 Nominal effective exchange rate of the Thai baht (NEER)**  
(Trade-weighted, 1994 = 100)

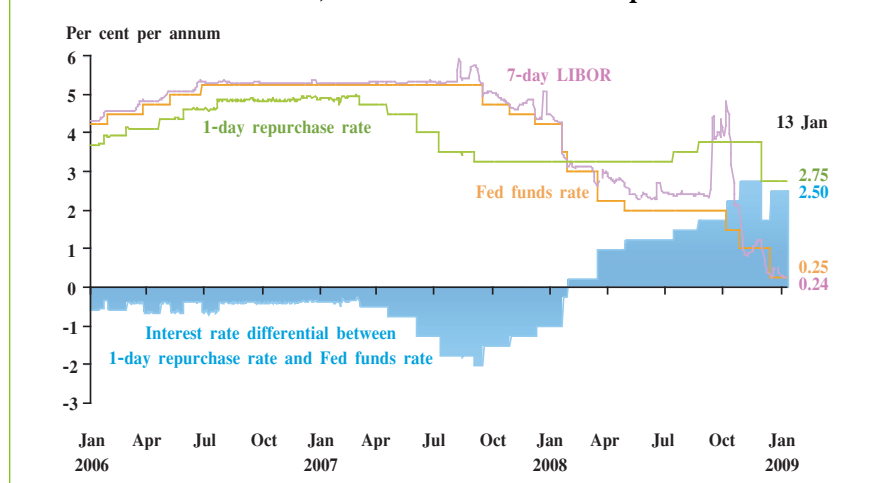


Source: Bank of Thailand

*The difference between the Thai and US policy rates at the end of 2008 widened but had no significant impact on capital flows.*

In 2008 Q4, the MPC decided to cut the policy interest rate by 1.00 per cent, while the FOMC reduced the Fed funds rate 3 times, totaling 1.75 per cent. As a result, the interest rate differential between Thai and US policy rates increased to 1.75 percent at end-quarter. Nevertheless, the widening interest rate gap had no significant impact on capital flows, which in recent periods were more sensitive to political factors and concerns over the ongoing global slowdown.

**Chart 3.16 LIBOR, Fed funds rate and Thai repurchase rate**



Source: Bank of Thailand

Overall external stability remained satisfactory. International reserves, inclusive of the BOT's net forward position, increased from 115.8 billion US dollars from the end of the previous quarter to 118 billion US dollars at end-December. At the same time, the ratio of international reserves to short-term debt registered at 4.0 at the end of October and was expected to rise in December due to the recent additional international reserve accumulation.

*Overall external stability remained satisfactory.*

Table 3.2 Balance of payments								
Unit: Billion US dollars	2007	2007		2008 <sup>P</sup>				
		H1	H2	H1	Q3	Oct	Nov <sup>E</sup>	Jan-Nov <sup>E</sup>
Current account balance*	14.0	5.1	9.0	3.1	-1.3	-1.1	-0.9	-0.3
Net capital flows*	-2.4	-1.6	-0.8	10.0	0.7	3.3	-0.2	13.8
Bank of Thailand	-0.6	-0.8	0.1	0.3	-0.1	-0.1	-0.05	0.1
Public	-2.2	-1.8	-0.4	0.2	-0.5	0.0	0.02	-0.3
Bank	-1.1	-6.7	5.5	5.5	2.1	2.3	-1.3	8.6
Others	1.6	7.6	-6.1	4.1	-0.8	1.0	1.1	5.4
Balance of payments	17.1	5.7	11.4	16.0	0.5	4.0	2.2	22.7

Note: \* "Reinvested earnings" are recorded as part of direct investment in the financial account, and its contra entry recorded as 'investment income' in the current account

P = Preliminary

E = Estimated data and will be adjusted except the current account balance.

Source: Bank of Thailand