BANK OF THAILAND

BOT Press Release

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Monetary Policy Report, December 2019

The Bank of Thailand (BOT) released the December 2019 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 2019

The Thai economy was expected to expand at a lower rate than previously assessed and below potential due mainly to a decline in exports which affected employment and domestic demand. Headline inflation in 2019 was projected to be lower than previously assessed and below the lower bound of the inflation target. Nonetheless, economic growth and inflation were expected to gradually improve in 2020. Financial stability risks had already been addressed to some extent, although there remained pockets of risks that might pose vulnerabilities to financial stability in the future. **The Committee voted 5 to 2 to cut the policy rate by 0.25 percentage point from 1.50 to 1.25 percent at the meeting on November 6, 2019 and voted unanimously to maintain the policy rate at 1.25 percent at the meeting on December 18, 2019.** At the most recent meeting, the Committee viewed that accommodative monetary policy stance following two policy rate cuts in the recent period would support economic growth and the rise of headline inflation toward target. The Thai baht movements were two-way and more in line with regional currencies. However, the Committee remained concerned about baht appreciation against trading partner currencies, and thus saw the need to continue to closely monitor developments of exchange rates and capital flows amid elevated uncertainties. Moreover, the Committee would monitor the effectiveness of the relaxation of foreign exchange regulations to encourage capital outflows and would also consider implementing additional measures if necessary. To ensure financial stability in the period ahead, the Committee viewed that the policy rate, microprudential measures, macroprudential measures, as well as structural policy such as debt restructuring, should be used jointly in an appropriate and well-targeted manner.

Looking ahead, the Committee would be data-dependent by closely monitoring the developments of the outlook for growth, inflation, and financial stability, together with associated risks, in deliberating appropriate monetary policy going forward. The Committee would stand ready to use policy tools as appropriate and monitor structural problems which would affect competitiveness and growth outlook going forward. This should be firmly addressed by all related parties.

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

1. Global Economy

The global economic outlook was expected to further expand. Despite a slowdown in 2019, the global economy would start to exhibit more stabilizing growth in 2020, especially in the manufacturing sector which was expected to improve in tandem with global trade volume, a recovery of the electronics cycle, and improved sentiment after the US and China unofficially reached an agreement on the phase one trade deal. **The Committee thus revised down growth projection of Thailand's trading partner economies to 2.7 percent in 2019, while maintained growth projection at 2.7 percent in 2020. Nonetheless, the probability of trading partner economies underperforming the baseline projection remained** owing to risks to global financial stability which were expected to be more vulnerable. Lower-for-longer policy rates would partly contribute to debt accumulation and increase risks of search-for-yield behavior, which could lead to underpricing of risks. Moreover, uncertainties pertaining to trade tensions remained high as the situation could be prolonged and intensified. Geopolitical risks could also be heightened and widespread. These risks might impact the manufacturing sector, exports, global trade volume, as well as confidence and investment in the period ahead.

Most central banks maintained a dovish monetary policy stance to shore up the economy**.** The Federal Reserve (Fed) cut its policy rate in October 2019 to 1.50 – 1.75 percent. The Fed was expected to keep its policy rate on hold throughout 2020. The European Central Bank (ECB) announced a package of additional monetary policy easing measures in November 2019. The Bank of Japan (BOJ) would likely ease monetary policy further should the economy experience a significant slowdown. Other regional central banks, including Bank Indonesia (BI), Bangko Sentral ng Pilipinas (BSP), the Reserve Bank of India (RBI), Bank of Korea (BOK), and the Reserve Bank of Australia (RBA) lowered their policy rates further to support weakening economic and inflation outlook.

2. Financial Conditions and Financial Stability

Thailand's overall financial conditions were more accommodative following a policy rate cut in November. This was reflected by the real policy rate which declined from the previous quarter and remained at a low level relative to those of other emerging markets (EMs). Interest rates in Thailand's financial markets, including short-term government bond yields, corporate bond yields, and some commercial banks' lending rates, declined in tandem with the policy rate cut. Meanwhile, long-term government bond yields increased in line with their US counterparts, propelled by improved sentiment in the global financial markets following an unofficial agreement between the US and China over the phase one trade deal. Private credit continued to slow down for both business and consumer loans as a result of economic slowdown and more tightening credit standards among financial institutions. The baht appreciated against the U.S. dollar from the end of the previous quarter. However, movements of the baht were two-way and more in line with regional currencies following the policy rate cut and the relaxation of foreign exchange regulations in November to encourage capital outflows. The real effective exchange rate (REER) index also appreciated from the last quarter.

