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Monetary Policy Report, December 2020

The Bank of Thailand (BOT) released the December 2020 issue of the *Monetary Policy Report*. The *Report*, published quarterly, is aimed at enhancing public understanding of the Monetary Policy Committee (MPC)'s policy stance and its assessment of Thailand's economic outlook. Details are summarized as follows.

Monetary Policy Conduct in the Fourth Quarter of 2020

At the meetings on November 18 and December 23, 2020[1/], the Committee voted unanimously to maintain the policy rate at 0.50 percent. The Committee projected that the Thai economy would see a smaller contraction in 2020 than previously assessed and continue to recover in 2021 and 2022. However, there could be adverse risks to the baseline projection. In particular, uncertainty surrounding the COVID-19 situation in the near term, as well as uncertainty regarding vaccine efficacy and vaccination coverage which could be limited, consequently affecting the progress in the admission of foreign tourists in the period ahead. In addition, uneven recoveries across economic sectors and areas would affect sustainability of economic growth going forward. The Committee assessed that the economy still needed support from the continued low policy rate, and thus the limited policy space should be preserved for the appropriate and most effective timing. Under the monetary policy framework with objectives of maintaining price stability, supporting sustainable and full-potential economic growth, and preserving financial stability, the Committee continued to put emphasis on supporting economic recovery. The Committee would stand ready to use additional appropriate monetary policy tools if necessary.

Going forward, the Committee assessed that the economic recovery would remain highly uncertain, and the continuity of government measures and policy coordination among government agencies would therefore be critical in supporting economic recovery. Uneven recoveries resulted in limited access to credit for some businesses. Thus, financial institutions should expedite debt restructuring and credit extension under various measures, for example, credit guarantee schemes. The Committee also viewed that fiscal measures would continue to play a crucial role in sustaining the economy amid high uncertainties. Moreover, the Committee assessed that the COVID-19

[1/] At the meeting on December 23, 2020, one MPC member was absent.

pandemic would cause some scarring effects on Thailand's economic growth potential in the long term. Therefore, structural reforms would be needed and should be accelerated alongside demand-management stimulus measures to boost economic recovery in the short term.

Assessment of the Economic and Financial Outlook as the Basis for Policy Formulation

1. Global Economy

The global economy would contract in 2020 by less than the previous assessment due to the recovery in global economic activities since the third quarter after the relaxation of outbreak containment measures. Looking ahead, trading partner economies would pick up as the pandemic subsided. Effective COVID-19 vaccines coupled with extensive vaccination coverage, ongoing fiscal measures and accommodative monetary policy would support economic recovery in the period ahead. **The Committee assessed that Thailand's trading partner economies would contract by 3.8 percent in 2020, before expanding by 4.8 and 3.1 percent in 2021 and 2022, respectively.** Risks to trading partners' growth remained tilted to the downside, albeit less so than the previous assessment, thanks to the higher-than-expected vaccine efficacy and vaccination coverage, and the positive outlook regarding the new U.S. president's international trade policy, that supported global trade sentiment.

Governments worldwide continued to implement fiscal measures, with some countries announcing economic recovery packages, to alleviate short-term and long-term economic impacts of the COVID-19 pandemic. At the same time, central banks in major advanced economies continued to maintain accommodative monetary policy, including both quantitative easing and low policy rates. The European Central Bank announced further expansions of asset purchases programs. Meanwhile, some regional central banks further cut their policy rates, such as the Bangko Sentral ng Pilipinas (BSP), and Bank Indonesia (BI).

2. Financial Conditions and Financial Stability

Overall financial conditions in Thailand remained accommodative. Short-term interest rates in financial markets remained at low levels consistent with the policy rate. Meanwhile, long-term government bond yields declined slightly as a result of higher demand in long-term government bonds. The new loan rates (NLR) edged up for some business sectors, owing partly to the slowdown in credit extension under the soft loan program. With regard to exchange rates, the baht against the U.S. dollar and the effective exchange rate appreciated in the fourth quarter, due to the clarity of the U.S. presidential election results and the news of the efficacy and distribution of COVID-19 vaccines. The Committee expressed concerns over the baht that could appreciate rapidly due to the risk-on sentiment in global financial markets and the weak outlook of the U.S. dollar. The Committee would closely monitor developments in foreign exchange markets, in order to assess the need for additional appropriate measures, as well as continue to expedite new foreign exchange ecosystem.