There remained risks in the financial system that could pose vulnerabilities to financial stability in the future. These risks included, for instance, (1) a weakening ability of households to manage liquidity and service debt amid the economic slowdown, (2) substantial oversupply in the real estate market, especially for condominiums, which caused condominium prices to start declining, and (3) the search-for-yield behavior which would persist as domestic and international policy rates would likely be lower for longer. This could lead to underpricing of risks, particularly among saving cooperatives and large corporates.

3. Economic and Inflation Outlook

The Thai economy was expected to expand at 2.5 and 2.8 percent in 2019 and 2020, respectively, which would be below its potential and lower than the previous assessment. Merchandise exports were projected to recover more slowly than expected due to the slowdown in global trade volume affected by trade tensions and the impact of structural changes in the Thai economy on export sector. Public expenditure and private investment would expand more slowly than the previous forecast. However, private consumption in 2019 was expected to be better than estimated thanks to the government's short-term economic stimulus measures. In 2020, consumption was nonetheless projected to slow down in tandem with slower growth in household income and the drought. In 2021, the Thai economy was expected to continue to gain further traction as some public-private partnership (PPP) and public investment projects were postponed to take place in 2021. Details of the forecasts are as follows:

The value of merchandise exports in 2019 was expected to contract by more than previously estimated. Global trade volume would slow down in line with global economy and trade tensions. Moreover, Thai exports would face additional pressures from (1) structural factors including a trade diversion loss to China and the loss of competitive advantage on production cost, (2) baht appreciation, and (3) lower-than-expected prices of export products which were sensitive to oil prices. **However, Thai exports in the period ahead were projected to record a moderate growth in 2020** thanks to improvements in global trade, a gradual pick up in the electronics cycle, as well as an unofficial agreement between the US and China over the phase one trade deal which would lead to reduction and exemption of previously imposed tariffs on import goods.

Exports of services were expected to continue expanding, in line with the outlook of most foreign tourist nationalities. The expansion was partly due to government measures to boost tourism through extending the exemption of visa-on-arrival (VOA) fees until the end of April 2020, although tourist spending per head was expected to somewhat slow down following subdued global economic growth.

Private consumption, in the short-term, was supported by government stimulus measures, but was expected to exhibit slower growth in the period ahead after the effects of such measures wane off and household income becomes weakened. The outlook of employment and work hours would continue to decline and the decline would become more broad-based across many business sectors. Meanwhile, farm income in 2020 was projected to contract following falling production as a result of the drought. In addition, elevated household debt would remain weighing on private consumption.

Private investment was projected to expand at a lower rate than previously assessed due to export contraction which had become more evident. Moreover, profitability and business confidence in investment continued to deteriorate while PPP projects were also delayed. Nonetheless, **private investment in the period ahead would be supported** by export recovery and the continuing infrastructure investment projects, including the 5G network investment.

Public expenditure was expected to expand more slowly than the previous forecast following the ability of government agencies to incur carry-over budget obligations under the new Budget Procedure Act, prolonged delays in state-owned enterprise (SOE) investment, and a reduction in SOE investment budgets in 2020.

Headline inflations in 2019 and 2020 were projected to be below the target and below the previous estimate due mainly to supply-side factors including (1) lower-than-expected energy prices over recent periods and downward revisions in the projection for crude oil prices in the period ahead, and (2) minimum wage hike in 2020 that would be lower than previously assessed. Moreover, core inflation would remain low in line with decelerating demand-pull inflationary pressures. However, **headline inflation was projected to increase from 0.7 percent in 2019 to 0.8 percent in 2020. Meanwhile, core inflation was projected to increase from 0.5 percent in 2019 to 0.7 percent in 2020 in line with the outlook of economic recovery and the impact of minimum wage hike. Headline inflation was anticipated to return to the target during the second half of 2021.**

Risks to economic growth and inflation projections remained tilted to the downside. The possibilities that the Thai economy would underperform the baseline projection would be due to (1) slower-than-expected growth in global trade volume and trading partner economies as a result of trade tensions which could re-intensify, (2) more-than-expected impact of a potential delay in the enactment of the Annual Budget Expenditure Act, B.E. 2563 (A.D. 2020) on public expenditure, as well as potential implementation delay and lack of continuity in government policies, (3) larger-than-expected effects from a slowdown in household income growth on private consumption, as well as the impact of intensifying drought, and (4) global financial stability risks which could impact the economy in the medium term. On the other hand, **there were possibilities that the Thai economy would outperform the baseline projection attributable to** (1) higher-than-projected growth of trading partner economies if there were additional government stimulus measures, improvements in trade tensions, as well as faster- and better-than-expected recovery in the electronics cycle, and (2) higher-than-expected domestic demand as a result of public infrastructure investment and PPP projects, which may incentivize private sector to invest at a higher level and faster, as well as the potential implementation of additional government stimulus measures. **There remained downside risks to headline and core inflation projections** in line with risks to the economic growth projection.

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