The Thai financial system remained highly vulnerable amid the slow economic recovery and new waves of the domestic COVID-19 cases. This led to more fragile balance sheets of households and businesses due to high debt levels and consequently deteriorated debt servicing capability. In the period ahead, the economic recovery would remain uncertain and uneven across business sectors, some of which would be unable to return to the pre-pandemic level. Therefore, provision of additional capital to high-potential businesses, appropriate debt restructuring, and adjustments to business structures and models would help mitigate these risks.

3. Economic and Inflation Outlook

Assumptions underlying the economic projection[2/] are summarized as follows. First, the government could contain new waves of COVID-19 infections in Thailand within a short period of time with strict measures imposed only in Samut Sakhon. Meanwhile, the number of cases in other areas could be brought under control by partial restrictions on some economic activities and without necessitating strict and extensive containment measures. As such, the services sector would only be partly affected while the impact on the manufacturing sector would not be significant. Second, COVID-19 vaccines would be widely available abroad by mid-2021. Vaccination in Thailand could commence in the second half of 2021, such that Thailand could re-open to foreign tourists without quarantine requirements, given that they could present vaccination certificates and negative COVID-19 test results. Then, by the end of 2022, Thailand would re-open for commercial flights and admit foreign tourists without quarantine or vaccination requirements. Third, disbursement of government budget under the post-COVID economic recovery plan would be expedited effectively.

The Thai economy was projected to contract in 2020 by 6.6 percent, which would be a smaller contraction than the previous assessment thanks to the faster-than-expected recovery in nearly all economic growth components in the third quarter. In particular, merchandise exports gradually improved in line with trading partner economies. Moreover, private consumption benefited from the relaxation of domestic containment measures as well as government measures that shored up household purchasing power. Nevertheless, tourism and private investment contracted sharply. **In 2021, the economy was projected to expand by 3.2 percent**, as merchandise exports would improve in tandem with trading partner economies' growth. Meanwhile, exports of services would contract more sharply and recover more slowly than previously assessed, as the admission of foreign

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[2/] Forecasts released on December 23, 2020 took into consideration the effects of containment measures in Samut Sakhon. However, the projections did not incorporate the impacts of new waves of infections that spread over other provinces and those of more stringent measures which took effect on January 4, 2021.

tourists to Thailand would likely be limited by the prolonged and severe COVID-19 situation abroad. With regard to domestic demand, new waves of infections would remain a main drag on private consumption. Meanwhile, public expenditure would remain a key economic driver. However, the government support would wane somewhat due to downward revision in the fiscal year 2021 annual budget and the carryover budget, following disbursement acceleration in 2020. Furthermore, some state-owned enterprise (SOE) investment projects were postponed and their budgets were reduced. **In 2022, the economy was projected to expand by 4.8 percent**, given the recovery of foreign tourist figures on the back of a widespread coverage of COVID-19 vaccination in Thailand and abroad. In the second half of 2022, GDP would return to the pre-pandemic level.

The value of Thai merchandise exports would decline by 7.4 percent in 2020. Exports to China and Europe remained subdued, while those to the U.S. and Australia grew past the pre-pandemic level. Merchandise exports were projected to expand by 5.7 and 5.0 percent in 2021 and 2022, respectively. However, Thailand's exports would recover at a slower pace than those of its trading partners, since Thai exports consisted of a relatively small share of electronic products, which benefited the most from COVID-19, compared with other regional countries.

The tourism industry would recover at a slower pace than previously assessed. The prolonged COVID-19 situation abroad and in Thailand would result in limited admission of foreign tourists to Thailand and a need for strict public health measures. The number of foreign tourists was projected to record 6.7 million and 5.5 million in 2020 and 2021, respectively. Nevertheless, foreign tourist figures would grow in proportion to vaccination in Thailand and abroad, and would accelerate toward the latter half of 2022 when Thailand could start admitting tourists without vaccine screening. The Committee thus projected that the number of foreign tourists would surge to 23 million in 2022.

Private consumption would contract in 2020 by less than the previous forecast, owing partly to the government stimulus packages to support domestic tourism and private consumption, which underpinned a swift recovery in economic activities after the lifting of lockdown restrictions. Another underlying factor was the gradual recovery of the labor market as reflected by the decline in numbers of unemployed and underemployed workers. Nevertheless, new waves of domestic COVID-19 cases, the phase-out of government measures, and the fragile recovery of the labor market would weigh on private consumption in the period ahead. Private consumption was projected to expand by 2.8 and 3.0 percent in 2021 and 2022, respectively.

Private investment would significantly contract in 2020, given high levels of excess production capacity and uncertainties surrounding economic recovery in Thailand and abroad. Nonetheless, private investment was projected to grow by 4.9 and 5.0 percent in 2021 and 2022, respectively, on the back of recovery in merchandise exports and private consumption, as well as the progress of public-private partnership (PPP) investment projects, particularly in the EEC.

The current account balance was projected to register a surplus of 16.2 billion U.S. dollars in 2020, due to the larger-than-expected trade surplus in the third quarter of 2020. Meanwhile, the surplus was projected to decrease to 11.6 billion dollars in 2021, mainly attributable to the decline in tourism receipts. In 2022, the current account surplus was expected to rise to 29.1 billion dollars thanks to the increase in tourism receipts following the re-opening to foreign tourists without quarantine and vaccination requirements.

Going forward, the economic recovery would remain highly uncertain and could underperform the baseline projection due to the following factors. First, new waves of domestic COVID-19 infections could intensify and become more widespread, (**Box: The Thai Economy and the New Wave of COVID-19**) triggering another round of strict and extensive containment measures. Second, COVID-19 vaccines could be less effective than expected or vaccine distribution could take longer than expected due to certain limitations, delaying the re-opening of the country to foreign tourists. Third, fiscal stimulus could be lower than estimated in the baseline projection if budget approvals for projects under the Emergency Decree were delayed. Fourth, balance sheets of businesses could deteriorate and eventually resulting in permanent shutdowns. This could cause scarring effects whereby recovery of businesses would be hindered even after the pandemic subsided. Fifth, default rates of businesses and households could surge after the phase-out of the credit relief measures, with could in turn affect the overall financial system stability.

Headline inflation in 2020 was projected to be close to the previous assessment at negative 0.9 percent, while headline inflation in 2021 would be at 1.0 percent as previously forecasted. The higher oil price projection was offset by the lower fuel adjustment surcharge (Ft) and the high-base effect in 2020 from fresh food prices. Meanwhile, core inflation was projected to remain low at 0.3 percent in both 2020 and 2021, before edging up to 0.4 percent in 2022 in tandem with the gradual recovery in demand. The Committee assessed that headline inflation would return to the target range around mid-2021, and would remain close to the lower bound of the target range throughout the forecast period.

The Thai Economy and the New Wave of COVID-19

The December 2020 *Monetary Policy Report* released the economic projection approved by the Monetary Policy Committee at the meeting on December 23, 2020. The projection was based on data as of December 22, 2020 when the new wave of domestic infections occured only in limited areas and the stringent containment measures were imposed only in Samut Sakhon province as well as the nearby provinces of Samut Prakarn and Samut Songkhram. **The baseline economic projection** was based on assumptions as follows.

(1) Infections would occur only in limited areas, i.e., within Samut Sakhon and the nearby provinces.

(2) No stringent and extensive containment measures would be implemented. Restrictions on certain economic activities in some areas could contain the new wave of infections within one to two months.

(3) The economy would be affected through different channels. For example, some activities in the services sector would be affected. Tourism would be severely affected only in high-risk areas. Meanwhile, the manufacturing sector would not be significantly affected and private consumption would be somewhat affected. Nevertheless, the acceleration of government spending on public health could partly alleviate some adverse economic impacts.

At the start of January 2021, the spread of COVID-19 turn out more severe than previously assessed. This increased the possibilities that the economy would underperform the baseline projection for 2021 and 2022. As of January 4, 2021, 28 provinces were declared maximum control areas and more stringent containment measures were announced with no end-date specified. **The impact on the economy would increase through different channels.** For example, the extent to which private consumption would be affected would depend on the severity of the containment measures being implemented. The services sector and tourism would be affected by the low consumer confidence countrywide. Meanwhile, the impact on the manufacturing sector would be limited, but there could be some difficulties with logistics. **Nonetheless, Thailand made better progress with regard to the purchase of vaccines than previously assessed.** The government had recently secured a certain supply of vaccines, which would allow widespread vaccination coverage to occur earlier than expected. In addition, the government also planned to purchase additional vaccines to cover at least 50 percent of the total population by 2021.

As the new waves of COVID-19 in Thailand would be highly volatile and uncertain, the Committee would closely monitor developments of the situation and assess the economic outlook through public health information together with monthly, weekly, and daily economic indicators as well as information from the Business Liaison Program (BLP) survey in order to inform appropriate monetary policy decisions in the period ahead.

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